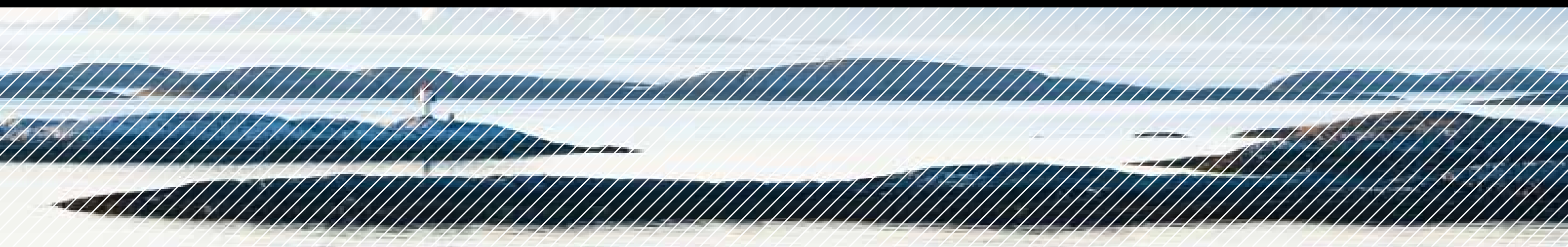
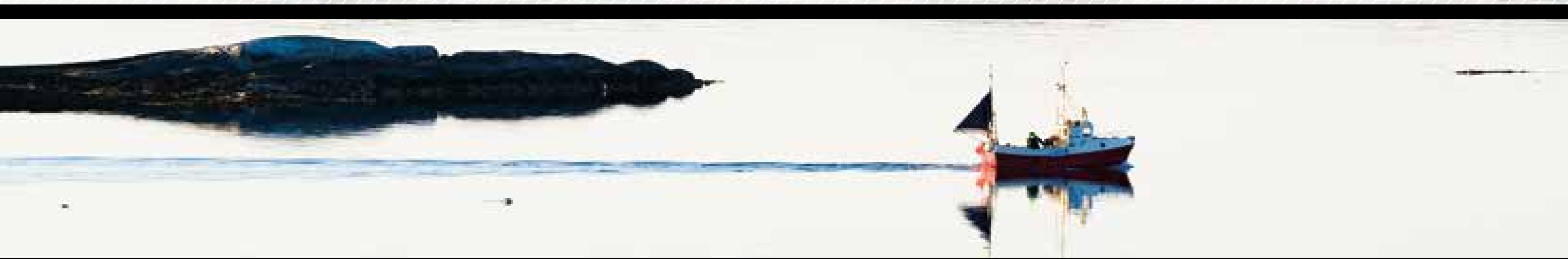
FINANSTILSYNET
THE FINANCIAL SUPERVISORY AUTHORITY OF NORWAY

ANNUAL REPORT
2012

Finanstilsynet is responsible for the supervision of banks, finance companies, mortgage companies, e-money institutions, payment institutions, insurance companies, pension funds, insurance intermediaries, investment firms, securities fund management, stock exchanges and other regulated markets, clearing houses and securities depositories, real estate agencies, debt collection agencies, external accountants and auditors. Finanstilsynet also oversees prospectuses, listed companies' financial reporting and conduct in the securities market.

"Finanstilsynet 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. Finanstilsynet shall ensure that the institutions it supervises attend to consumer interests and rights in their activities."

(Financial Supervision Act, section 3)

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The chapters on external accounting services, estate agency and debt collection are not included in the English annual report.

For analyses of financial market trends, see the report *Risk Outlook 2013: The Financial Market in Norway*.

PREFACE

Imbalances in public finances, with high debt and large deficits, continue to mark the industrialised countries' economies and international financial markets. Growth rates in the industrialised countries are low. Much of Europe is in economic decline.

The Norwegian economy is, however, so far little affected by the international financial turbulence and weak developments in the industrialised economies. Capacity utilisation and growth rates in the mainland (non-oil) economy are high, driven in part by heavy demand from the petroleum industry and households.

In order to sustain economic activity, central banks have maintained very low interest rates and supplied the markets with extra liquidity. Low rates are expected in the financial markets for quite some time. A low interest rate level internationally supports continued low rates in Norway.

Norwegian banks are solid and profitable. High activity in the Norwegian economy and low interest rates are keeping loan losses down. In a period of economic expansion accompanied by a high oil price, international uncertainty and low interest rates it is imperative for the authorities and banks alike to apply a long-term perspective to their risk assessments. Creditworthiness assessments must make allowance for a future economic turnaround and interest rate hike.

After the international financial crisis, governments and banks' creditors have tightened their requirements on banks' solvency. This could be demanding for countries in an economic contraction since it may prompt banks to tighten credit assessments in order to trim their balance sheet, and thereby intensify the economic decline. However, in countries with expanding economies and rapid credit growth, such as Norway, higher capital requirements can promote economic stability.

As part of its follow up of the European Banking Authority's recommendations to strengthen financial positions, Finanstilsynet expressed its expectation for Norwegian banks and credit institutions to achieve a common equity tier 1 ratio of at least 9 per cent of risk weighted assets by the end of June 2012. This ambition was largely achieved, and, in the case of many banks, by a significant margin. Finanstilsynet concurrently indicated that common equity positions should be further strengthened, and that the sound profits achieved in 2012 should largely be retained. This will put the banks in a better position to tackle downturns without being compelled to sharply tighten lending.

New, more stringent capital and liquidity requirements are expected to be adopted by the EU shortly. The new regime will be based on the principle of a level playing field across the EEA. However, some scope for national discretion is expected in order to accommodate specific national features related to systemic risk and the economic cycle. In its supervisory practice Finanstilsynet stresses that Norwegian banks must be well equipped to meet higher regulatory requirements.

Although Norwegian banks have good control of institution-specific risk, the individual bank will not sufficiently capture systemic risk in its internal risk assessments. Losses on residential mortgage loans have been low for many years, leading banks to view the credit risk associated with such loans as low. However, the authorities must take due account of the fact that strong growth in household debt and house prices could lay the basis for a future sharp cutback in household purchases of goods and services that will adversely affect the Norwegian economy and business and industry. This will in turn lead to heavier loan losses, especially losses on loans to corporates.

Household debt and house prices continued their rapid growth in 2012 and are at very high levels. The growth is driven mainly by high demand resulting in part from low interest rates, high income growth and low housing taxes. The trend gives cause for concern.

The guidelines for residential mortgage lending were tightened in December 2011, and in 2012 Finanstilsynet duly checked compliance. Although banks have largely fallen into line, resulting in tighter lending practices, there is still room for improved compliance. Finanstilsynet will follow up on this at future inspections.

Higher requirements on banks' equity capital contribute to prudent lending practices. However, low risk weights assigned to mortgage loans in banks' internal risk models, which do not reflect relevant systemic risk, may, through low capital tie-up, provide a detrimental stimulus to residential mortgage lending. Finanstilsynet accordingly attaches much importance to applying capital adequacy calculations that counteract this effect, and will take further measures in this respect into consideration.

At the start of 2012 there was much nervousness in international funding markets, triggered by the sovereign debt crisis in the euro area. Risk premiums rose, and funding markets dried up. Norwegian banks also observed this in their market funding, despite their solidity and sound profits. However, various EU measures to avoid collapse brought lower risk premiums and improved funding opportunities for banks through the year. The European Central Bank's announcement, as part of its monetary policy operations, to purchase, under certain circumstances, government securities issued by crisis-stricken Euro states appears to have contributed significantly in this respect.

The sovereign debt crisis in the euro area has not been resolved, and we must be prepared for renewed turbulence. Although Norwegian banks' market funding is more robust than during the international crisis in autumn 2008, they are still vulnerable to turbulence in international markets. Banks therefore need to continue to put their funding on a more robust footing.

Longevity in Norway has risen more than expected in earlier population projections, and a continued increase in longevity can be expected in the years ahead. Norwegian pension providers (life insurers and pension funds) carry substantial pension obligations in the form of guaranteed life-long benefits. These insurance obligations and the appurtenant reserves are based on calculations that inadequately reflect higher life expectancy amongst the insureds.

Concurrently, low interest rates are making it more difficult than previously to honour nominal rate-of-return guarantees in defined benefit pension plans. Rate-of-return risk is particularly high in the case of paid-up policies, since such risk cannot be covered by raising insurance premiums.

Increased longevity and low interest rates in combination bring a significant need for pension providers to build up technical reserves and solvency capital. Policyholders must be prepared to shoulder a significant portion of the need for higher reserves through recourse to their surplus return and higher premium payments. Pension providers themselves must also contribute to increased technical reserves and strengthen their solvency capital. The capital need refers to already earned entitlements. Hence the transition to new occupational pension products, where employees must to a greater degree than in traditional defined benefit schemes bear rate-of-return and longevity risk, will only limitedly reduce the challenges faced by pension providers.

New EU solvency requirements (Solvency II) will make insurance risk more transparent than under current solvency requirements and will raise the minimum requirements for solvency capital. Finanstilsynet assumes that the new requirements will be introduced across the EEA, although final consideration by the EU has been significantly delayed.

The object clause of the Financial Supervision Act was amended in 2012 to make clear Finanstilsynet's responsibility for safeguarding consumer interests and rights in financial markets. Consumer protection is a basic concern for the entire business of supervision. Finanstilsynet considers it particularly important for providers of financial services and products to fulfil the requirements for good customer counselling to ensure that customers understand the risk inherent in the products offered, and for counselling to safeguard the individual customer's needs in a sound manner. As a part of the consumer protection effort, Finanstilsynet established in 2012 consumer information pages on the Authority's website.

Oslo, 30 January 2013

Endre Skjørestad	Morten Baltzersen
Board chair	*Director General, Finanstilsynet*

FINANSTILSYNET'S STRATEGY 2010–2014

MAIN GOAL:

Finanstilsynet's main goal is to promote financial stability and well-functioning markets.

INTERMEDIATE GOALS:

1. **Financially sound and liquid financial institutions**
2. **Good monitoring of risk in the economy and markets**
3. **Consumer protection through good information and advice**
4. **Fit and proper management and satisfactory governance at institutions**
5. **Robust infrastructure ensuring satisfactory payments, trade and settlement**
6. **Adequate and reliable financial information**
7. **Good market conduct**
8. **Effective crisis management**

Finanstilsynet's strategy was adopted by Finanstilsynet's Board of Directors on 24 November 2010. The strategy identifies the following priorities:

- supervision of institutions and areas of greatest significance to financial stability and well-functioning markets
- macroeconomic surveillance and macroprudential supervision
- ensuring that international requirements on institutions and supervision are implemented and complied with
- promoting investor and consumer protection and ensuring a broad public awareness of Finanstilsynet's requirements and supervisory activities

The strategy also describes measures and priorities in the respective areas of supervision.

MAIN GOAL

Finanstilsynet's main goal is to promote financial stability and well-functioning markets. Behind this goal lie important economic considerations. Financial stability and well-functioning markets are key to assuring confidence in the financial system and stable economic growth and to protecting the users of financial services.

The financial system promotes efficient distribution of society's resources and contributes to economic growth. Financial stability enables the financial system to absorb disturbances and unexpected shocks and to discharge its functions, thereby avoiding major, negative consequences for the wider economy. Well-functioning markets promote efficient distribution and pricing of capital and risk. There is a close link between financial stability and well-functioning markets. Without financial stability, markets cannot distribute capital and risk in an efficient manner. If capital is not distributed efficiently, and risk is wrongly priced, the upshot may be financial instability.

FINANCIAL STABILITY

Financial institutions, financial markets and the financial infrastructure together make up the financial system. Stability problems can originate in any one of these, but will often unfold and intensify through an interplay of parts of the system. Problems in individual institutions, especially larger financial institutions, can spark contagion effects to other institutions.

Finanstilsynet has long experience of macroprudential supervision and of dealing with financial stability issues. It is important to coordinate instruments building on macroprudential supervision with instruments used in the supervision of individual institutions.

Given the financial system's large significance for the real economy, institutions are subject to a comprehensive body of rules. Regulation and supervision of institutions' capital adequacy, liquidity, risk management and deposit insurance schemes also give consumers security with regard to their bank deposits, insurance claims and pensions.

WELL-FUNCTIONING MARKETS

Competition and information are basic to markets' efficient functioning. In a well-functioning market, prices and interest rates reflect the underlying economic realities, uncertainties in the economy and market actors' risk tolerance.

A well-functioning market is predicated on good liquidity, sufficient size and low transaction costs. This is true for the banking, insurance, real estate, securities and commodity markets. In a well-functioning capital market, risk is distributed so that actors best equipped to bear various types of risk do so, while actors not wishing to assume a particular type of risk can hedge against that risk. Timely and precise information and advice enable actors to make decisions in keeping with their wealth position, employment and income situation, and risk tolerance.

Active inspection of actors' compliance with laws and regulations and effective enforcement of sanctions against rule breakers are important for achieving well-functioning markets. Consumers such as savers, borrowers and insurance policy holders need protection due to the complexity of the products, and because the financial consequences of their investments may be substantial and difficult to gauge.

INTERMEDIATE GOALS

1. FINANCIALLY SOUND AND LIQUID FINANCIAL INSTITUTIONS

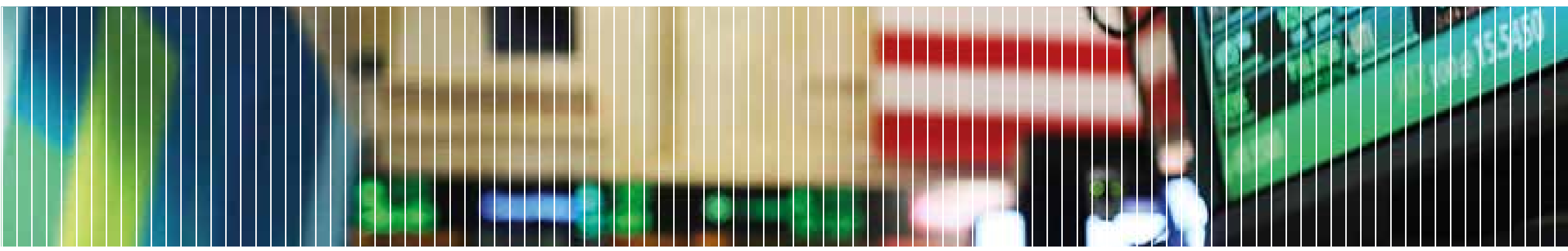
Finanstilsynet is required to see to it that financial institutions and investment firms have sufficient capital to withstand unforeseen setbacks. Sufficient capital has to be accumulated in good times to absorb losses and value falls in deep economic downturns. This capital must be ample enough to maintain confidence in the institutions, enabling them to raise fresh capital and refinance their operations in a downturn. Finanstilsynet seeks to ensure that financial institutions have the liquidity and the robust funding needed to maintain normal lending in periods of poorly functioning money and capital markets. In view of the major financial groups' importance to financial stability, particular weight is given to their solidity and liquidity. Finanstilsynet is expected to play an active part in international supervisory cooperation addressed to border-crossing financial institutions of significance for Norwegian financial markets.

2. GOOD MONITORING OF RISK IN THE ECONOMY AND MARKETS

Finanstilsynet analyses and assesses potential stability problems in Norway's financial industry against the background of developments in the Norwegian and international economy, and uses this information in its ongoing oversight of individual institutions. Macroprudential supervision requires alertness to possible imbalances, bubble tendencies and corrections in markets and the economy that may threaten financial stability. Potential stability problems resulting from contagion effects between institutions and markets are also assessed. Finanstilsynet will combine and utilise information from its supervision of individual institutions with information from its macroprudential supervision. The Authority will further develop and actively use instruments to mitigate systemic risk. As part of its macroprudential supervision Finanstilsynet will exchange information and collaborate with the Ministry of Finance and Norges Bank to find appropriate risk-mitigating measures.

3. CONSUMER PROTECTION THROUGH GOOD INFORMATION AND ADVICE

Through its supervision of advisers and product providers Finanstilsynet will seek to ensure that product sales and advice are sound and suited to the individual customer. Sales and advice must be based on customers' ability to understand what investments, loans, insurance and pension products entail. As part of its consumer protection effort Finanstilsynet will introduce new European requirements for information on savings and investment options with regard to banking, insurance and securities products. Finanstilsynet's checks on real estate agents' market conduct and their compliance with due care requirements are also important for consumer protection.



4. FIT AND PROPER MANAGEMENT AND SATISFACTORY GOVERNANCE

Finanstilsynet will ensure that entities under supervision have good governance, are properly run and conduct their business in accordance with applicable rules. Finanstilsynet will critically assess whether business activities are based on a sound business model and will see to it that firms actively monitor and control all important risks. It is important for financial stability that firms have in place good risk management systems as a basis for ensuring sufficient capital and liquidity. Firms' risk management must also be sufficiently robust and sound to deal with operational risk. Fit and proper management, satisfactory risk management and internal control will help to ensure that firms comply with the conduct of business rules, which are important for markets' proper functioning.

5. ROBUST INFRASTRUCTURE ENSURING SECURE PAYMENTS, TRADING AND SETTLEMENT

Finanstilsynet will contribute to a robust infrastructure featuring secure and stable information and communication systems. Finanstilsynet must ensure that payment services systems – including online banking and card facilities – are efficient, effective and secure. It is important that integrated technological systems function satisfactorily and that the risk of criminal acts arising in connection with internet-based solutions is under control.

Finanstilsynet will seek to ensure that marketplaces function in such a way that investors can be certain that prices of securities and other financial instruments are based on updated and relevant information. Finanstilsynet will see to it that settlement systems are secure and efficient, enabling the market to function efficiently and attract investors. Finanstilsynet will work to ensure that settlement and depository functions are organised in accordance with international standards and the objective of an integrated European securities settlement system.

6. SUFFICIENT AND RELIABLE FINANCIAL INFORMATION

Finanstilsynet will ensure that ongoing and periodic information from listed companies is sufficient, reliable and timely. The same applies to the quality of information published by institutions under supervision and their reporting to the authorities. Finanstilsynet will ensure that prospectuses, financial information and other reporting are in conformity with applicable rules, and that the audit of companies fulfils its purpose and is of satisfactory quality. Through its supervision of external accountants and auditors, Finanstilsynet will help to ensure that annual accounts data from the business sector in general is of satisfactory quality. This is highly important for banks and other lenders.

7. GOOD MARKET CONDUCT

Finanstilsynet will ensure that the markets are characterised by appropriate rules of conduct, effective supervision and general good conduct on the part of the actors. A prerequisite for well-functioning markets and adequate investor and consumer protection is that all actors comply with laws, regulations and good practice. To achieve this, Finanstilsynet will in all areas of supervision contribute to a high detection rate and a rapid and effective response in the case of rule breaches. Effective and rapid enforcement of the conduct of business rules, which include the prohibition of insider trading and price manipulation, promotes investor and consumer confidence in the markets.

8. EFFECTIVE CRISIS MANAGEMENT

Finanstilsynet will maintain preparedness to deal with critical situations and avoid harmful knock-on effects and lasting problems for the financial sector and financial services users. A preparedness must be in place to meet unforeseen problems in individual institutions, markets and infrastructure, and wider-scale crises in the financial system. The close collaboration with the Norwegian Banks' Guarantee Fund will continue.

Finanstilsynet will hold regular national crisis drills, ensure good collaboration with other affected national authorities, and participate in international crisis exercises and in international supervisory collaboration for cross-border institutions. Finanstilsynet will play its part in ensuring that the guarantee schemes, including the deposit guarantee, function as intended and are practised in such a way as to minimise inconveniences to the individual customer. Further, Finanstilsynet will discharge its responsibility related to the Financial Infrastructure Crisis Preparedness Committee so that any crisis in this area can be handled in a satisfactory manner.

INSTRUMENTS

Finanstilsynet's activity is wide-ranging and requires active use of various instruments, on their own or in combination; in the supervisory effort, risk and materiality are given priority.

To achieve its goals, Finanstilsynet makes use of the following instruments:

- supervision and monitoring
- licensing
- regulatory development
- information and communication

FINANS-TILSYNET'S GOAL ATTAINMENT IN 2012

Finanstilsynet oversees a large number of institutions and markets. Resource use in the respective areas of supervision varies with market developments and the national and international regulatory framework in which institutions operate. Each year Finanstilsynet prepares a plan of operations setting out measures and tasks for each intermediate goal in the strategy. The Ministry of Finance's prioritised tasks are also covered by these measures and tasks.

Finanstilsynet's strategy for 2010–2014 contains main goals and intermediate goals. Further goals for Finanstilsynet's activity in the particular year are set out in the Ministry of Finance's letter of allocation. They are mainly qualitative outcome goals for institutions and markets under supervision. Attaining them will depend on decision-takers and factors additional to the instruments that are available to Finanstilsynet. While Finanstilsynet's activity will contribute to the attainment of these goals, it cannot assure that outcome on its own.

Progress made in the implementation of the individual measures and tasks described in the plan of operations is a key basis for assessing goal attainment. This is reported on separately to the Ministry of Finance. Finanstilsynet has in the main implemented the measures and tasks planned for 2012.

SOME IMPORTANT EVENTS IN 2012

SUPERVISION AND MONITORING

Banks' risk and capital need

When reviewing banks' risk and capital need, Finanstilsynet stressed that banks should continue to strengthen their financial position. As part of its response to recommendations from the European Banking Authority to strengthen solidity, Finanstilsynet declared that all Norwegian banks and credit institutions should have a common equity tier 1 capital ratio of at least 9 per cent of risk weighted assets by the end of June 2012. This ambition was in all essentials fulfilled, and many banks had a capital ratio well above the 9 per cent mark by the end of 2012.

Banks' liquidity risk

Finanstilsynet's on-site inspections focused particularly on liquidity risk. Banks' liquidity risk was followed up through written feedback on their ICAAPs, in the case of larger banks through direct contact and, in the case of banks with divergent liquidity indicator levels, through analyses. Liquidity risk was also a theme at semi-annual and quarterly meetings with the largest banks.

Compliance with home mortgage lending guidelines

Finanstilsynet checked banks' compliance with home mortgage lending guidelines through on-site inspections and direct approaches in 2012. The guidelines were largely met by the banks, but there is still room for improvement.

Compliance with regulations on tied and bundled products

Over the course of 2012 Finanstilsynet asked 25 banks to spell out their assessment of whether the bank's tied and bundled products were compliant with the law. Most withdrew or revised these products after Finanstilsynet's approach. Six banks were ordered to halt their marketing and sales of such packages. Two of the banks appealed against the order.

Unlawful payment services activity

In light of the "Touchpay affair", Finanstilsynet looked into possible deficiencies or weaknesses in the regulation of payment services. In August, in a move to halt unlawful payment services, the Authority published a circular clarifying the responsibilities assumed by banks when they sign and follow up on agreements on card payments. Finanstilsynet also contacted Touchpay's auditors since they had not considered the business to be licensable.

Survey of information and advice given by life insurers when selling pension products

Finanstilsynet reviewed life insurers' compliance with the information requirement imposed on vendors of individual unit-linked life insurance products where the customer takes the investment decisions, including endowments, annuities and pension products. The abiding impression was that life insurers provide information and advice ahead of sale, but that information on costs and historical return could be improved.

Withdrawal of Terra Markets' licences to provide investment services

In April Finanstilsynet withdrew Terra Markets' licences to provide investment services. The withdrawal came after Finanstilsynet conducted an on-site inspection. The company appealed the withdrawal to the Ministry of Finance which is considering the appeal.

Withdrawal of Acta Asset Management AS's licences to provide investment services

In April Finanstilsynet withdrew Acta Asset Management AS's licences to provide investment services. It did so in response to serious, systematic breaches of the Securities Trading Act's conduct of business rules. The company appealed the withdrawal to the Ministry of Finance which is considering the appeal.

Withdrawal of European Economy Control AB's debt collection licence

In June 2012 Finanstilsynet withdrew European Economy Control AB's licence to carry on debt purchase and collection. It did so because to the company had failed to handle protests in accordance with good debt collection practices.

Serious rule breaches at real estate agencies

In 2012 Finanstilsynet handled several cases of gross rule violation. One licence to carry on real estate agency was withdrawn, and four agents' right to function as estate agent in charge was revoked. Two lawyers saw their right to carry on real estate agency revoked after misappropriation of client funds.

Increase in number of approved bond prospectuses

The number of applications for approval of bond prospectuses was higher than normal. Finanstilsynet vetted and approved many bond prospectuses related to admission of bonds to quotation on Oslo Børs.

Oslo Børs' notification system taken into use

As from March 2012 Finanstilsynet has used Oslo Børs' notification system to publish final letters in cases arising after inspection of listed companies' financial reports. The new arrangement makes such matters known to the market and promotes information symmetry.

LICENSING

DNB Bank merges with Nordlandsbanken

DNB Bank ASA received permission to merge with Nordlandsbanken ASA and to restructure the DNB group as a result of the merger.

Several savings banks set up foundations and merge

- Lillestrøm Sparebank received permission to set up the foundation Sparebankstiftelsen Lillestrøm through the conversion of parts of the bank's ownerless capital into equity capital instruments to be owned by the foundation.
- Finanstilsynet recommended that the Ministry of Finance give permission to set up the foundations Sparebankstiftelsen Hallingdal and Sparebankstiftelsen Øystre Slidre and for the merger of the two savings banks.
- Finanstilsynet recommended that the Ministry of Finance give permission for the merger of Sparebanken Møre and Møre Finans AS.
- Finanstilsynet recommended that the Ministry of Finance give permission to set up the foundation Sparebankstiftelsen Telemark – Grenland.
- Finanstilsynet recommended that the Ministry of Finance give permission to set up the foundation Sparebankstiftelsen Telemark – Holla og Lunde and for the merger of the two banks.
- Finanstilsynet recommended that the Ministry of Finance give permission to set up the foundations Sparebankstiftinga Bø and Sparebankstiftinga Seljord in Telemark – and for the merger of the two savings banks.

Admission of Oslo Børs VPS Holding to Oslo Børs advised against

Oslo Børs VPS Holding applied for admission to Oslo Børs ASA. The Ministry of Finance rejected the application in line with Finanstilsynet's recommendation.

REGULATORY DEVELOPMENT

Offers through estate agents to be made in writing

In December Finanstilsynet recommended that offers made by potential home buyers through estate agents should be in writing. This was in response to an increase in supervisory cases of malpractice in bidding rounds and numerous approaches from home buyers who were uncertain whether the bidding round had proceeded correctly. The Ministry of Finance circulated the proposal for comment with the response deadline set at 19 April 2013.

Covered bonds reviewed

Norwegian banks are increasingly dependent on market funding; covered bonds have risen strongly in volume and now account for a large portion of market funding. Finanstilsynet, on commission from the Ministry of Finance, examined the relevant rules and recommended that moves be made to limit the use made of covered bonds in order to counter the systemic vulnerability that this form of funding may entail.

Introduction of new financial sector regulation – CRD IV

A new regulatory regime for credit institutions and investment firms, CRD IV, brings a restructuring of existing rules and sets new minimum requirements on capital and liquidity, limits to concentration risk, and financial disclosure requirements. CRD IV was scheduled for entry into force on 1 January 2013, but is delayed. A new implementation date has yet to be set.

Introduction of Solvency II framework in Norway

Finanstilsynet prepared in 2012 for the introduction of Solvency II, in part through its participation in EIOPA's working groups and its contacts with companies intending to use internal (IRB) models under Solvency II. A draft law on financial institutions and financial groups, incorporating Solvency II provisions, is expected to be presented to the Storting in spring 2013. The onward process in Norway depends on the process in the EU. Finanstilsynet aims to finalise draft regulations shortly after adoption of the Omnibus II Directive and publication of a final proposal for implementing provisions and technical standards. Draft regulations can be forwarded to the Ministry of Finance at the end of 2013 at the earliest.

Longevity risk taken into account in new occupational pension product

On commission from the Ministry of Finance, Finanstilsynet has drafted law provisions for one or more alternative models for the conversion of accrued pension capital into annual pension benefits and for the treatment of such capital during the payout period. The proposal was forwarded to the ministry in January 2013 and circulated for comment.

ORGANISATIONAL SET-UP AND RESOURCE USE

Finanstilsynet's Board of Directors has by law the overarching responsibility for Finanstilsynet's activities and handles important matters in relation to regulations and licences, budgets and action plans. The Board has five members. Members and alternates are appointed by the Ministry of Finance for a four-year period. Mr Endre Skjørestad, Board chair, took up duties on 15 April 2010.

BOARD OF DIRECTORS

The Board had the following composition in 2012:

Endre Skjørestad
attorney-at-law
chair

Vivi Lassen
assistant director
deputy chair

Hilde C. Bjørnland
professor
board member

Mette Bjørndal
professor
board member

Harald Indresøvde
former bank manager
board member

Beate Sjåfjell
professor
first alternate

Jostein Skaar
department director
second alternate

Arild J. Lund
director at Norges Bank
attended as observer from 1 June 2012

Kristin Gulbrandsen
director at Norges Bank
attended as observer from 5 January 2012 to 31 May 2012

Sindre Weme
director
alternate for the observer from Norges Bank

Two members elected by and from among the employees supplement the Board when administrative matters are dealt with. As from February 2011 the employee representatives have been:

Aud Kogstad
senior supervisory adviser

Anders N. Kvam
special adviser

Their alternates were senior supervisory adviser **Ole-Jørgen Karlsen**, senior supervisory adviser **Anne-Kari Tuv** and special adviser **Jo-Kolbjørn Hamborg.**

Eleven ordinary board meetings and one extraordinary board meeting were held in 2012. The Board dealt with a total of 29 administrative matters and 58 supervisory matters requiring decisions. The Board received information on a further 36 administrative matters and 59 supervisory matters, bringing total items dealt with to 182. In addition, the Board is given a verbal briefing at each meeting on relevant matters.

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BOARD OF DIRECTORS OF FINANSTILSYNET

Endre Skjørestad	*Attorney-at-law, partner at HAVER Advokatfirma ANS*
Vivi Lassen	*Assistant Director, Agency for Public Management and eGovernment (Difi)*
Hilde C. Bjørnland	*Professor, Department of Economics, BI Norwegian Business School*
Mette Bjørndal	*Professor, Department of Finance and Management Science, Norwegian School of Economics*
Harald Indresøvde	*Former bank manager, SpareBank 1 Søre Sunnmøre*
Beate Sjåfjell	*Professor, Department of Private Law, University of Oslo*
Jostein Skaar	*Partner at Oslo Economics from 1 January 2013, formerly director, Market Monitoring, Competition Authority*
Arild J. Lund	*Director, Norges Bank Financial Stability, Regulatory Policy*
Aud Kogstad	*Senior Supervisory Adviser*
Anders N. Kvam	*Special Adviser, consumer affairs coordinator*

From left: Vivi Lassen, Beate Sjåfjell, Anders N. Kvam, Endre Skjørestad, Hilde C. Bjørnland, Harald Indresøvde, Aud Kogstad, Arild J. Lund, Jostein Skaar, Mette Bjørndal
Photo: Jarle Nyttingnes

FINANSTILSYNET'S MANAGEMENT TEAM

Morten Baltzersen	*Director General*
Emil R. Steffensen	*Deputy Director General, Finance and Insurance Supervision*
Anne Merethe Bellamy	*Deputy Director General, Accounting and Auditing Supervision and Acting Deputy Director General, Capital Markets Supervision from 1 August 2012*
Cecilie Ask	*General Counsel*
Gun Margareth Moy	*Deputy Director General, Administration*
Kjetil Karsrud	*Communications Director*
Eirik Bunæs	*Deputy Director General, Capital Markets Supervision until 1 August 2012*

From left: Anne Merethe Bellamy, Cecilie Ask, Kjetil Karsrud, Morten Baltzersen, Gun Margareth Moy, Emil R. Steffensen
Photo: Jarle Nyttingnes

PERSONNEL POLICY AND ORGANISATION

Finanstilsynet adopted a new HR strategy in 2012. The strategy supports the main strategy of the Authority and describes the overarching direction and instruments applied to further develop the Authority as an attractive employer with committed and competent staff. At centre-stage of the HR strategy are measures designed to attract, recruit and develop staff with a high level of competence in the respective areas of supervision. Employer profiling was a priority area in 2012, and will remain so in 2013 along with greater emphasis on competence management and development.

Overseeing the various industries requires cross-disciplinary competence, spearhead competence in the various areas of supervision and industry knowledge. At the end of 2012 89 per cent of Finanstilsynet's staff held a university degree or the equivalent, and about 70 members of staff had solid work experience (generally more than five years) from industries under supervision.

Staff turnover has been stable in the past two years, in 2012 measuring 6.9 per cent. Applicants for vacant positions are generally of high quality. However, competition for candidates is growing in parts of the labour market. A major effort will continue to be needed on the recruitment front in the period ahead.

With its espousal of the Government-sponsored “IA Agreement” designed to promote inclusive employment, Finanstilsynet attaches much importance to reducing sickness absence, to diversity and to a good policy on older employees. Sickness absence was 4 per cent in 2012, compared with 3.6 per cent in 2011. The work environment and gender equality committee systematically follows up such matters and considers the advisability of initiating measures when needed.

Thirty-one vacancies were advertised in 2012 compared with 28 in 2011. Two of these were in-house compared with six in 2011. Applicants totalled 1,170 in 2012 compared with 639 in 2011.

At the end of 2012 Finanstilsynet had 281 full-time staff, compared with 275 at the end of 2011. Fifty-two per cent of the full-time staff are women. At the end of 2012 the management team comprised equal proportions of women and men. Women made up 44 per cent of all staff with managerial responsibilities.

The Director General’s salary at the end of 2012 totalled NOK 1,345,000. The Chairman of the Board’s fixed annual remuneration was NOK 220,000, the Deputy Chair’s was NOK 150,000, and each board member's was NOK 130,000. Remuneration for the first alternate was NOK 110,000, and for the second alternate NOK 35,000 in addition to NOK 9,000 per meeting attended.

CASES AND CASE PROCESSING TIME

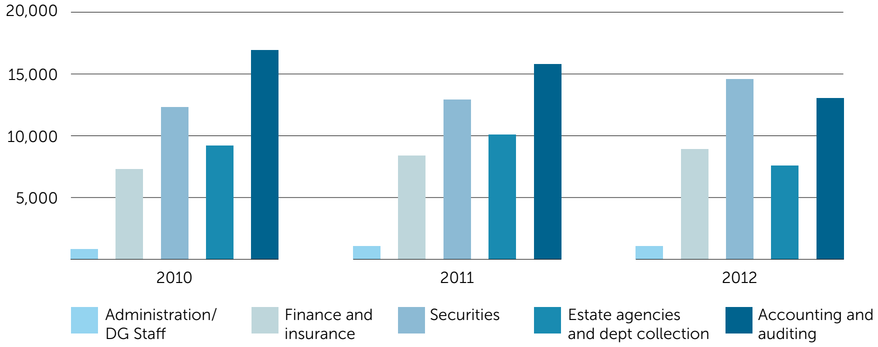
In keeping with Finanstilsynet’s strategy, specific targets are set for the time spent on a selection of administrative cases and for supervisory reports and resulting observations. The aim is to process 90 per cent of administrative cases within 30 days. A longer period is allowed for some types of complex cases. The deadline for supervisory reports and ensuing observations varies from one area of supervision to the next.

An improvement was noted in all areas in 2012 compared with 2011. Target attainment remains unsatisfactory and efforts to reduce case processing time will continue.

TABLE 1: CASE PROCESSING TIME AT FINANSTILSYNET IN 2012

	2011		**2012**	
	No. of cases	Target attainment	**No. of cases**	**Target attainment**
Total no. of cases with processing time target	3,578	77%	**3,391**	**85%**
- Cases with 30-day deadline	3,472	78%	**3,343**	**85%**
- Cases with deadline longer than 30 days	106	55%	**48**	**77%**
Supervisory reports	229	87%	**219**	**86%**
Supervisory observations	187	81%	**218**	**84%**

CHART 1: REGISTERED CASE DOCUMENTS – BY SECTOR



	2010	2011	**2012**
Total number of cases	46,470	48,156	**45,052**

The number of incoming and outgoing documents registered in 2012 was about 3,104 lower than in 2011, partly because the transitional arrangement for estate agents following the introduction of a new Estate Agency Act no longer generates the same volume of applications and because notifications of change of auditor are no longer received and processed. The volume of e-mails received is generally higher.

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Document access at Finanstilsynet

Finanstilsynet received a total of 2,751 requests for document access in 2012. Of the documents in question, 2,066 were in the public domain, 194 were distributed as public versions, and 491 were not released since their entire content was barred from publication. On an annual basis there was a decline in requests for access. The same was the case in 2011 after Finanstilsynet hooked up to the new public electronic mail journal, used by all central government agencies, in July 2010. Most access requests are now directed through this portal.

TABLE 2: REQUESTS FOR DOCUMENT ACCESS

	2010	2011	**2012**
Orders placed	3,531	3,210	**2,751**
Not released	342	678	**491**

Security and crisis preparedness

Finanstilsynet aims to be a confidence-inspiring and reliable agency, and acknowledges its security responsibilities towards entities under its supervision, its staff and central authorities. The agency accordingly works continuously on security and preparedness both in its core area of operation and within its own organisation. Finanstilsynet adheres to Norges Bank's security regulations, which cover physical security and preparedness with respect to the office premises. Finanstilsynet has specific security and crisis preparedness plans in place for the various areas under supervision in the financial market, including technical infrastructure. Separate security rules apply to internal ICT solutions and the technical infrastructure. Safety tests are regularly conducted in the ICT area. A secondary site of operation has been established in preparedness for crisis situations.

FINANCES

Expenditure

The Storting determines Finanstilsynet's budget as part of the government budget. The budget for 2012 originally totalled NOK 323.2 million. An additional appropriation of NOK 6.1 million was made as compensation for the public sector wage settlement. Including NOK 10.5 million carried forward from 2011 and refunds of parental and sickness benefits worth NOK 3.3 million, the aggregate disposable budget came to NOK 343.1 million.

Aggregate expenditure came to NOK 325.4 million, an increase of 4.5 per cent. Total salary expenditure rose by 6.2 per cent, attributable to staff increases and general wage growth. Overall expenditure on goods and services was unchanged. Fees for attending meetings of EU supervisory authorities rose, while ICT costs fell as a result of delayed processes in the EU's introduction of Solvency II. Finanstilsynet's aggregate expenditure was NOK 18.4 million less than disposable revenues. Unutilised revenues were carried forward to 2013.

As in the case of other government agencies included in the central government accounts, Finanstilsynet's accounts are kept on a cash basis and are prepared in accordance with the central government chart of accounts, which employs natural classification of revenues and expenses. Based on this chart, Finanstilsynet classifies expenditures by function. The main classification by function is shown in Table 3.

The closing letter dated 30 May 2012 from the Office of the Auditor General on the accounts for 2010 had no adverse comments with regard to the accounts or to Finanstilsynet's implementation of the budget.

TABLE 3: ACCOUNTS

Figures in NOK 1000s	2010	2011	**2012**
Salaries	202,491	223,685	**237,673**
Of which:			
Salaries and social costs (all positions)	197,486	220,094	**232,073**
Stand-ins/substitutes	4,002	2,792	**4,388**
Other remuneration (board members' fee)	1,003	799	**1,212**
Goods and services	90,553	87,794	**87,884**
Of which:			
Operating expenses	38,780	29,762	**31,114**
Information	2,154	1,843	**1,615**
Travel and meeting attendance, subscriptions	8,355	9,988	**12,495**
Inspections and other supervisory work	3,467	2,972	**2,144**
Organisation development, management and competence development	5,657	5,511	**5,585**
ICT expenditure	32,140	37,818	**34,931**
Total expenditure	293,044	311,479	**325,557**
Contribution from supervised institutions	246,508	280,933	**292,870**
Prospectus fees	3,775	7,151	**6,565**
Budget carryover from previous year	5,237	7,627	**10,520**
Benefit refunds (parental and sickness)	4,407	4,272	**4,161**
Total revenues	259,927	299,591	**314,116**

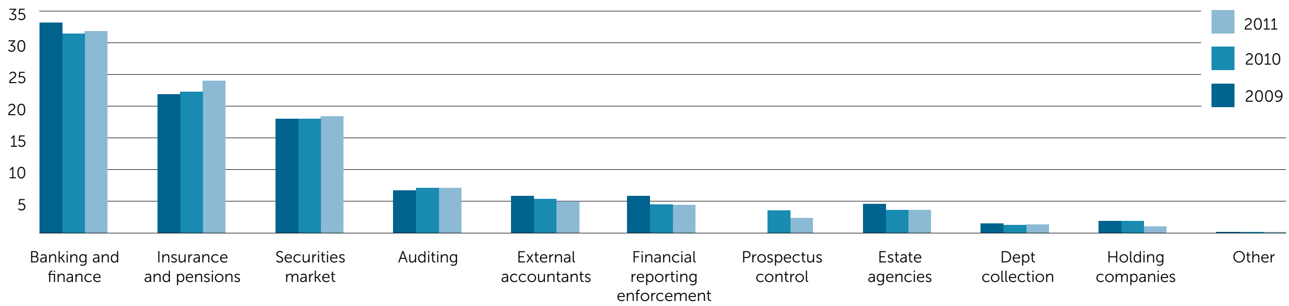
Revenues

Pursuant to section 9 of the Financial Supervision Act, Finanstilsynet'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 supervision, and expenses are therefore paid in arrears. Contributions are also claimed from branches of companies from other EEA states.

Contributions from institutions under supervision totalled NOK 293.5 million in 2012. Total revenues were smaller than actual expenses since contributions from supervised institutions are paid in arrears and unutilised revenues from the previous year are deducted. The levy proposed by Finanstilsynet for 2011 was approved by the Ministry of Finance on 25 June 2012 after prior consultation with the trade organisations concerned. Supervised entities liable to pay the amount levied for 2011 numbered 13,998, of which 71 were foreign branches. The largest category of supervised entities is accountants, numbering 9,944. The overall figure in 2010 was 13,407 entities.

The total amount levied for 2011 was 8 per cent higher than for 2010. The increase is due to several factors, in particular a need for the additional resources required to discharge Norway's obligations to implement regulatory measures and supervisory cooperation within the EEA.

CHART 2: LEVY DISTRIBUTED ON SUPERVISED GROUPS



RESOURCE INPUT BY AREA OF SUPERVISION

TABLE 4: RESOURCE INPUT BY AREA OF SUPERVISION

	2010		2011		**2012**	
	FTEs	%	FTEs	%	**FTEs**	**%**
Banks	49.8	20.8	50.6	20.1	**55.7**	**21.4**
Finance companies	2.3	1.0	2.8	1.1	**2.4**	**0.9**
Mortgage companies	3.2	1.3	2.7	1.1	**3.2**	**1.2**
Payment institutions					**2.0**	**0.8**
Insurers	33.6	14.1	36.6	14.5	**38.6**	**14.8**
Holding companies	3.4	1.4	1.4	0.5	**1.7**	**0.7**
Pension funds	7.6	3.2	7.3	2.9	**7.7**	**3.0**
Securities market	37.3	15.6	42.4	16.8	**43.2**	**16.6**
Prospectus control	6.5	2.7	9.2	3.7	**9.9**	**3.8**
Estate agents	7.8	3.3	9.0	3.6	**8.4**	**3.2**
Debt collection	2.8	1.2	3.9	1.5	**3.4**	**1.3**
Auditors	13.1	5.5	14.1	5.6	**14.4**	**5.5**
Accounting rules et al.	0.4	0.2	0.7	0.3	**0.6**	**0.3**
Financial reporting	7.9	3.3	6.9	2.8	**7.2**	**2.8**
External accountants	10.1	4.2	11.6	4.6	**11.4**	**4.4**
Miscellaneous	2.7	1.1	2.6	1.0	**2.9**	**1.1**
Undistributed	50.5	21.1	50.1	19.9	**47.4**	**18.2**
Total	239	100	252	100	**260.1**	**100**

KEY FIGURES ON SUPERVISORY ACTIVITIES

TABLE 5: FIGURES FOR SUPERVISED ENTITIES AS AT 31.12.2012

	2008	2009	2010	2011	**2012**
Banks and financial institutions					
Savings banks	121	118	113	111	**109**
Commercial banks	18	20	20	19	**17**
Finance companies and mortgage companies	46	59	57	56	**52**
Foreign branches of Norwegian banks and other credit institutions	13	16	17	14	**16**
Norwegian branches of foreign banks and credit institutions	46	44	35	42	**42**
Payment institutions					
Payment institutions[1]	–	–	1	17	**22**
E-money institutions					
E-money institutions	3	3	3	3	**2**
Insurance					
Life insurers	11	12	12	12	**12**
Non-life insurers	45	45	44	43	**43**
Local marine insurance associations	13	13	13	13	**12**
Local fire insurance associations	20	20	20	19	**19**
Norwegian insurers' foreign branches	9	11	5	12	**16**
Norwegian branches of foreign insurers	44	41	43	37	**36**
Insurance intermediaries[2]	103	97	98	99	**96**
Private pension funds	81	76	66	63	**56**
Municipal pension funds	30	31	31	32	**32**
Pension schemes	15	9	8	7	**5**
Holding companies					
Holding companies	12	11	11	11	**12**
Securities institutions					
Investment firms	154	150	154	143	**136**
Norwegian branches of foreign investment firms	13	17	17	19	**23**
Fund management companies	22	26	27	29	**32**
Clearing houses	3	3	3	3	**3**
The Norwegian Central Securities Depository	1	1	1	1	**1**
Regulated markets, incl. stock exchanges	5	6	4	4	**4**
Auditors					
Auditors	5,777	5,943	6,210	6,484	**6,704**
Audit firms	825	820	776	674	**600**
External accountants					
External accountants	8,340	8,780	9,260	9,971	**11,128**
External accounting firms	2,676	2,693	2,691	2,817	**2,862**
Estate agency					
Estate agency firms	611	516	550	530	**517**
Lawyers' practices incl. estate	1,307	1,346	1,294	1,317	**1,329**
Debt collection					
Debt collection agencies	110	105	110	96	**94**
Debt purchase businesses	5	6	5	5	**4**

Finanstilsynet also oversees the financial reporting of 258 listed firms.

TABLE 6: NUMBER OF ON-SITE INSPECTIONS BY TYPE OF INSTITUTIONS (INCL. IT INSPECTIONS*)

	2008	2009	2010	2011	**2012**
Banks/finance	37	58	70	53	**51**
Payment institutions	–	–	–	1	**–**
E-money institutions	–	–	–	–	**–**
Holding companies	–	–	–	–	**–**
Insurers	6	8	12	14	**8**
Insurance intermediaries	3	7	6	7	**3**
Pension funds	6	4	8	2	**6**
Investment firms	19	21	24	19	**17**
Other securities institutions (incl. fund management companies)	1	3	5	8	**5**
Auditors	29	47	87	47	**48**
External accountants	60	49	58	56	**60**
Estate agencies	66	30	49	93	**43**
Debt collection agencies	13	12	13	12	**11**
Data processing centres/IT providers	4	2	4	5	**3**
Other	–	–	1	–	**–**

* Seventeen IT inspections were conducted, of which five were thematic inspections in banking and finance. Inspections are conducted either separately or in conjunction with ordinary on-site inspections. Finanstilsynet also conducted 45 simplified IT inspections and processed five notifications received under the Payments Systems Act after investigating compliance with the requirement to notify any establishment of new, or changes to existing, payment systems.

TABLE 7: CASES HANDLED AFTER DELEGATION FROM THE MINISTRY OF FINANCE

	2011	**2012**
Cases pursuant to the Savings Banks Act of 24 May 1961 No. 1	23	**23**
Cases pursuant to the Commercial Banks Act of 24 May 1961 No. 2	18	**20**
Cases pursuant to the Financial Institutions Act of 10 June 1988 No. 40	204	**154**
Cases pursuant to the Insurance Activity Act of 10 June 2005 No. 44	77	**90**
Cases pursuant to the Securities Trading Act of 29 June 2007 No. 75	28	**22**
Cases pursuant to the Securities Funds Act of 12 June 1981 No. 52	5	**–**
Cases pursuant to the Estate Agency Act of 29 June 2007 No. 73	2	**1**
Cases pursuant to the Electronic Money Institutions Act of 12 December 2002 No. 74	1	**–**

[1] Payment institutions came under Finanstilsynet's supervision as from 2010.

[2] Insurance agent firms that distribute insurances exclusively for Norwegian insurers are not included in this overview, nor are entities engaged in accessory insurance agent business, i.e. entities whose business includes insurance mediation on a part-time basis.

INFORMATION AND COMMUNICATION

Information and communication are one of four strategic instruments of supervision, along with supervision and monitoring, licensing and regulatory development. The information effort is directed in the first instance at institutions and sectors under supervision.

COMMUNICATION DIRECTED AT INSTITUTIONS AND SECTORS

Finanstilsynet has many areas of responsibility featuring extensive bodies of rules and complex issues. Information and communication are based on the principles guiding the central government communication policy, and are accordingly a management responsibility in each area of supervision.

Finanstilsynet is dependent on the confidence placed in it by supervised entities, and by the wider society. Confidence is largely a product of the high quality of the supervisory effort, but also of clear and consistent communication. Good communication with market actors, trade organisations, various government authorities, the media and the wider society are imperative if Finanstilsynet is to discharge its social role.

A key channel of communication with supervised entities and individuals is letters written and distributed by Finanstilsynet each year. A total of 17,340 letters were sent (outgoing documents) in 2012. A central aim of all communication and information is clarity and comprehensibility.

Rule clarifications, report-filing requirements and matters of which institutions and sectors are obliged to take note are usually communicated in the form of circulars. Finanstilsynet released 22 circulars in 2012.

Seminars and presentations

Seminars and presentations are an important part of Finanstilsynet's communication with sectors under supervision. Each year, for example, the Authority organises a seminar for investment firms and management companies. In 2012 Finanstilsynet also held a seminar for stock issuers.

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Collaboration

Finanstilsynet has an extensive network of contacts, and meets regularly with collaborating public authorities in Norway and elsewhere and with trade organisations.

New communication strategy

Finanstilsynet adopted a new communication strategy in 2012. The new strategy has the following goals:

1. To ensure that society has a knowledge of Finanstilsynet and its role. To this end the organisation must be open and predictable.
2. To ensure that Finanstilsynet performs its social role in a manner that instils public confidence.
3. To ensure that financial market participants have good access to structured information on the current body of rules, proposed amendments, practices and administrative decisions.
4. To ensure that that the users of financial services have good access to structured information on products, services and rights.
5. To ensure that communication in critical situations is handled in such a way as to minimise harmful effects.
6. To ensure that Finanstilsynet is accountable, to the point and focused in all communication.

Overarching communication strategy:

1. All relevant public information to target groups should be available at all times at www.finanstilsynet.no.
2. Rules and amendments, guides and assessments of particular importance should in addition be communicated actively through other channels.
3. Finanstilsynet should have good contact with trade organisations and other important actors in the drafting of rules and in matters of consumer protection.
4. Finanstilsynet should publicise activities designed to protect the consumer.
5. Finanstilsynet should tailor its communication to the target group in question.
6. Finanstilsynet should regularly evaluate and adjust the communication effort.

GENERAL INFORMATION ACTIVITY

Thirty-five press releases were issued in the course of the year. Two press conferences and a press briefing were held. In March Finanstilsynet presented *Risk Outlook 2012: The Financial Market in Norway* and the annual report for 2011, and in April *Risk and Vulnerability Analysis* on the use of made of information and communication technology in the financial sector. In October Finanstilsynet presented *Financial Trends 2012*. These reports analyse and review trends and risk in the financial market and potential sources of stability problems in the Norwegian financial sector.

The broad media coverage of Finanstilsynet's new guidelines for banks' home mortgage lending continued in 2012, and early in the year the government's requirements on banks' capital adequacy were discussed in articles and debates in the media. The revocation of the licences of Acta Asset Management AS and Terra Markets AS to provide investment services drew much attention in spring 2012. Finanstilsynet's work on consumer protection was also frequently discussed in the period, in particular in connection with sales of structured savings products to the consumer. At year-end conditions at Verdibanken ASA and Carat Financial Group AS drew attention. Finanstilsynet's proposal for a bidding process handled by an estate agent to be conducted in writing also received broad coverage in the same period.

www.finanstilsynet.no

The website is the main channel for information from Finanstilsynet, containing information on rules, licensing requirements, reporting etc., applying to the various areas of business. Reports, analyses, rules and matters of topical interest are published along with, for example, circulars and press releases. Key statutes and regulations are translated into English.

The licence register is the most used service on the website. This is a searchable register of all firms and individuals under Finanstilsynet's supervision. The website also provides an overview of market warnings against firms that are not licensed to engage in the business they are pursuing in Norway.

In 2012 the website had 435,000 visits. Around 17 per cent of all visits were by users outside Norway. A menu item dedicated to updated consumer information was published on the website in February 2012.

FINANSTILSYNET'S KEY RELATIONS

Storting

Government

Ministry of Finance

Norges Bank

Statistics Norway

Oslo Børs and other regulated markets

ØKOKRIM

Consumer Council and Consumer Ombudsman

Brønnøysund Register Centre

Competition Authority

FINANSTILSYNET

Supervised entities

Banking and finance

Insurance and pensions

Securities market

Listed companies

Auditing services

External accounting services

Estate agency

Debt collection

Data Inspectorate

National Security Authority

Water Resources and Energy Directorate

Foreign Supervisory authorities

International supervisory organisations

Trade organisations

Media/public opinion

Consumers and investors

FINANSTILSYNET'S WORK ON CONSUMER PROTECTION

Given the complexities inherent in today's financial market, and the many new products being marketed, consumer issues are of importance. Finanstilsynet oversees all significant actors in the financial market and sees to it that relevant consumer-oriented rules are complied with in all areas of supervision. Providers of financial services to the consumer are expected to provide relevant and understandable information about their products, and to place the interests of the consumer above their own interests.

Finanstilsynet collaborates with consumer authorities and trade organisations to ensure that information to consumers about products and associated risks is objective and reliable.

Finanstilsynet's website includes a page containing information aimed primarily at the consumer. It gives an overview of rights and obligations in the financial area. Many actors offer financial services without the requisite authorisation. Finanstilsynet urges all consumers to check the Authority's licence register before signing agreements with providers they are not familiar with.

Consumer protection role added to Financial Supervision Act

Consumer protection is at centre stage of statutory regulation of the financial market, and behind Finanstilsynet's main goal – to promote financial stability and well-functioning markets through supervision of institutions and markets – lie important economic considerations and a wish to protect consumers and investors. This has become even more important given products' increasing complexity, and consumers in many countries lost money in the housing market or after purchasing financial products during the last financial crisis.

On 1 January 2013 a clarification was added to the Financial Supervision Act requiring Finanstilsynet to ensure that supervised institutions give due consideration to the interests and rights of consumers.

New European rules – consumer package presented by EU Commission

The European Commission presented a consumer package in July 2012. Its key element is a body of rules governing packaged retail investment products (PRIPs). These require manufacturers to prepare a key information document (KID) when marketing and selling structured products in the fields of insurance, mutual funds, securities and banking. The investor must receive such information well before a purchase is made, regardless of sales channel. The information must enable investors to compare products in a simple manner. Each country is free to introduce the requirements for other financial products than those that are regulated directly.

The consumer package also contains a proposal for common rules applying to sales irrespective of sales channel.

Specific issues

Home mortgage lending guidelines

Finanstilsynet's guidelines on prudent mortgage lending practice are designed to promote solid banks and financial stability, and to reduce the risk of borrowers incurring a debt they are unable to service. Adherence to the guidelines is checked by means of a mortgage lending survey, thematic inspections and ordinary on-site inspections. See the report in the chapter "Banking and finance" on pages 32–34.

New rules on bidding in house purchases

Finanstilsynet has proposed new rules for bidding in house purchases that will require all bids, reservations, rejections and acceptances to be in writing. Participants in bidding rounds must identify themselves to the estate agent when making their initial bid.

Finanstilsynet considers the proposal will make for a safer bidding process that strengthens consumer confidence that house purchase is based on reliable information.

Information and advice from life insurers when selling savings products

Finanstilsynet has carried out a document-based survey of sales of individual unit-linked life insurance products where the customer makes the investment decisions, including endowment insurance, underwriting of annuities and pensions and individual pension saving. The abiding impression is that life insurers provide information and advice prior to sale, but that information about costs and historical return could be improved. For further details, see the chapter "Insurance and pensions" on page 42.

Prohibition of bundled and tied products

A financial institution cannot offer a service on condition that the customer simultaneously purchases another service, nor may it offer particularly favourable terms on condition that the customer simultaneously purchases further services. The prohibition does not apply where cost savings are demonstrably available to the customer. Finanstilsynet asked 25 banks to consider whether their bundled and/or tied products complied with the regulations. Most responded by halting or revising such products. See the chapter "Banking and finance" on page 35.

Payment institutions – licence revocations

Finanstilsynet has investigated payment institutions' compliance with the terms of their licences. Payment institutions engage in money transfers for customers, mainly to countries in the third world. The investigation prompted the revocation of four licences due to non-compliance with the obligation to report to Finanstilsynet and breaches of the audit obligation. See the chapter "Banking and finance" on page 36.

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Mobile operators – relationship to the Financial Contracts Act

Mobile operating companies offer services which in some cases require a licence under the provisions of the Financial Contracts Act. Only licensable services provide customers with protection under the Act. At the request of the Consumer Ombudsman, Finanstilsynet has provided a clearer definition of the licensing threshold. Many more services that could previously be invoiced via the telephone bill can now only be offered by operators licensed as payment institutions or electronic money institutions. See the chapter "Banking and finance" on page 36.

Protection of payment services and new payment solutions

Finanstilsynet attaches importance to actors' effort to secure payment services against criminality. Attacks on internet bank solutions increased in 2012, but losses incurred by banks due to criminal attacks remain limited. It is important for actors to ensure that new payment products such as smartphones and cards with near field communication (NFC) chips are safe in payment situations. See the chapter "Supervision of IT and payment services" on page 69.

Investment advice and good business practice

Finanstilsynet has withdrawn the licences of investment firms Terra Markets AS and Acta Asset Management AS due to improper investment advice. Finanstilsynet's decisions have been appealed to the Ministry of Finance. The decisions will not be enforced until the appeal process is complete. See the chapter "Securities market supervision" on page 50.

BANKING AND FINANCE

Banks play a key role for the entire economy as providers of finance and savings solutions. Regulation and supervision are important contributors to financial stability and confidence in the financial system. Supervision of the banking and financial sector promotes solid financial institutions with good risk awareness, management and control. Financial service provision must be compliant with the regulatory framework and in the best interest of society and the users of financial services.

SUPERVISION AND MONITORING

Monitoring and analysis

Finanstilsynet conducts regular analyses of developments in the industry and of the economic framework conditions, national and international. Analyses of credit, liquidity and financial positions at an aggregated level are part and parcel of the supervision of individual banks and finance companies.

Twice yearly Finanstilsynet presents analyses of developments in institutions and markets in which assessments of the risk picture are at centre stage. The report *Risk Outlook* was presented in spring 2012, and the report *Financial Trends* in the autumn. In addition, Finanstilsynet publishes quarterly analyses of financial institutions' results and developments in their liquidity and financial positions. Other analyses of topical themes are also conducted over the year. The various public reports with press releases are available on Finanstilsynet's website.

Reporting

To ensure close monitoring of developments in financial institutions and markets, Finanstilsynet is dependent on data submitted by the institutions. All credit institutions in Norway report to ORBOF (a database for accounting information from banks and finance companies) on which Finanstilsynet collaborates with Statistics Norway.

The European Supervisory Authorities have in recent years compiled more and more information on developments in the respective countries' financial markets. This information is used by the European Banking Authority (EBA), both for its own supervisory purposes and to pass on to the European Systemic Risk Board (ESRB). Finanstilsynet was responsible for data collection and for reporting on the situation among Norwegian banks to the EBA.

With the impending introduction of the new prudential framework, CRD IV, Finanstilsynet has worked on new reporting requirements for financial institutions. Impact studies will be conducted to assess the effect of a new regime, and to tailor the final requirements.

Financial soundness and profitability of Norwegian banks

The sluggish trend in the international economy has thus far not fed through to the Norwegian economy. The banks maintained sound profits, and even improved their performances in 2012. Growth in lending to retail borrowers remained high, while growth in lending to corporates slowed.

The cost of funding in securities markets remains far higher than in the years prior to the financial turmoil of 2008, bringing banks' margins under persistent pressure. A favourable trend in the domestic economy led to low overall bank loan losses in 2012. Low losses over the past three years have been a major contributor to the banks' relatively sound results in the period. Banks have for some time reduced their operating expenses as a share of total assets, and continued to do so in 2012.

Norwegian banks further improved their financial positions in 2012, and all banks met the minimum capital requirement. In keeping with the EBA's recommendation for larger banks, Finanstilsynet wished to see all Norwegian banks maintain a common equity tier 1 ratio above 9 per cent. Common equity tier 1 capital is capital of the highest loss-bearing quality. All Norwegian banks had a common tier 1 ratio of at least 9 per cent at year-end.

FACTS

At the end of 2012, 109 savings banks, 17 commercial banks and 52 finance/mortgage companies were licensed to operate in Norway. In addition there were 16 branches abroad of Norwegian banks and other credit institutions and 42 branches in Norway of foreign banks and credit institutions. Twenty-two payment institutions and two electronic money institutions held a licence at year-end.

Household debt – high risk

The combination of high house prices and Norwegian households' substantial indebtedness poses a risk to the stability of Norway's economy and financial sector. Households' debt burden has risen markedly in recent years. Debt and house prices have shown a largely convergent trend and have reached a very high level. Indebtedness and house prices continue to rise quicker than household incomes.

The substantial and growing debt burden heightens the household sector's vulnerability to unemployment, income reduction and interest rate hikes. A combination of a further setback in the international economy and a steep oil price fall could reduce demand for Norwegian goods and services. This could reverse households' expectations of future incomes and house prices, leading to a marked fall in house prices. Experience from Norway and elsewhere shows that when households are compelled to significantly tighten consumption as a result of high debt and falling house prices, the secondary effects to the wider economy are substantial, and bank losses rise.

Much use of interest-only mortgages and longer mortgage repayment periods also heighten vulnerability in the event of an economic downturn. Finanstilsynet's home mortgage loan surveys of recent years show a rising share of loans with a high loan-to-value ratio coupled with greater use of interest-only borrowing and longer repayment periods among new borrowers. In a move to encourage more sober-minded lending practices, Finanstilsynet established in March 2010 guidelines for prudent mortgage lending. Continued growth in household borrowing, combined with the results of a thematic round of inspections and the 2011 home loan survey, prompted Finanstilsynet to tighten its guidelines in December 2011, in particular in regard to loan-to-value ratios and instalment repayments. The guidelines are intended to promote solid institutions, financial stability and to reducing the risk of borrowers taking out mortgages they are unable to service.

Liquidity monitoring

Norwegian banks obtain much of their funding on international money and credit markets. Market conditions with a bearing on liquidity are liable to change rapidly, refinancing during a crisis of confidence may be difficult and risk premiums can rise steeply. Finanstilsynet accordingly has a tight focus on liquidity risk. Increased liquidity buffers and a larger element of long-term funding have put Norwegian banks in a better position to meet tighter liquidity. The past year again saw much turbulence in Norwegian loan markets, at times making long-term funding hard to obtain without collateral. Covered bond issuance accordingly became highly important for Norwegian banks' long-term funding.

The new CRD framework includes two indicators for liquidity: Net Stable Funding Ratio (NSFR) for long-term funding and Liquidity Coverage Ratio (LCR) for short-term liquidity buffers. Finanstilsynet oversaw Banks' fulfilment of these requirements, which have yet to be finally defined in 2012. Norwegian banks face particular challenges in fulfilling the LCR requirement due to the limited supply of LCR-compliant securities in the Norwegian market.

Finanstilsynet sent supervisory reports on liquidity risk to 29 institutions following on-site inspections. Liquidity risk was also addressed in ICAAP feedback. Sixteen of the reports pointed to insufficient levels of one or more liquidity indicators used by the Authority to measure liquidity risk at institutions. Ten institutions were asked to increase their deposit-to-loan ratios. Twenty were told that the management limits adopted were insufficiently precise, that the minimum limits applied to manage the risk level were too few or too low, or that the guidelines adopted permitted investment in insufficiently liquid securities and deposits. Twelve reports called for improvement of internal or external reporting of liquidity risk. A number of reports pointed to the absence, or unsatisfactory nature, of stress testing. The Authority drew attention to flawed emergency preparedness planning,

or to insufficient separation between personnel with executive tasks and personnel with control tasks. Finanstilsynet also pointed to the need for institutions to plan their adjustment to the forthcoming international, quantitative liquidity requirements.

From September 2011 onwards all banks have reported their LCR. LCR denotes the size of a bank's liquid assets relative to net liquidity outflow over the next 30 days under liquidity stress. The ratios are defined by the Basel Committee as part of the Basel III reforms. In addition, Finanstilsynet has computed a liquidity buffer indicator (LBI) based on banks' reporting of LCR. LBI has a wider definition of securities eligible for inclusion in the liquidity buffer and, in contrast to LCR, does not entail a reduction of securities portfolio values. Finanstilsynet will until further notice use LBI as a key indicator of the adequacy of banks' liquidity buffers.

In addition Finanstilsynet computes each quarter the ratio of banks' long-term funding to illiquid assets ("liquidity indicator 1 and 2") on the basis of submitted data. Institutions with liquidity indicators significantly below the average of the 13 largest Norwegian-owned banks, or with low LBI values, were followed up.

Assessment of banks' risk and capital need

In 2012 Finanstilsynet urged banks to continue to strengthen their financial positions. It considered it important to prepare the banks for market expectations of higher capital requirements and of higher quality capital that would result from a new regulatory regime.

As a step in this process the 18 largest banks and 23 selected banks were instructed to submit the result of their internal capital adequacy assessment process (ICAAP). Their capital structure was also assessed and commented on during the ordinary inspection activity. Written feedback with comments on capital structure went to a total of 52 institutions.

In 23 feedback letters the board of directors was asked to consider increasing common equity tier 1 capital adequacy. In seven of these cases the board was asked specifically to consider reducing the dividend payout for 2012.

In autumn 2011 the EBA published a recapitalisation plan for the largest European banks, recommending a common equity tier 1 ratio of at least 9 per cent by 30 June 2012. Considering that this should also apply to Norwegian banks and finance/mortgage companies, Finanstilsynet kept a close eye on banks whose common equity tier 1 ratio at the start of the year was below 9 per cent. The Authority also followed up four finance/mortgage companies whose common equity tier 1 ratio was below 9 per cent at the half-year mark.

The ongoing monitoring of banks' financial position showed that some banks faced capital adequacy challenges owing to strong growth. Finanstilsynet indicated to these banks that measures to strengthen capital adequacy must be given priority either by reducing dividend, bringing in further capital or reducing growth.

On-site inspection

On-site inspections are important in identifying problem areas at individual banks at an early stage. They build on Finanstilsynet's risk modules which are based on international supervisory standards. The modules are used to gauge banks' credit risk, market risk, liquidity risk, operational risk and overall management and control. Both the actual risk level and the bank's system for management and control of the risk level are assessed in all risk areas. The inspections start out from documents submitted by the banks in response to Finanstilsynet's notice of inspection. The modules are available at Finanstilsynet's website.

A total of 46 inspections were carried out at banks and finance companies in 2012. Five were thematic inspections focusing on banks' observance of the guidelines for prudent home mortgage lending practices, while five were ICT inspections.

At small and mid-size banks most inspections were of a general nature covering all main risk areas, but with particular attention given to credit and liquidity risk. In the credit area Finanstilsynet examined credit quality and management and control. This included scrutiny of selected exposures, assessment of banks' credit limits and lending process and compliance with the bank's management documents and public rules. Compliance with the mortgage lending guidelines was also central. In the liquidity area, management and control of liquidity risk were central themes. The supervisory effort focused on ensuring the presence of sufficient liquidity buffers and a long-term funding structure through sound deposit-to-loan ratios and long market funding.

With regard to credit risk at larger banks, a particular focus was in 2012 given to loan portfolios liable to be particularly affected by the financial crisis. These include shipping, commercial property and acquisition finance. At some banks attention was drawn to high risk in the loan portfolio, often related to concentration on particular lines of business or individual exposures. The banks concerned were asked to put in place tighter limits on such exposures.

Several banks were called on to increase their liquidity ratios or deposit-to-loan ratios. Attention was also drawn to the need for clearer internal policies with regard to the size of liquidity buffers and the quality of liquid assets included in the buffer.

Compliance with mortgage lending guidelines

After Finanstilsynet revised the guidelines for prudent home mortgage lending as from 1 December 2011, the Authority checked the steps taken by the 18 largest banks' to incorporate the changes in their internal policies. In addition a thematic inspection of actual compliance with the guidelines, and of whether the boards at the respective banks are given sufficient information about compliance with the guidelines, was carried out at five larger banks. Implementation of the mortgage lending guidelines is also taken up during ordinary inspections and in the annual home mortgage lending survey.

Banks' incorporation of the mortgage lending guidelines in their own policies

The survey of March 2012 of the largest banks' mortgage lending policies showed that most of the changes in Finanstilsynet's home loan guidelines had been implemented at almost all banks. After the survey Finanstilsynet wrote to each bank pointing out any flaws in its lending policy. Finanstilsynet also sent identically worded letters with clarifications to all savings and commercial banks in May 2012.

At ordinary inspections about 20 per cent of the inspected banks had not, as of the inspection date, undertaken to take account of all loans secured on a dwelling when calculating the loan-to-value ratio. At about 35 per cent of the banks the board of directors had not established criteria for prudential assessment for cases of negative liquidity or high loan-to-value ratios. As in 2011, the autumn 2012 survey showed that banks were still granting a large number of loans with a loan-to-value above that stipulated in Finanstilsynet's guidelines.

Thematic inspection of compliance and reporting to management

The inspection round revealed that the share of loans with a loan-to-value ratio in excess of 85 per cent varied from 10 to 18 per cent as of the first quarter of 2012 at the five banks where a thematic inspection was carried out. Two of the banks lacked systems to check whether specific prudential assessments had been made for the anomalous cases concerned, and at one bank almost two-thirds of instances of high loan-to-value ratios had been decided at too low a level of authorisation.

The review of individual cases showed that in Finanstilsynet's assessment there is still a need for a general improvement of prudential assessments in cases of liquidity deficit and/or high loan-to-value ratios.

Follow-up of trading at smaller savings banks

At inspections Finanstilsynet saw indications of high-velocity trading in shares at a number of small banks. This prompted scrutiny of trading at the 90 smallest savings banks in 2012. At the 15 banks with substantial trading activity this was taken up with the board of directors of each bank, either by way of on-site inspection or in separate letters. For Finanstilsynet it was important to ensure that the banks' boards were informed of the trading and to get them to take a position on the activity. All 15 banks subsequently reported that they had ceased or markedly reduced their trading in shares.

NIBOR (Norwegian Interbank Offered Rate)

In August 2012, on commission from the Ministry of Finance, Finanstilsynet looked into the need for clearer guidelines for banks involved in setting Norwegian benchmark interest rates. In Finanstilsynet's assessment clear guidelines were needed to prevent, identify and manage interest conflicts that may arise because the banks themselves have interests in the market where Nibor rates are a benchmark. Further, Finanstilsynet saw a need for better communication with the public on how Nibor is fixed and monitored, and for the Nibor steering group to be given a clear responsibility for handling errors and complaints. In a letter of 14 December 2012 the Ministry of Finance endorsed Finanstilsynet's assessments and asked Finanstilsynet to act on the recommended measures. Finanstilsynet did so in the course of its on-site and off-site supervision, and through its ordinary market monitoring. In light of discussions and regulatory development in other countries and in the EU, the ministry also asked Finanstilsynet, in conjunction with Norges Bank, to review the existing Nibor fixing arrangement and, if appropriate, recommend alternative arrangements. Finanstilsynet will present its assessments in spring 2013.

EUROPEAN BANKING SUPERVISION AT THE ECB / BANKING UNION

In December 2012 the Ecofin Council (composed of EU economics and finance ministers) resolved to establish a joint European supervisor (Single Supervisory Mechanism, SSM) for banks in the euro area. This is the first step on the way to a European banking union. According to the plan the banking union will comprise a joint supervisor, a joint crisis resolution mechanism and a joint deposit guarantee arrangement, in addition to a joint body of rules for banking activity. Participation will be mandatory for euro states, voluntary for other EU states. Under the agreement the largest banks in the euro countries will be placed under the supervision of the European Central Bank (ECB). At the outset, supervision will cover up to 200 of the 6,000 largest banks in the EU, with assets in excess of EUR 30bn and operating in two or more countries. The ECB will also be empowered to intervene in all banks in participating countries should problems arise. The new system opens the way for eurozone crisis funds to be used to strengthen the equity capital of crisis-struck banks directly, and not via the respective states as at present. The banking supervisor will be fully functional as from 1 April 2014. National supervisors will retain responsibility for a number of supervisory tasks which have not been assigned to the ECB, for example tasks related to consumer protection, money laundering and payment services.

The European Banking Authority (EBA) will retain its authority and its tasks, and will continue its work on the harmonisation of European supervisory practices. The EBA will relate to the ECB as supervisory authority as it relates to all member countries' supervisory authorities.

Accounts meetings

Quarterly or twice-yearly meetings are held with the largest banking groups at which the management teams present their results and give updates on key developments in the markets in which the banks operate, on organisational matters and on strategic discussions at the individual bank.

Meetings with branches of foreign credit institutions

Finanstilsynet has supervisory responsibility for parts of the activity of branches of foreign credit institutions in Norway. The focus here is on the ‘general good‘ which essentially comes under the rules governing the relationship between institution and customer. The branches keep Finanstilsynet informed of their activities in Norway, of their interim financial statements and of any changes in group structure.

Supervisory collaboration

The supervision of large individual banks operating in several countries is coordinated through supervisory colleges in which the various countries' supervisory authorities are represented.

As coordinating authority for the DNB supervisory college, Finanstilsynet held in 2012 meetings with representatives of the supervisory colleges of the other countries in which DNB maintains a presence. Drawing up a joint risk and capital assessment of the group was at centre stage.

Finanstilsynet also participates in nine supervisory colleges for foreign banks operating in Norway.

Consumer protection/information

Compliance with the regulations on bundled/tied products

Over the year Finanstilsynet asked 25 banks to explain their view of their bundled/tied products' compliance with regulations. Banks citing the regulations' derogation for cost savings must document any savings and the connection between them and the terms offered. Finanstilsynet reviewed the banks' reasoning and concluded that their documentation and description of cost savings were inadequate. Most of the banks halted or made changes to such products after Finanstilsynet's approach. The Authority ordered six banks to halt the marketing and sale of bundled/tied products. Two of the banks appealed against the order.

THE LIIKANEN REPORT

In the wake of the financial crisis several new regulatory requirements have been introduced or proposed to lessen the likelihood, or the consequences, of financial instability. In November 2011 the EU Parliament announced a decision to appoint a high-level expert group to consider structural reforms of the EU's banking sector. The group was headed by Finland's central bank governor Erkki Liikanen. Its mandate was to consider the need for structural reforms and whether such reforms could contribute to strengthening financial stability, increase the sector's efficiency and strengthen consumer protection. Reports on banking sector structure have fairly recently also been produced in the United States and the United Kingdom, and important changes have been or will be made in these countries' legislations in the years ahead. The Liikanen Group's final report was published in October 2012.

The Liikanen Group sees the need to require legal separation, within banking groups, of certain particularly risky activities from the deposit-taking entity (the deposit bank), in addition to introducing new, improved legislation for capital and liquidity etc. Separation should include proprietary trading in financial instruments and other activities closely linked with securities and derivatives markets. The Group recommends that loans, credit lines and unsecured credit exposure to hedge funds, structured investment entities etc., and private equity investments should be included in the investment banking entity (trading entity). Mandatory separation is also recommended for activities that account for a large portion of the business, or where the activities are considered essential for financial stability. In addition, the Group recommends that only the deposit bank should be entitled to supply retail payment services and to use insured deposits as a source of funding. Further, the Group recommends that provision of hedging services to non-banking clients which fall within narrow position risk limits in relation to own funds need not be separated. These services could thus be carried out by the deposit bank. However, securities underwriting must not be separated. The legally-separate deposit bank and trading entity could operate within a joint holding company structure. In the Group's assessment this would ensure banks’ continued ability to offer a wide range of financial services to customers, to use the same marketing organisation and to maintain benefits to the customer from a diversity of business lines.

In addition to the above separation, the Group suggests an additional separation of activities conditional on recovery and resolution planning. Further, it may be necessary to amend the rules governing conversion of debt to equity capital (bail-in instruments), to review capital requirements on the trading book and real estate lending and to strengthen management and control of banking activities.

The EU Commission is now considering the report and has held a round of consultation on the Group's recommendations seeking contributions from market actors, governments and supervisory authorities. It is uncertain whether the Liikanen Report will lead to regulatory changes in the EU.

Payment systems

In June-July 2012 Finanstilsynet pursued a case against a payment terminal supplier that had omitted to settle up with its customers – the Touchpay affair. Touchpay offered its customers payment terminals where settlement for transactions was credited to Touchpay's account for subsequent transfer to the customer. Touchpay provided its services without the requisite licence. Finanstilsynet made clear in circular no. 15/2012 the responsibility assumed by banks when entering payment terminal agreements. Banks are required by law to verify that the payment terminal is the point of sale and that transactions involving payment terminals are carried out by transfer from the payer's to the point of sale's account. See more on Touchpay in the chapter "Auditing" on page 64.

LICENSING

Licence applications and dispensations

Banks and foundations

- DNB Bank ASA was authorised to merge with Nordlandsbanken ASA and to modify the DNB Group structure as a result of the merger. The merger is a consequence of terms of the authorisation granted to the then DnB NOR Bank in 2003 to take over all shares of Nordlandsbanken ASA. Up to the merger DnB NOR Bank had time-limited dispensation to own Nordlandsbanken as a subsidiary.
- Lillestrøm Sparebank received permission to set up the foundation Sparebankstiftelsen Lillestrøm by converting parts of the bank's ownerless capital into equity capital instruments to be owned by the foundation. The foundation's portion of the equity share capital of Lillestrøm Sparebank will equal or exceed 25 per cent at all times.
- Finanstilsynet recommended the Ministry of Finance to authorise the establishment of the savings bank foundations Sparebankstiftelsen Hallingdal and Sparebankstiftelsen Øystre Slidre – and the merger of the savings banks.Finanstilsynet recommended the Ministry of Finance to authorise the merger of Sparebanken Møre and Møre Finans AS.
- Finanstilsynet recommended the Ministry of Finance to authorise the establishment of the foundation Sparebankstiftelsen Telemark – Grenland.
- Finanstilsynet recommended the Ministry of Finance to authorise the establishment of the foundation Sparebankstiftelsen Telemark – Holla og Lunde and the merger of the two banks.
- Finanstilsynet recommended the Ministry of Finance to authorise the establishment of the foundations Sparebankstiftinga Bø and Sparebankstiftinga Seljord in Telemark – and the merger of the two savings banks.
- SEB Privatbanken ASA was absorbed into SEB's Norwegian branch SEB NUF.

Finance companies

- Finanstilsynet authorised Visma Finans AS to carry on business as a finance company.
- Finanstilsynet authorised Spiro Finans AS to carry on business as a finance company.
- The licence of Western Union Retail Services Norway AS ceased upon the company being authorised to take over Forex Bank AB with the associated licence.

Electronic money institutions and payment institutions

New regulations on electronic money institutions entered into force on 1 January 2012. In the course of 2012 Finanstilsynet was in touch with the telecoms operators and the Consumer Ombudsman regarding correct interpretation of the new electronic money legislation and regarding what services are payment services. In a letter to the Consumer Ombudsman, Finanstilsynet advised that where films, music, games and electronic books are paid for by way of the telephone bill, the service provided by the telecoms operator must be regarded as a payment service and is accordingly covered by the Financial Contracts Act's consumer protection provisions.

In 2012 Finanstilsynet received five applications for a licence to operate payment institutions. Four of these were applications for a limited licence to engage in money transfers. All were refused. Mcash Norge AS applied for an ordinary licence as a payment institution. The application was granted in August 2012. In January 2012 Vina Remittance Express AS had its limited licence extended to a full licence to offer money transfer services. In addition, two limited licences were granted based on applications filed in 2011.

Four payment institutions had their limited licences revoked, mainly as a result of non-compliance with reporting obligations and the obligation to appoint an auditor. A further two companies surrendered their licences voluntarily.

Permission to use internal (IRB) models to compute capital requirements

Financial institutions can use internal models to compute minimum capital charges for various categories of risk, subject to Finanstilsynet’s permission. In 2012 permission to use the IRB foundation approach was granted to Sparebanken Hedmark.

REGULATORY DEVELOPMENT

A number of regulatory changes are in process in the banking and finance area. The proposed EU capital requirements directive, CRD IV, sets stricter capital requirements for credit institutions and investment firms. The financial crisis has led to a considerable focus on systemically important banks and crisis management systems. New rules have been drafted in both areas. In Norway the Bank Law Commission presented several major reports in 2012, including a proposal for new umbrella financial legislation.

New solvency framework – CRD IV

CRD IV restructures legislation by replacing the capital adequacy directives for credit institutions and investment firms with a Regulation and a Directive. The Regulation addresses institutions directly and contains minimum requirements on capital and liquidity, limits on concentration risk and disclosure requirements (Pillar 3). The Directive regulates institutions' business rules and risk management, as well as the authorities' supervisory practices and sanctions related inter alia to the review of institutions' internal capital adequacy assessment process (Pillar 2). Provisions on capital buffers will also be incorporated in the Directive. Implementation, scheduled for 1 January 2013, has been postponed. A new implementation date has yet to be set.

Large exposures

The regulations on large exposures set an upper limit for exposures that an institution may incur with a single counterparty.

The risk weight for exposures to institutions that are not subsidiaries was in 2011 raised from 20 to 100 per cent. Under a transitional rule, exposures to jointly-owned covered-bond-issuing mortgage companies were allowed to retain a risk weighting of 20 per cent. The transitional arrangement expired on 31 December 2012. Eksportfinans operated under a similar transitional rule which expired on the same date. Due to dispensations granted for a number of exposures, the company faced no particular challenges when the transitional arrangement expired.

Implementation of CRD IV will not bring major changes to the existing framework. Importantly, exposures to local authorities and appurtenant local authority enterprises will be subject to a grouping requirement. Thus far this requirement features solely in guidelines issued by the European Banking Authority (EBA), and has not been enforced in Norway.

EU Commission' proposal for a new crisis management directive

The European Commission presented on 6 June 2012 a draft directive on crisis management at banks and financial institutions. The instrument aims to establish a European crisis management system that promotes financial stability and predictability while protecting public assets. Finanstilsynet participated in 2012 in the Crisis Management working group under EBA auspices.

Initially intended for submission to the European Parliament in March 2013, the proposal is now a part of the process towards a European banking union. Implementation is proposed for 1 January 2015. The Bank Law Commission is mandated to review the Norwegian crisis management legislation (Guarantee Schemes Act), a process expected to progress in step with the changes taking place at the European level.

New financial legislation

The Bank Law Commission drafted new umbrella financial legislation in NOU 2011: 8. The proposal was circulated for comment and is under consideration by the Ministry of Finance.

Deposit guarantee scheme

The European Commission's proposal from 2010 to shorten the period for disbursement under deposit guarantee schemes to one week is still under consideration by the European Parliament and the European Council. In Norway several actors, including Finanstilsynet, have called for the payment period to be cut from three months to one week. An amendment to the Guarantee Schemes Act in 2012 reduced to one week the period available to the Guarantee Schemes Fund to reimburse eligible deposits to a bank that is unable to settle its accounts.

In addition to the reduced period for disbursement, the power under the Act to exempt banks from levy payments is removed such that all member banks are obliged to pay an annual levy. The amendments to the Guarantee Schemes Act became effective on 1 January 2013.

Accounting rules for the financial industry

In 2012 Finanstilsynet prepared a consultation paper proposing limited adjustment of accounting rules to IFRS in the case of unlisted banks and finance companies. The paper was forwarded to the Ministry of Finance in March 2012. After a round of consultation the Ministry of Finance decided not to implement the proposal.

COVERED BONDS

Norwegian banks are becoming increasingly dependent on market funding, and covered bonds make up a large and important share of such long-term funding. As of 31 December 2012 the market for covered bonds totalled NOK 797bn, and 23 Norwegian mortgage companies were authorised to issue such bonds. All Norwegian residential mortgage companies issue covered bonds in Norwegian currency. The largest such companies also issue covered bonds denominated in foreign currency – in particular the euro and US dollar. The European bond markets are an important funding source for Norwegian banks and mortgage companies, and in recent years more than half of Norwegian mortgage companies' foreign currency issues have been denominated in euro. As from 2010 large parts of foreign funding have also been denominated in the dollar.

Virtually all banks in Norway have access to funding through wholly or partly owned covered-bond-issuing companies. Overall about 50 per cent of all Norwegian home loans reside in such companies. The largest banks have on average transferred a higher proportion of loans to their bond issuing companies than have small banks. A substantial portion of the cover pool for covered bond issues has already been utilised.

Norway did not suffer a serious credit contraction as a result of the international financial crisis. Growth in lending to the corporate sector was, however, very low and for a period negative, while growth in lending to households remained relatively high throughout the period. Since its amendment in 2007, the covered bond legislation has provided Norwegian banks with a reliable and reasonably priced source of funding. Covered bonds' success as a funding source in an otherwise difficult market is partly because such bonds are secured, in contrast to senior bonds. In addition, because loans transferred to a residential mortgage company cannot exceed 75 per cent of property value, less risk attaches to default at residential mortgage companies compared with banks' loan books in general.

Some risk factors

Finanstilsynet has examined whether transfer of secured loans from banks to residential mortgage companies has impaired banks' balance sheets, thereby putting depositors and investors at increased risk. Banks customarily issue liquidity guarantees in favour of residential mortgage companies. Such guarantees impair unsecured creditors' position compared with holders of covered bonds since they confer a claim on the bank in a winding up situation. While not altering a banking group's risk, such guarantees shift risk between parent bank and residential mortgage company, thereby shifting more risk onto depositors and unsecured bondholders.

There are also concerns attached to the high proportion of home loans being transferred from Norwegian banks to residential mortgage companies. Norwegian households' debt burden is disturbingly high, and banks' access to favourable funding of home mortgage loans may have fuelled growth in home loans and intensified price pressures in the housing market. Further, increased mortgaging of banks' "best" assets reduces flexibility in banks' asset and liability management. The larger the portion of assets that is mortgaged, the smaller the portion is available as collateral in future periods. This may render banks more vulnerable in periods of major uncertainty in the market.

In its assessment of the legislation on covered bonds, Finanstilsynet pointed to the fact that covered bonds have provided Norwegian banks with a supply of liquidity in periods of international turbulence and credit contraction, and that they remain a significant and important source of funding. Making substantial, fundamental changes to the rules as they stand would be neither appropriate nor constructive. However, Finanstilsynet is at pains to point out that the volume of covered bonds has risen in the space of just a few years and has reached a high level in relation to banks' total loan books. This is worrying for financial stability since it may lead to structural weaknesses in banks' funding, heightened vulnerability and detrimental incentives to lenders. Finanstilsynet therefore recommended the Ministry of Finance to consider rule adjustments able to dampen the scale of covered bond issues by Norwegian banks.

MACROPRUDENTIAL SUPERVISION

Macroprudential supervision has acquired increased prominence in international debate in the wake of the financial crisis. Experience gained from the crisis showed that the authorities of many countries were insufficiently aware of systemic risk and of the need for measures to mitigate this risk. Macroprudential supervision and regulation are designed to limit systemic risk in financial markets and institutions and contribute to financial stability. Strong macroprudential supervision and sound macro regulation reduce the likelihood of financial crises, and dampen the impact of such crises when they occur.

Primarily two dimensions of systemic risk are relevant to macroprudential supervision. One is the time dimension, i.e. the development over time of, say, strong credit growth, high house and stock prices, appreciation of the Norwegian krone and reduced risk premiums. At some or other point, events leading to loss of confidence followed by credit contraction, falling house and stock prices and a steep increase in risk premiums, are likely to occur. The other dimension covers risk allocation in the financial system at a given point in time (cross-section dimension). This refers inter alia to the complexity and opaqueness of group structures, mutual interdependencies, exposure to the same risk factors and vulnerability to the same types of shock. Items monitored by the authorities to uncover systemic risk include GDP growth, unemployment, interest rate level, risk premiums, credit growth, house-price and stock-price growth, debt ratios, liquidity and risk concentrations.

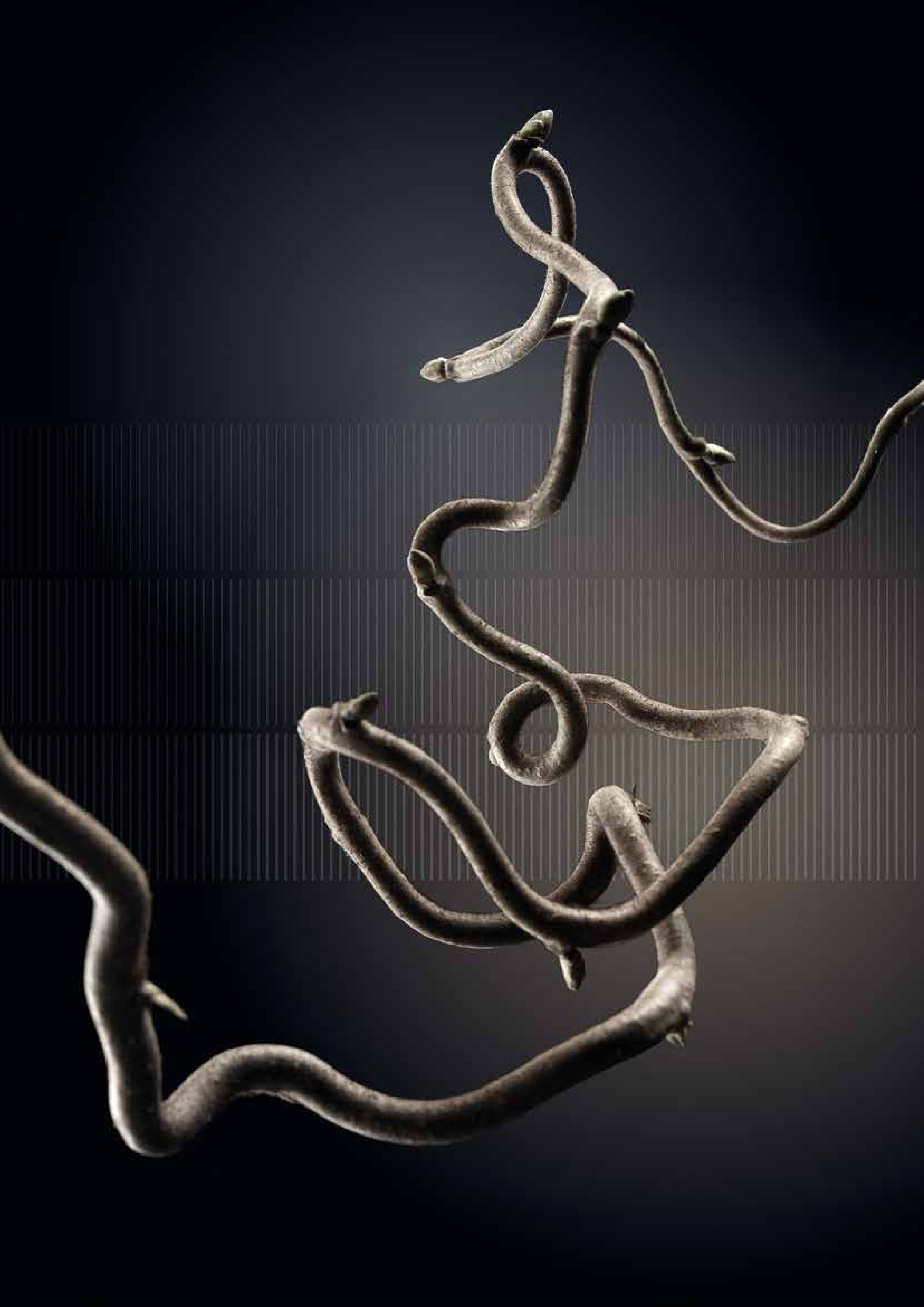
Macroprudential supervision and regulation have interfaces to other policy areas, including monetary and fiscal policy. Most important is the interface to the regulation and supervision of individual institutions (microprudential supervision). Drawing a clear distinction between macroprudential and microprudential supervision is no simple matter, as already became clear after the Norwegian banking crisis in the 1990s. The individual financial institution's situation can only be assessed in light of the wider economy and the markets. Financial stability and systemic risk have accordingly been integral aspects of Finanstilsynet's activity over the past two decades. The experiences gained from the banking crisis in the 1990s spurred the establishment of a macroeconomic surveillance capability at Finanstilsynet. It was primarily the banks that were affected, and the three largest commercial banks were taken over by the government. This was the reason why banks – in particular the large, systemically important ones – have received most attention in the Authority's effort to assure financial stability. Several of the largest Norwegian banks are part of mixed financial groups, where life insurance is an important business line. Norwegian life insurers are substantial investors in securities and property markets, and have accordingly been subject to supervision since the start-up in 1994. Micro- and macroprudential supervision overlap and are mutually reinforcing and complementary. This was an important lesson from the banking crisis. Finanstilsynet has attended to both macro- and microprudential supervision through the following policy instruments: supervision and monitoring, licensing, regulatory development, and information and communication.

In Finanstilsynet's strategy for the period 2010–2014 the main goal is to foster financial stability and well-functioning markets. Behind these goals lie important economic considerations. Finanstilsynet's two main goals are given concrete form through a set of intermediate goals. See the presentation of Finanstilsynet's main goal and intermediate goals on pages 5 to 8.

Macroprudential supervision benefits from its close contact with on-site and off-site supervision, thanks in part to the inspection activity's ability to identify possible sources of risk. At the same time macroeconomic assessments are an important basis for evaluating special-purpose analyses and an important backdrop to on-site inspections. Macro analyses are employed in the Supervisory Review and Evaluation Process (SREP), which is Finanstilsynet's review and evaluation of the banks' Internal Capital Adequacy Assessment Process (ICAAP). In reviewing banks' capital need, Finanstilsynet takes a basis in the risk present in the individual bank and in the economy as a whole. It assesses whether the banks' capital adequacy and future capital plans assure the financial strength needed to maintain lending activity during an economic setback lasting several years. Future macroeconomic developments and their inherent uncertainty are therefore very important to these assessments. At the same time, information culled from on-site and off-site institutional supervision is highly important to assessments of systemic risk and financial stability.

Macroprudential supervision at Finanstilsynet and its interface to microprudential supervision focus on identifying possible sources of economic shocks which could lead to stability problems in the financial industry. The risk of bubbles, particularly in credit and property markets, receives much attention. Monitoring is now mainly based on a set of indicators and analysis tools which roughly speaking cover six main categories and capture both macro and micro factors. Finanstilsynet's analyses are published in the spring report *Risk Outlook* and the autumn report *Financial Trends*.

Internationally a number of policy instruments have been put forward with a view to curbing systemic risk. Many of them are familiar from institution-specific supervision, such as solvency and liquidity requirements. Finanstilsynet has for some time, through the Pillar 2 processes, expected banks to maintain a capital ratio well in excess of the minimum required by existing legislation. Finanstilsynet has also underscored the importance of robust liquidity measurement and of banks' early adjustment to the capital and liquidity requirements of CRD IV. Finanstilsynet's guidelines for home mortgage lending, which were tightened in 2011, were introduced partly to safeguard financial stability. Under these guidelines, loans for residential purposes should not be granted unless the borrower retains a liquidity surplus even after an interest rate increase of 5 percentage points, and mortgages should normally not exceed 85 per cent of property value. All banks must report their liquidity indicators (LCR and NSFR). Finanstilsynet regularly presses home the need for larger liquidity buffers and long-term stable funding at on-site inspections, in its risk assessments of banks and in its response to reports submitted by supervised entities. Finanstilsynet will come back with a concrete step-up plan once important processes in the EU system have been clarified.



INSURANCE AND PENSIONS

Regulation and supervision are important in safeguarding customers' rights under insurance and pension contracts, and in instilling public confidence in the market. The supervisory regime aims to foster financially solid, risk-aware companies and sound management and control. Supervision of the insurance industry covers insurance intermediaries.

SUPERVISION AND MONITORING

Monitoring and analyses

Monitoring and analyses of developments in the economy and markets and of the situation in the financial sector is a prerequisite for ongoing oversight of individual institutions' liquidity and financial strength. The analyses provide the background for Finanstilsynet's assessment of the general state of the financial sector and its supervision of individual institutions.

Quarterly reports are prepared on profitability, financial strength and balance sheet composition at life insurers and non-life insurers, while reports for pension funds are half-yearly. Press releases in February, May, August and November summarise these analyses, which are also published in *Report for Financial Institutions* on Finanstilsynet's website.

Overall assessments of the situation in the financial sector and of various risks faced by Norwegian financial institutions in light of developments in the economy and markets were published in the spring 2012 report *Risk Outlook* and the autumn 2012 report *Financial Trends*.

Reporting

The reports filed by institutions are an important basis for analyses and on-site inspections. A complete overview of current requirements on reporting, along with updates on any adjustments to the reporting set-up, is available at Finanstilsynet's website. Finanstilsynet collaborates with Statistics Norway on the quarterly reports filed by insurers through FORT (the Norwegian acronym for 'public financial and supervisory reporting by insurers'), while pension funds report annually via PORT (the Norwegian acronym for 'public financial and supervisory reporting by pension funds'). Insurers report stress test results to Finanstilsynet on a quarterly basis.

Insurers report two stress tests to Finanstilsynet each quarter, stress test I and stress test II. Stress test I builds on the methodology and assumptions employed in the impact assessments of Solvency II, while stress test II builds on current rules. The stress tests assess overall risk against the insurers' buffer capital.

Like the insurers, the three largest pension funds have reported stress tests since 2008. Pension funds with total assets above NOK 2bn, 21 in all, started semi-annual reporting of stress tests at the end of 2011. Other pension funds report stress tests as from end-2012, with the same frequency.

Financial strength and profitability of Norwegian insurers and pension funds

Since a large proportion of life insurers' and pension funds' total assets are invested in securities markets, developments in these markets are of great significance to their profits and financial strength.

After a stock market plunge in 2011, which depleted life insurers' equity asset revaluation reserves, markets took a more favourable turn in 2012. Concurrently long interest rates fell, especially in the first half-year. While falling interest rates increase the value of parts of the bond portfolio in the short term, they also limit life insurers' opportunity to build up new reserves and create a rate of return over and above the interest guarantee. In addition, life insurers face a challenge in terms of rising longevity in the population, which will require a substantial increase of technical provisions in the years immediately ahead. Stress testing shows that, given today's business rules, Norwegian life insurers will need a considerable supply of capital to meet the requirements that appear likely to result from Solvency II.

Pension funds, in particular in the private sector, have a higher equity share and share of bonds measured at fair value than life insurers. Over time this has resulted in wide fluctuations in (adjusted) return. The equity market upturn in 2012 brought higher return for pension funds in 2012 than in 2011 when the market trend was negative and pension funds' rate of return low. Pension funds' buffer capital strengthened in 2012 due to rising fluctuation reserves.

Non-life insurers have lower exposure to equities and long-term bonds than do life insurers and pension funds. Even so, the stock market upturn brought increased financial revenue for non-life insurers in 2012. Moreover, revenue from the insurance business was on a stable, good trend for non-life insurers as a whole, bringing improvements in comprehensive income and increased buffers for most companies.

On-site inspection

Life insurers

Five on-site inspections were conducted at life insurers in 2012. Three were thematic inspections in the insurance field and one was an IT inspection. The inspections were based in risk modules designed to cover the various areas of risk faced by life insurers.

The inspections focused on overarching governance and control systems. Matters raised included the capital situation, cost overruns in some lines of business/product types, increased life expectancy and a need for higher provisions in 2012. Comments were made regarding lack of strategy for the insurance area; little formalisation of the substitute function; risk limits and risk tolerance in asset management; risk limits and risk tolerance with regard to insurance risk; inadequate profit analysis of price tariffs and future IT challenges.

Pension undertakings

Inspections were conducted at six pension funds in 2012, one of which being a thematic inspection in the asset management area.

Finanstilsynet pointed to breaches of the capital adequacy requirement and the solvency margin requirement, and drew attention to poor risk management and the need for an overall risk assessment. Investment limit structures and insufficient independence between manager and control functions also drew comments.

FACTS

At the end of 2012 12 life insurers, 43 non-life insurers, 12 marine insurance associations and 19 fire insurance companies were licensed to carry on business in Norway. A further 16 branches of Norwegian insurers were operating abroad and 36 branches of foreign insurers in Norway. Moreover, 96 insurance intermediaries, 56 private pension funds and 32 municipal pension funds held a licence at year-end.

Other supervisory comments covered rules on action to be taken in connection with breaches of overall risk limits, monitoring of compliance with internal policies/statutory requirements and reporting to the board of directors.

Non-life insurers

Inspections were conducted at three non-life insurers in 2012.

One of the above companies had posted poor results. Finanstilsynet drew attention to its capital situation and business plan and to whether fresh capital could be supplied by the owner.

At the other non-life insurers, Finanstilsynet drew attention to inadequate formalisation of internal procedures and policies, poor governance of asset management, absence of procedures to oversee regulatory compliance and inadequate documentation of outsourcing agreements. In addition, the companies were vulnerable to loss of key personnel. A lack of response to breaches of maximum exposure limits and problems related to distribution of responsibilities were also pointed out.

Insurance intermediaries

On-site inspections were conducted at three insurance brokers in 2012. At the inspections attention was drawn to flawed risk management and internal control. The need to formalise risk assessment, procedures, controls and a clear distribution of responsibility between the board of directors and the day-to-day management also received comment.

Consumer protection and information

Survey of compliance with the information and advice requirement by vendors of individual unit-linked life insurance products

In 2012 Finanstilsynet conducted a document-based review of Norwegian life insurers' sales of individual unit-linked life insurance products where the customer takes the investment decisions. The Authority examined what steps insurers took to ensure that the customer receives mandatory information and advice on the insurance contract, the investment options that are offered and associated costs, and that the products recommended by the insurer meet customer needs.

The main impression gained is that life insurers do ensure that information and advice are given prior to sale. However, a number of them could improve the information given on costs and historical return in the various product categories. Return to customers less costs for each of the requested years 2009, 2010 and 2011 varies widely, both between companies and between product categories.

Several companies do not make it sufficiently clear that the contracting party is a life insurer, that a premium will be payable for an insurance element and that the customer will not own underlying investments but will receive a claim on the company.

Some insurers sell their products to cover investment needs rather than insurance needs. In such cases it is particularly important that the product meets the customer's needs. The riskier the investment, the greater is the need for information and personal advice. Two companies sold such products without providing personal advice.

Accounts meetings

Finanstilsynet has twice yearly meetings with the management teams of the largest insurers. At these meetings the insurers present their latest financial results and developments in key risk factors. In addition, updates are given on the markets in which the insurers operate, on organisational matters and on strategic issues at the individual insurer.

Supervisory cooperation

The supervision of large insurance companies operating in two or more countries is coordinated through supervisory colleges in which the various countries' supervisory authorities are represented. As the coordinating authority for supervision of Gjensidige Forsikring ASA and Storebrand ASA, Finanstilsynet arranged in 2012 a college meeting for Storebrand. By agreement, a college meeting was not held for Gjensidige in 2012, but the supervisory authorities concerned were continuously updated on developments in the Group. Finanstilsynet also participates in supervisory colleges for foreign insurers operating in Norway through a subsidiary (Nordea and Danica) or through a branch (Alpha, If and Tryg).

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LICENSING

Licence applications

Information on individual cases considered by Finanstilsynet is published on Finanstilsynet's website. Cases dealt with by Finanstilsynet in 2012 included the following:

Borettslagenes Sikringsordning AS was in 2012 authorised to establish a non-life insurance company to offer protection against loss of maintenance payments at housing cooperatives.

Nordmøre Gjensidige Båttrygdelag merged with Bud og Hustad Forsikring with effect from 1 January 2012.

Kvitsøy Gjensidige Motorbåtassuranse merged with Rennesøy Gjensidige Fartøysassuranse with effect from 1 January 2012.

Winding up applications from seven private pension funds were approved in 2012. Pension rights in the funds were transferred to a life insurer. Four of the windings up were due to the establishment of a new defined benefits pension scheme at a life insurer, one to conversion to a defined contributions scheme and two to cessation of the pension scheme concerned.

Four insurance intermediaries (three insurance and reinsurance brokers and one insurance agent) were awarded licences in 2012. Several Norwegian insurance intermediaries applied for permission to set up branches abroad in 2012. Several hundred notifications of cross-border activities into Norway from other EEA states were dealt with.

Deletion of register entry as insurance agent

By order of 24 September 2012, Finanstilsynet deleted Vega Insurance Agencies AS (VIA) from Finanstilsynet's insurance agent register due to gross violation of the requirement of the Insurance Intermediation Act regarding treatment of client assets. VIA had used funds from the client account to finance the company's operations in order to avoid bankruptcy. The order was appealed to the Ministry of Finance, and effectuation of the order was postponed pending a final ruling on the appeal. Bankruptcy proceeding were however opened against the VIA estate on 15 November 2012.

Revocation of right to carry on insurance mediation

Finanstilsynet resolved on 6 June 2012 to withdraw Goldberg Partners AS's insurance mediation licence. Finanstilsynet considered the firm to have been in gross violation of the Insurance Intermediaries Act's requirement regarding treatment of client assets, the Risk Management Regulations' requirement regarding outsourcing and the Financial Supervision Act's information requirement. In addition, they had clearly overstepped the Insurance Intermediaries Act's rules regarding good insurance broker practices. The revocation order has been suspended pending the Ministry of Finance's ruling on an appeal.

Maximum guaranteed rate of return in life insurance

Finanstilsynet is required to stipulate the highest interest rate available to life insurers and pension funds when calculating premiums and associated technical provisions. With a view to strengthening life insurers' financial position, the maximum guaranteed interest rate in the premium formula was lowered as from 1 January 2011 from 3.0 per cent to 2.5 per cent for new life insurance contracts. In the case of collective annuity and pension insurances, the maximum permitted interest rate for accrual after 1 January 2012 is 2.5 per cent.

On 4 June 2012 Finanstilsynet circulated for comment a proposal to reduce the maximum permitted interest rate from 2.5 to 2.0 per cent for new life insurance contracts and new pension accrual for collective annuity and pension insurances from 1 January 2013. Finanstilsynet's decision to reduce the above rate in keeping with the consultation document's recommendation was submitted to the Ministry of Finance. The ministry decided to retain the maximum permitted interest rate at 2.5 per cent.

New mortality tables for life insurers and pension funds

Finance Norway (formerly the Norwegian Financial Services Association) has proposed a new mortality base table for collective annuity and pension insurance based on updated risk statistics, termed K2013. The proposal is based on a dynamic mortality base, replacing the current statistical base, K2003. The new mortality base includes the latest updates on marital status elements. Finanstilsynet has called for a stronger mortality base than that proposed by Finance Norway.

The implementation date for the new mortality base is 1 January 2014. In a letter of 18 December to all pension institutions the Authority emphasised that it was inadvisable on solvency grounds for net profits to be employed as buffer capital in the form of supplementary provisions or to write up benefits in a situation where the underlying premium reserves are inadequate. Pension institutions were urged to devote net profits for 2012 to strengthening premium reserves as a result of the new mortality base, K2013.

Change in mortality tables for individual insurances

Finance Norway's new mortality base for individual annuity and pension insurances, R2008, was introduced on 1 January 2009. R2008 is based on updated mortality experience data accumulated by life insurers. Two companies notified Finanstilsynet of their introduction of mortality base R2008 for their portfolios of individual annuity and pension insurances as of 1 January 2008.

REGULATORY DEVELOPMENT

SOLVENCY II – THE NEW EUROPEAN SOLVENCY FRAMEWORK FOR INSURERS

EU preparations for the new body of rules

The European Commission's proposal for a new directive incorporating risk-based solvency rules for insurers (the Solvency II Directive) was adopted in 2009. Negotiations on amendments to the Solvency II Directive have been under way for some time. It appears clear that the Solvency II framework will not become effective on 1 January 2014, as previously assumed. The European Commission has stated that it will recommend entry into force on 1 January 2015. It is uncertain if the European Parliament and the European Council will adopt this date. Further postponement is therefore possible. It is uncertain when a revised schedule will be finalised.

The Solvency II Directive will be supplemented by implementing provisions and technical standards and recommendations. A proposal for supplementary provisions will not be published until agreement on Omnibus II has been reached, in the second half of 2013 at the earliest.

In light of the postponement EIOPA plans to draw up a recommendation facilitate implementation of parts of the Solvency II framework as from 2014. The recommendation will be confined to measures implementable under the current legal framework (Solvency I). The recommendations are expected to include requirements on insurers' risk management and internal control, including self-assessment of risk and solvency, requirements for supervisory review, requirements on advance dialogue for internal models and reporting requirements. EIOPA's recommendation will probably be published for a round of consultation in the first half of 2013.

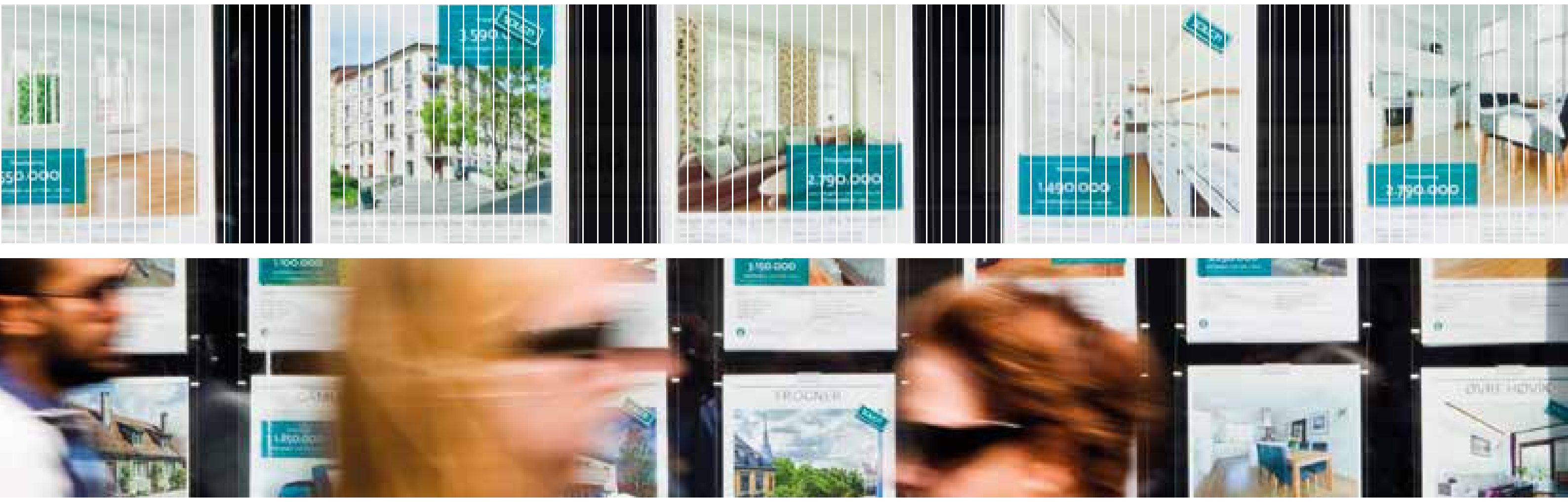
Calculating the solvency capital requirement under Solvency II will, far more than under the current rules, reflect all types of risk to which insurers are exposed. The current solvency margin requirement is largely geared to insurance risk and is calculated with a basis in insurers' premiums, provisioning and claims expenses, but does not reflect risk attending the assets (market risk). Given the changes in the principles for valuing technical provisions, solvency capital under Solvency II may also differ from solvency margin capital under current rules.

Introduction of the framework in Norway

The new Act on financial institutions and financial groups, which includes Solvency II provisions, is scheduled for submission to the Storting in spring 2013.

The further process in Norway depends on the process within the EU. Finanstilsynet aims to finalise draft regulations shortly after adoption of Omnibus II and publication of the final proposal for implementing provisions and standards. Draft regulations can be forwarded to the Ministry of Finance at the end of 2013 at the earliest.

Finanstilsynet's stress tests and development of modules in the risk-based supervisory regime are an important aspect of the preparations for implementation of the Solvency II framework in Norway. Finanstilsynet will consider possible adjustments to national rules and supervisory processes



resulting from the postponement of Solvency II. Such adjustments must be considered in light of EIOPA's forthcoming recommendations.

Finanstilsynet plays an active part in EIOPA's work on the Solvency II framework.

Internal models for calculating solvency requirements

Under Solvency II insurers will be entitled to compute the solvency capital requirement (SCR) using a standardised approach or using internal models approved by the supervisory authorities. In 2012 Finanstilsynet organised a series of meetings with insurers intending to use internal models.

Finanstilsynet participates in a Nordic supervisory collaboration on internal models under Solvency II. The object is to facilitate harmonised processes and assessments across the Nordic region and by that means support the supervisory authorities' work on model approval.

Impact assessment of rules related to long-term guarantees

In the course of the first half of 2013 impact assessments will be carried out of a number of the proposals under discussion in the Omnibus II process. The proposals in question relate to long-term guarantees, mainly covering proposed adjustments to the yield curve used to discount liabilities with a view to reducing the fluctuations in insurers' capital and capital charges. The results of the calculations will be summarised in a report due to become available at the end of June 2013. The results will be a key basis for further negotiations on and final adoption of Omnibus II.

The proposals with regard to long-term guarantees should be viewed in light of recent years' developments in the fixed income markets. Declining long rates have impaired the financial position of life insurers that have issued long-term rate-of-return guarantees; this will become visible under Solvency II. Hence, for many life insurers the capital requirement under Solvency II could prove significantly higher than under the present regime. Some of the proposals related to long-term guarantees call for adjustments in the discount rate for liabilities to compensate to a greater degree for changing values of interest-rate-dependent assets such as government bonds. The proposals also include extrapolation methods to achieve greater stability in the yield curve for longer maturities. A further proposal recommends a gradual transition from the existing discount rate (minimum guaranteed interest rate) to discounting using the Solvency II yield curve.

Change in mortality tables for collective insurances

The current mortality base for collective annuity and pension insurances, K2005, was introduced on 1 January 2008, and on 1 January 2009 for pension funds.

Five pension funds notified Finanstilsynet of their introduction of the new mortality base.

Six life insurers and 26 pension funds (private and municipal) received approval to devote surplus funds for 2011 to increasing provisions called for by the forthcoming transition to a new mortality base for collective annuity and pension insurance in 2014.

Insurance Complaints Board

Finanstilsynet acts as secretariat to the complaints board for insurance broking activities and reinsurance broking activities. The board handles disputes between principals and brokers. No complaints were received by the board in 2012.

New Directive on institutions for occupational retirement provision

Preparations are under way in the EU for revision of the Occupational Pensions Funds Directive (2003/41/EC). The Directive applies to pension institutions whose business is confined to occupational retirement provision in employment relationships and sets requirements for pension institutions' organisation, scale, asset management and capital requirements. A fully harmonised framework is aimed for, and the European Commission intends it to have the same structure as the Solvency II regime for insurance companies. From Norway the seven largest pension institutions participated, the same as in the case of impact assessments for Solvency II.

In April 2011 the European Commission sent a Call for Advice to EIOPA on the shaping of a new body of rules for pension institutions designed to strengthen the single market and introduce risk-based supervision. EIOPA delivered its advice to the EU Commission in February 2012.

As part of the process of formulating a new Directive on occupational retirement provision, the EU Commission asked EIOPA to conduct an impact study to test the consequences of the proposal. From Norway the seven largest pension institutions participated, the same as in the case of impact assessments for Solvency II.

The results of the impact study will be summarised in a report due to be published at the end of June 2013. These results will be an important basis for the European Commission's proposal for a new Directive on occupational retirement provision, due to be presented in summer 2013.

Owing to the uncertainty regarding the entry into force of Solvency II, the implementation date for the new Directive is a matter of conjecture.

Conversion of paid up policies to unit-linked

The Bank Law Commission has proposed new rules in the Act on financial institutions and financial groups (NOU 2012: 3) to allow paid-up policyholders to convert their paid-up policies to unit linked pension agreements. The insurer will be required to provide information and advice to the paid-up policyholder before a unit linked agreement is signed. Law amendments based on the Bank Law Commission's proposal were adopted on 14 December 2012. The amendments will not be put into effect until supplementary regulations have been prepared and the position regarding new mortality tariffs is clarified. Entry into force will also be considered in light of progress made in amending the pensions legislation for the private sector in the wake of the National Insurance Scheme's new rules governing retirement pensions.

Bill on collective occupational pension insurance

The Bank Law Commission has reported on a new tax-favoured occupational pension product in the private sector (NOU: 2012: 13). The report is phase II of the process of adapting the rules governing pension schemes in the private sector to the new National Insurance scheme and contains a Bill on collective occupational pension insurance. The Bill sets out two alternative models for regulating cost and risk distribution in the individual pension scheme between pension institution, company and employee. The report recommends inter alia that biometric risk, which is traditionally incorporated using a set of mathematical formulae based on mortality risk for men and women (mortality tariffs), should be replaced by an arrangement based on a model building on the National Insurance scheme's life expectancy adjustment ratio. The intention is to establish a system for insurance-based occupational pension schemes that accords with the main principles of the new National Insurance scheme and meets present-day challenges to insurers' financial position and economy. The report has been circulated for comment.

A number of consultative bodies pointed to negative aspects and vagueness in the method proposed for handling rising longevity. The Ministry of Finance asked Finanstilsynet to draw up a consultative statement proposing statutory provisions for one or more alternative methods for conversion of accumulated pension capital into annual pension benefits and for treatment of the benefits during the period of payment. The proposals should assure proper management of biometric risk (survival risk), and correct pricing of such risk. The need for gender-based differentiation of premiums was also to be looked into.

In January 2013 Finanstilsynet sent the Ministry of Finance a proposal for law provisions for a model assuring proper treatment of mortality risk. The proposal is based on a projection model employing a dynamic mortality base rather than a model based on the National Insurance scheme's life expectancy adjustment ratio. Finanstilsynet's recommendation assumes that pension institutions will include gender as a factor when managing mortality risk in order to take account of the significant difference in longevity between man and women. This will ensure an identical level of pension benefits for men and women. The proposal has been circulated for comment with the deadline for response set at 12 April 2013.

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New non-life insurance legislation

Finanstilsynet proposed new regulations on non-life insurers' obligation to provide information to the financial services information scheme, Finansportalen, which have now been adopted by the Ministry of Finance. Under the regulations non-life insurers will be required to provide, or keep available, information on standardised products and product combinations for which premium tariffs are required. The regulations entered into force on 1 January 2013.

Appraisal in non-life insurance

On commission from the Ministry of Finance, a working group was appointed to review appraisal in insurance. Appraisal is carried out in claims settlements to establish insured values and damage costs under an insurance contract, for example after a fire in an insured building. The working group comprised representatives from the insurance industry, the consumer lobby, valuers' and surveyors' bodies, government departments and Finanstilsynet. The working group delivered its report to the Ministry of Finance on 29 November 2012. The report evaluates the current arrangements, and recommends stricter information requirements and the establishment of a register of valuers and surveyors that will put insurer and insured on an equal footing.

Accounting rules for the insurance and pensions area

Finanstilsynet is following the work done internationally in the accounting area on insurance contracts.

On 17 December 2012 Finanstilsynet sent the Ministry of Finance a draft consultation document proposing adjustments to the annual accounts regulations for insurers and pension undertakings as a result of changes in IFRS. Finanstilsynet recommends that unlisted insurance companies along with pension undertakings should be required to apply the rules governing recognition and measurement of pension obligations etc., in IFRS (IAS 19 *Benefits to Employees*). The consultation document also deals with measurement of assets etc. at fair value and appurtenant note disclosure requirements. The document further deals with information on financial instruments (set-off and derecognition) and statements of changes in equity capital.

THE SECURITIES AREA

Supervision of the securities area includes overseeing issuers' information to the market, securities institutions' financial position and operations, and their compliance with business rules and general rules of conduct.

Stock markets saw another year of turbulent markets in 2012. Several factors changed substantially, posing new challenges to marketplaces and market actors alike.

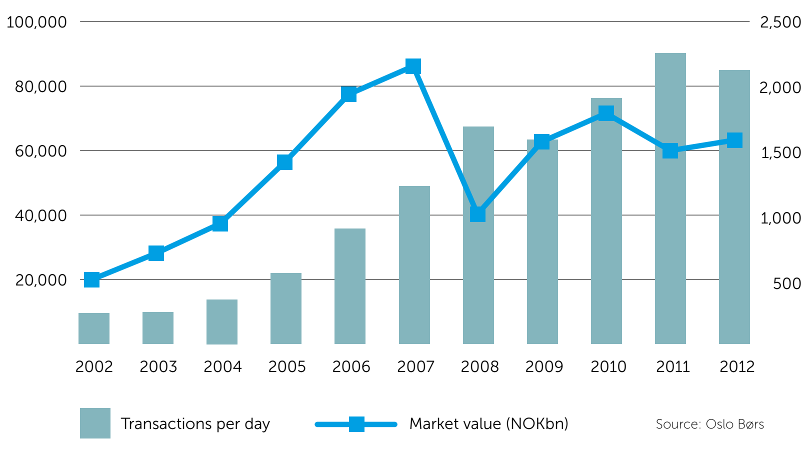
Like other traditional stock exchanges, Oslo Børs saw a considerable decline in trading volumes. At year-end Oslo Børs accounted for about 65 per cent of trading in shares quoted on Oslo Børs. The number of share derivatives traded on the exchange also dropped about 20 per cent. The exchange responded to the heightened competition by lowering share trading fees, partly through its acquisition of the multilateral trading facility Burgundy and the introduction of a trading system more aligned to the market.

Share prices rose in 2012 by 15.4 per cent, despite the uncertainty in the international economy. The number of new entrants fell in 2012, with three new entrants to Oslo Børs and one to Oslo Axess, in addition to four transfers from Oslo Axess to Oslo Børs. A total of NOK 17.5bn was raised through stock issues.

In 2012 NOK 696bn was raised via the exchange on new stock issues and expansion of existing issues. NOK 425bn of this was government debt and NOK 271bn was fresh capital for business and industry. Bond trading also showed an increase, and there was a substantial shift in market trading away from shares towards bonds.

The oil price was relatively stable through 2012 compared with previous years. In the other markets monitored by Finanstilsynet, prices and markets were fairly stable. Electricity market prices stabilised at a lower level than in previous years due to increased reservoir levels. Turnover value at Nasdaq OMX ASA accordingly fell from EUR 50m in 2011 to EUR 34.5m in 2012. Prices of salmon derivatives fluctuated between NOK 22 and 32 per kilo.

CHART 3: MARKET VALUE – TRANSACTIONS



Securities markets are expected to become further fragmented, a process augmented by the continued growth of dark pools and crossing networks. These are unregulated, non-transparent marketplaces where major actors trade large blocks of securities without impacting the official market. The proposed new Directive on Markets in Financial Instruments (MiFID) will enable better oversight over this activity by making it licensable. Among other things, the proposal will require market actors to report to the markets in real time.

Further fragmentation of securities trading, with no marketplace having a total overview, poses a continuing challenge to the effort to expose market abuse. Traditional stock exchanges' squeezed operating margins mean that market monitoring cannot be given the same priority as previously and must increasingly be left to the public authorities.

In algorithm-based trading, orders are automatically generated by the trading support system based on advanced prior programming of the system (the algorithm). A subcategory of algorithm-based trading is high frequency trading where computers generate a large number of trade orders in a very short space of time and can exploit marginal price differences between markets. Such trading boosts liquidity but also heightens the risk of market disruptions. There is also a risk that algorithmic trading could intensify natural market reactions.

Another trend that needs to be followed up through supervision is investment firms' offering of direct market access to selected customers through their marketplace membership. This is a form of self-service in the market whereby the customer trades in the name of the investment firm, which is responsible for correct settlement. Inadequate control on the part of investment firms of customers that are offered this service could lead to heavy losses.

SECURITIES MARKET SUPERVISION

The overarching aim of regulation and supervision of the securities market is to ensure secure, orderly and efficient trading in financial instruments, thereby enabling the securities market to function as a source of capital for business and as a basis for saving and investment. Supervision encompasses actors' financial position and operations, and their compliance with business rules and general rules of conduct.

INVESTMENT FIRMS

Finanstilsynet's on-site inspections aim to promote an informed attitude to risk among firms and to maintain a high level of client protection in the securities market by ensuring that firms comply with the conduct of business rules. Supervision also promotes market integrity. At the end of 2012 there were 159 investment firms in Norway, of which twenty-three were 23 were branches of foreign investment firms.

SUPERVISION AND MONITORING

On-site inspection

On-site inspections were conducted at 15 investment firms in 2012. In addition, one inspection was conducted at a Norwegian branch of a foreign investment firm and one which specifically targeted an investment firm's ICT solutions. Firms' investment advice was a central theme of the on-site inspections. Finanstilsynet checked that the recommended investment services and financial instruments were appropriate to the clients and that the firms had given clients balanced, correct and understandable information. Finanstilsynet also checked the investment advice at firms' broker desks to ascertain whether they gave advice on short-term trading that was counter to the conduct-of-business rules.

Finanstilsynet also addressed investment firms' control function, in particular the organisation of this function and how the control effort was structured and arranged. A central theme of on-site inspections was the steps taken to limit potential interest conflicts.

Two on-site inspections at investment firms in 2011 led to the withdrawal of the licences of Terra Markets AS and Acta Asset Management AS in 2012. In the case of Terra Markets AS the main justification was extensive short-term investment advice. In the case of Acta Asset Management AS it was due to general recommendation to clients to shift investments to a new business concept resulting in very high costs to the clients. Both investment firms appealed the licence withdrawals to the Ministry of Finance, which is currently considering them. Terra Markets AS handed in its licences.

There was much focus on the increased issuance of corporate bonds in 2012. Investment firms' bond issuance was followed up by Finanstilsynet at on-site inspections and via general oversight of the savings and investment market. Finanstilsynet followed up investment firms' advice regarding investment products and mutual funds involving bonds. Firms' placement of new loans and trading in the secondary market were also investigated.

Thematic inspection of short trading

Prompted by findings made at the on-site inspections, Finanstilsynet started in 2012 a systematic review of the volume of advice given on short-term trading at investment firms' broker desks. The result of the review will be clear in 2013.

Market warnings

Finanstilsynet published 28 warnings on its website against firms that had provided financial services in Norway in 2012 without the requisite licence. A further 537 warnings given by foreign supervisory authorities were published. In very many cases the firms in question are engaged in fraud, and individuals who transfer money to such firms must in many cases consider the money lost. Finanstilsynet warns against dealing with such firms, and its website contains information on investment fraud, advising investors on how to protect themselves against fraudsters. Finanstilsynet's market warnings are also available at Finansportalen.no.

Monitoring of firms' financial development

Finanstilsynet monitors investment firms' profitability and financial positions through their periodical reporting. The reporting also provides a picture of possible trends in income distribution and of the risk associated with the business.

Up to the end of the third quarter 2012 investment firms' profits were the lowest since 2002. However, for the year as a whole there was a slight increase in profitability compared with the previous year. This was due to a substantial improvement in profit in the fourth quarter of 2012 compared with the same period of 2011.

Finanstilsynet noted 40 increases of capital designed to strengthen own funds, distributed across 29 firms. Nine warnings of possible licence withdrawal were issued due to capital inadequacy. One firm handed back its licence, while the others rectified the circumstance in question. Three firms filing quarterly capital adequacy reports were in November ordered to report on a monthly basis due to marginal compliance with capital requirements, negative profit growth and unverifiable reporting.

Based on investment firms' and management companies' quarterly returns, Finanstilsynet publishes each quarter press releases in which trends in these entities' business are presented and commented on. The clearest trends in 2012 were a decline in brokerage income from secondary trading in shares and an increase in income from managing bond issues.

As previously, Finanstilsynet conducted in 2012 quarterly surveys of larger investment firms' counterparty risk associated with unsettled trades and lending to customers.

LICENSING

Authorisation process

Seven new investment firms were licensed to provide investment services in 2012, the same as in 2011. Six expanded licences were granted to existing firms. Licence applications include those from new firms as well as from existing financial conglomerates. A number of the new firms were relatively small and have few employees. These firms mainly engage in order reception and transmission and in investment advisory services. Some market entrants also provide portfolio management services. Finanstilsynet received two licence applications in 2012 prompted by the introduction of a requirement for authorisation to provide investment services related to partnership shares.

Fourteen licences were revoked due to restructuring, mergers and corporate acquisitions, and business area reorganisations.

Fit and proper testing

Again in 2012, a substantial number of fit-and-proper tests were carried out of board members and managers at entities in the securities field. Assessments are made of qualifications, job experience and previous conduct. Testing is carried out in connection with licence applications and management changes. Firms largely abided by Finanstilsynet's assessments. In most cases where a manager was not considered suitable, the decision cited a lack of relevant experience. In some cases it was a matter of unsuitability due to previous conduct at a firm guilty of serious law violations. In one case Finanstilsynet issued a rectification order because certain branch managers at a firm fell short of the requirements. The personnel concerned appealed, and Finanstilsynet set aside the order.

REGULATORY DEVELOPMENT

Licensing requirement for entities intending to provide investment services related to partnership shares

With effect from 1 January 2013 a licensing requirement was introduced for entities intending to provide investment services related to shares in general partnerships, limited partnerships and internal partnerships. The licensing requirement does not apply to entities which only provide services to professional customers or to customers investing a total of at least NOK 5m. Widening the licensing requirement is designed to strengthen consumer protection in the securities area.

Right of access to the central securities depository

The Securities Register Act was amended on 1 July 2012 to allow police access to Norwegian securities registers. This will afford the police a better opportunity to investigate securities crime effectively. Register searches will only take place where the object is to prevent and combat crime. Right of access is not limited to ØKOKRIM, and is granted to the police service as a government agency.

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FUND MANAGEMENT COMPANIES

At the end of 2012 32 management companies were licensed to manage securities funds. Twenty-two of these were licensed to carry on portfolio management. The number of securities funds managed by these companies rose from 442 at end-2011 to 454 at end-2012. Net new subscription in Norwegian management companies' securities funds amounted to NOK 43.1bn in 2012. New subscription broke down to NOK 6.4bn on equity funds and NOK 43.9bn on fixed income and bond funds. Net redemption in money market funds came to NOK 10.5bn. Total net subscription, combined with rising values in 2012, caused total assets in Norwegian securities funds to rise by 14 per cent in 2012 to reach NOK 552bn by year-end.

SUPERVISION AND MONITORING

Finanstilsynet conducted three on-site inspections at management companies in 2012. The inspections covered governance and control, establishment of customer relationships and associated information requirements as well as actual management of the funds.

Management companies are required to report possible breaches of investment limits set out in the Securities Fund Act and in fund rules. The number of reported breaches in 2012 was in line with previous years, and Finanstilsynet noted none of a sizeable, serious nature. Depositories' obligation to inform Finanstilsynet of any management company where rule breaches are brought to light is an important supplement to off-site supervision. Such reports by trustees were few in number in 2012.

Finanstilsynet monitors management companies' financial situation and their compliance with the rules governing capital adequacy and large exposures on the basis of quarterly reports they file with Finanstilsynet. Finanstilsynet publishes quarterly press releases on management companies' results where trends in the companies' business are presented and commented on. Management companies' profits declined slightly for the third year running. Six management companies increased their capital in 2012 in order to meet the own funds requirement.

Finanstilsynet checked in 2012 that management companies had prepared key information in keeping with new legislation.

FUND MANAGEMENT

Three new management companies were authorised to engage in securities fund management in 2012, two of them to carry on portfolio management.

Finanstilsynet authorised the establishment of 29 new securities funds in the course of 2012, while 15 securities funds were wound up. Finanstilsynet granted one application to establish a Norwegian specialised fund and two applications to market foreign specialised funds in Norway.

A new securities funds act passed into law on 1 January 2012. The new framework underscores in general the need for management companies to prepare good information on securities funds to unit holders, and sets requirements for key information. The key information document should provide investors with a basis for comparing different securities funds. Management companies were given until 1 July 2012 to prepare key information for funds established before 1 January 2012. From then on, key information documents must be prepared for all funds covered by the requirement.

The new Securities Trading Fund Act also empowers Finanstilsynet to authorise securities fund mergers. Finanstilsynet processed four merger applications in 2012.

Suspension of securities funds upon stock exchange closures

The bad weather at the end of October 2012 led to the closure of US stock exchanges for a couple of days. The Securities Funds Act permits Finanstilsynet to consent to the suspension of a securities fund if a stock exchange is closed. Three management companies received consent to postpone valuation and disbursement of redemption payments for certain affected securities funds until the stock exchanges reopened.

REGULATORY DEVELOPMENT

New Securities Funds Act and Regulations

The Securities Funds Act contains new provisions on the implementation of changes to securities fund rules. The new provisions require unit holders to make up their minds about central fund rule changes at unit holder meetings. Finanstilsynet will continue to approve fund rule changes and oversee compliance with requirements on fund rule content and with rule change procedures, but will no longer assess whether changes are in the unit holders' interests. Finanstilsynet's circular no. 16/2012 gives guidelines on the process to be followed by securities funds when implementing fund rule changes.

AIFM directive

On commission from the Ministry of Finance, Finanstilsynet has appointed a working group to propose amendments to the Norwegian regulatory framework to implement Directive 2011/61/EU of the European Parliament and of the Council (the AIFM Directive). The Directive regulates the managers of alternative investment funds. These are defined as funds with capital contributions from a number of investors and which are not regarded as UCITS funds. The Directive is scheduled for transposition into national legislations in the EU by 22 July 2013. The working group will inter alia consider how existing Norwegian rules for domestic funds, including specialised funds, can be retained alongside new rules for managers of alternative investment funds. The working group's report will be forwarded to the Ministry of Finance early in 2013.

MARKET INFRASTRUCTURE

SUPERVISION AND MONITORING

The securities market infrastructure comprises Oslo Børs ASA, Verdipapirsentralen ASA (Norwegian Central Securities Depository (VPS)), Oslo Clearing ASA, Fish Pool ASA, NOS Clearing ASA, Nasdaq OMX Oslo ASA (formerly Nord Pool ASA) and Nasdaq OMX Oslo NUF (Norwegian branch of Nasdaq OMX Stockholm AB). The activities of investment firms Icap Energy ASA and Spectron Energy Services Ltd Norway Branch are also regarded as a part of the infrastructure.

Oslo Børs ASA operates the marketplaces Oslo Børs, Oslo Axess and Oslo Alternative Bond Market (Oslo ABM), the first two of which are regulated marketplaces. It also operates the multilateral trading facility Oslo Connect on which OTC derivatives are traded. The Central Securities Depository (VPS) maintains the securities register and is operator of the central securities settlement system in Norway (VPO NOK).

The clearing houses Oslo Clearing and NOS Clearing reported quarterly through 2012 on the trend in own funds and risk exposure. No serious events or unusually high risk exposure were reported by the clearing houses in the period. Finanstilsynet followed up the supervision of and reporting by the clearing house Nasdaq OMX Oslo NUF in cooperation with the Swedish FSA. In April 2010 Oslo Clearing ASA's licence was expanded to allow it to carry on business as a clearing house for equity instruments. Finanstilsynet monitored over the course of 2012 the entity's compliance with the terms and conditions set in its licence.

In spring 2012 Nasdaq OMX introduced a joint trading platform (Genium Inet) for the various marketplaces in the group, including Nasdaq OMX Oslo ASA. The marketplaces are integrated at member level, quotation level and settlement level. In autumn 2012 Oslo Børs ASA introduced the trading platform Millennium Exchange, delivered by the London Stock Exchange for use in the equity and fixed income market. Finanstilsynet oversaw the introduction of the new trading platforms, and no particular problems were observed. Reporting of critical ICT events from infrastructure entities was also followed up.

Finanstilsynet conducted on-site inspections in 2012 at Oslo Clearing ASA and Nasdaq OMX Oslo ASA. Finanstilsynet also closely followed the entities by other means, for example when handling a number of licensing cases of some significance.

No major operating problems affected the central securities settlement system (VPO) in the course of 2012. Finanstilsynet kept a continuous watch on the settlement rate, which averaged just over 96 per cent. This is still considered a high figure, albeit lower than prior to the introduction of compulsory clearing of equity instruments in 2010. Settlement participants experience all in all a higher settlement rate after the introduction of clearing of equity instruments through a clearing house. This is thanks to a reduction in the number of transactions settled at the Central Securities Depository (VPS) enabled by contract netting at the clearing house. In addition, the clearing house is now permitted to make part deliveries. In 2012 about 10.1 million transactions were settled in the VPO system, compared with just over 40 million prior to the introduction of clearing of equity instruments.

LICENSING

Approvals resulting from the conditions set for the merger between Oslo Børs Holding ASA and Verdipapirsentralen Holding ASA

The Ministry of Finance's decision of 8 November 2007 set a number of conditions for the merger of Oslo Børs Holding ASA and Verdipapirsentralen Holding ASA. In assessing the conditions, Finanstilsynet submitted a recommendation to the ministry regarding the VPS's payment of dividend for the financial year 2011. The ministry acted on Finanstilsynet's recommendation. Finanstilsynet also considered an appeal from the VPS against a decision to increase the VPS's minimum own funds requirement from six to nine months' operating expenses plus a buffer. The ministry was advised to uphold its decision. The ministry duly dismissed the appeal, pointing out that the VPS ought to be well positioned to meet future challenges and uncertainty regarding the size of its profit. The company ought also to have own funds equivalent, together with buffer capital, to more than one year's operation.

Application for stock exchange listing of Oslo Børs VPS Holding ASA

Oslo Børs VPS Holding applied for listing on Oslo Børs. The ministry rejected the application in keeping with Finanstilsynet's recommendation.

Application for permission to own Burgundy AB

Oslo Børs ASA applied for permission to operate abroad through a subsidiary after acquiring the Swedish bourse Burgundy AB. Finanstilsynet authorised it to do so in keeping with Finanstilsynet's recommendation.

Rules governing significant holdings for stock exchanges and securities registers

In 2011 the ESA took Norway to the EFTA Court alleging that Norwegian rules governing significant holdings of stock exchanges and securities registers were counter to the EEA Agreement. The EFTA Court ruled on 16 July 2012 that these rules contravened the EEA Agreement, and Finanstilsynet is asked to propose changes.

Change in clearing and margin model at Oslo Clearing ASA

In September 2012 Oslo Clearing ASA made some changes in the clearing and the margin model, in particular regarding the derivatives area. The changes were a step in increasing business efficiency and in preparing for a new European body of rules for clearing houses. Finanstilsynet took due note of the changes in the clearing and margin model, but informed the undertaking that a closer look at some aspects of the clearing rules would be needed.

Nasdaq OMX Oslo ASA applies for expanded licence

Finanstilsynet recommended the Ministry of Finance to widen Nasdaq OMX Oslo ASA's licence to include trading of "other instruments" with the same characteristics as other derivative financial instruments. The matter is under consideration by the ministry.

Nasdaq OMX Stockholm AB appeals against rejection of application

Nasdaq OMX Stockholm AB appealed against Finanstilsynet's decision not to approve the settlement system used by the undertaking for the Norwegian settlement business as a securities settlement system under the Payment Systems Act. The settlement business is run through a Norwegian branch of Nasdaq OMX Stockholm AB. Finanstilsynet concluded that there was no basis for setting aside the rejection, and the appeal was referred to the Ministry of Finance for decision.

Fit and proper testing of new owner at NOS Clearing ASA

Upon the sale of NOS Clearing ASA to Nasdaq OMX Stockholm, Finanstilsynet deemed the new owner to be suitable to ensure sound and prudent management of the undertaking under the Securities Trading Act.

EMIR working group

The European Market Infrastructure Regulation (EMIR) is an EEA-relevant framework that introduces rules on compulsory clearing of OTC derivatives and reporting of derivative trades to a trade repository. The Regulation also introduces pan-European rules for clearing houses and a requirement to register the trade repository with the European Securities and Markets Authority (ESMA). Finanstilsynet heads up a working group charged with transposing the rules into Norwegian law.

MARKET CONDUCT RULES

SUPERVISION AND MONITORING

The overarching aim of supervision and monitoring of compliance with the market conduct rules is to safeguard the reputation of the Norwegian market and thereby its role as a well-functioning source of capital.

The rules on insider trading, market manipulation and due care in handling inside information are at centre-stage. Finanstilsynet also oversees compliance with the rules on the drawing up of insider lists, the duty to investigate, the prohibition of unreasonable business methods, notification rules and rules requiring the disclosure of acquisitions of large shareholdings. Hence a wide range of supervised entities is involved: investors, advisers, issuers of financial instruments 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 rules are applicable, in the markets for commodity derivatives. The supervisory effort is intended to have both an individual, and a general, deterrent effect in the market.

Most of the large number of cases investigated by Finanstilsynet in 2012 were reported to it by investment firms, the media and investors. Many were also referred to it by Oslo Børs or initiated by Finanstilsynet itself in response to market events.

A number of the insider trading and market manipulation cases handled by Finanstilsynet were time-consuming, especially where the investigations involved other countries. Finanstilsynet also assisted foreign supervisory authorities in their investigations.

In 2012 Finanstilsynet investigated:

- 63 new cases of unlawful insider trading and/or breaches of confidentiality
- 28 new cases of market manipulation/unreasonable business methods
- 35 new cases of securities trading requiring disclosure
- 64 new cases of securities trading requiring notification

Fifty-six of the above cases were received from investment firms under an obligation to report transactions giving rise to suspicion of insider trading or market manipulation.

Administrative fines

Finanstilsynet is empowered to impose an administrative fine for violation of the Securities Trading Act's provisions requiring notification/disclosure of share acquisitions or disposals. The availability of this sanction makes for effective rule enforcement and its imposition is an adequate response to rule violations.

Over the course of 2012 Finanstilsynet imposed nine administrative fines for breaches of the disclosure requirement and ten administrative fines for breaches of the notification requirement. Finanstilsynet publishes the fines on its website on the presumption that this has a preventive effect. One administrative fine for breach of the disclosure requirement was appealed to the Ministry of Finance where it is currently under review.

Notifications to the prosecuting authority

Finanstilsynet reported five cases of suspected unlawful insider trading and/or breach of the duty of confidentiality to the prosecuting authority in 2012. One case of market manipulation was reported. Three cases were referred to the prosecuting authority for suspected breach of the insider listing requirement.

Follow up of reported cases

The fruitful cooperation between Finanstilsynet, ØKOKRIM (National Authority for Investigation and Prosecution of Economic and Environmental Crime) and local police districts on reported cases continued in 2012. This cooperation makes for more effective and efficient combating of crime in the securities market. Finanstilsynet assisted the prosecuting authority at interviews and in analysing share transactions. Finanstilsynet also witnessed in a number of court cases.

Surveys in connection with information handling

In 2012 Finanstilsynet conducted surveys of stock issuers and communication agencies regarding their handling of inside information, including procedures for insider listing and trading rules for employees. The surveys targeted procedures and policies for ensuring due care in information handling at entities that manage inside information, while also signalling Finanstilsynet's intention to focus attention on these areas.

In 2011 Finanstilsynet conducted a survey of information handling at issuer entities. Based on the survey findings Finanstilsynet, ØKOKRIM and Oslo Børs held an issuer seminar in 2012 covering topics related to information handling.

COURT RULINGS

The following court rulings were delivered in 2012 in cases which Finanstilsynet investigated and reported to the prosecuting authority:

- In February 2011 the Supreme Court delivered judgment in a case concerning insider trading and incitement to insider trading. Two persons had been acquitted in the court of first instance of insider trading on the ground that the term "significant" is to be understood as a requirement that the information concerned has a "not insignificant" effect on the price. The court of appeal concluded that this understanding of the law was incorrect, and that the acquittals should be set aside. The Supreme Court agreed with the court of appeal that a quantifiable effect on price cannot be made a requirement of the "reasonable investor test" set out in the act in its definition of insider information. The appeal was accordingly dismissed and the judgment of the court of appeal is final and unappealable.
- In May 2012 the Supreme Court handed down judgment in a case concerning the duty of confidentiality for insiders. In his capacity of portfolio manager the defendant had received information on an invitation to acquire a large shareholding, leading him to suspect information asymmetry in the market. The defendant passed this information to the management of the target company. The Supreme Court concluded that the unusual circumstances of the case meant that the target company could not be considered "unauthorised" in relation to the provision of the Securities Trading Act, and that the defendant had not breached the insider confidentiality provisions. The defendant was accordingly acquitted.
- In May 2012 the Supreme Court handed down judgment in a case of suspected market manipulation. Two investors used a brokerage firm that applied algorithm-based trading. By entering small-volume orders the investors moved the price of illiquid shares. The investors found that the share price moved automatically, regardless of the trade's volume. They exploited this knowledge to their advantage. The Supreme Court found that while the investors' actions came under the law's definition of market manipulation, the said actions were not a criminal offence since the wording of the law covers actions beyond those deemed criminal. The investors were accordingly acquitted.
- In June 2012 the Supreme Court rejected an appeal in a case of suspected market manipulation. In the court of appeal an investor was convicted of market manipulation after commissioning a lawyer to write a misleading letter about a listed company. The court of appeal found that the investor had – by leaking the letter, which wrongly gave the impression of having been written on behalf of a number of the issuer company's bondholders, to the press – manipulated the share price and thereafter took out a gain on his position in the issuer company. The court of appeal's judgment is final and unappealable, imposing a prison sentence of one year and six months.
- In December 2012 the Borgarting court of appeal delivered judgment in a case of suspected insider trading. A stockbroker was convicted for a total of seven breaches of the Securities Trading Act, including five counts of unlawful insider trading. The defendant possessed inside information about two issuer companies while at the same time encouraging or inciting the purchase and sale respectively of their shares. The defendant was also convicted of having leaked information about one of the issuers to unauthorised parties, and of breaching the duty of investment firm employees to carry out their duties in accordance with good business practice. A prison sentence of three years was handed down.
- In January 2012 the Stavanger court of first instance handed down judgment on a plea of guilty to insider trading. The defendant had learned that a stock exchange notice would be released the following day from a listed company concerning a find in the North Sea. Later the same day the defendant traded shares in the company. The defendant

Further development of the transaction reporting system

Investment firms are required to report transactions in quoted financial instruments and their derivatives to a European transaction reporting system, TRS. Substantial resources have been devoted to establishing a pan-Nordic system that meets the Directive requirements and to assisting firms subject to a reporting obligation.

In 2012 about 112 million transactions were reported to Finanstilsynet, of which 57 per cent were from foreign and 43 per cent from Norwegian investment firms.

Improved data quality and easier access to entries and analyses have enabled ever increasing use of TRS data in the work of supervision.

In 2012 Finanstilsynet contacted the Central Securities Depository (VPS) to gain access to structured transaction data from the VPS register with a view to integrating such data with systems in current use. To this end the VPS will each day send Finanstilsynet a file listing all transactions executed that day. These account transactions will then be integrated and collated with existing transaction reporting data. The aim is to create a more complete picture of transactions in the securities market and to improve supervisory efficiency. The project is planned to be fully operative in February 2013.

acknowledged the facts of the case, and consented to judgment being entered on a guilty plea. He was sentenced to 90 days' imprisonment.

- In May 2012 the Jæren court of first instance delivered judgment on a plea of guilty to insider trading. The managing director of a listed company traded the company's bonds while in possession of inside information. He was aware of being unable to trade in the company's shares but believed erroneously that bonds were not covered by the insider trading rules. The defendant agreed to judgment being entered on a guilty plea. He was sentenced to 30 days' imprisonment. The judgment is not final and unappealable.
- In September 2012 the Oslo court of first instance handed down judgment in a case involving two defendants. The police suspected one of the defendants of having received inside information from the other. The two were friends, and one had been made an insider on the issuer and was privy to inside information on the share in question. The suspicion was not confirmed, and the defendants were acquitted. The judgment is final and unappealable.
- In November 2012 the Oslo court of first instance handed down judgment in a case concerning insider suspicion of trading and incitement to insider trading. Five persons were charged with trading shares of a listed company despite being aware of a research report showing that the company's HIV vaccine had a significant effect. The defendants were acquitted on the ground that the information they had received could not be characterised as inside information. The judgment is not final and unappealable.
- In November 2012 the Oslo court of first instance delivered judgment in a case of suspected insider trading. The managing director of a listed company was accused of trading the company's shares despite, prior to the share purchases, having on behalf of the company negotiated and promoted two acquisitions, which were only made known to the market at a later point. The defendant was acquitted. The judgment is not final and unappealable.
- In November 2012 the Stavanger court of first instance delivered judgment in a case of suspected market manipulation, insider trading and breach of the obligation to notify trading in financial instruments. A person (principal defendant) was convicted of having given the market incorrect, insufficient and/or misleading information by concealing share transactions he had undertaken via straw men at a company of which he was a primary insider. The principal defendant was convicted of breach of the notification duty, and criminal market manipulation. The six straw men through whom the principal defendant had traded were convicted of complicity in the said offences. Moreover, the principal defendant was convicted of insider trading as a consequence of his exposure to his accomplices' portfolio, while the accomplices were convicted of aiding and abetting such insider trading. The judgment is not final and unappealable.

Court ruling in a civil action brought by Finanstilsynet:

In November 2012 the Oslo court of first instance delivered its ruling in a case concerning unreasonable business methods. Finanstilsynet launched in November 2010 an investigation into transactions in shares of the listed company Reservoir Exploration Technology ASA (RXT). As a result of the investigations Finanstilsynet ordered seven investors to relinquish gains made through the use of unreasonable business methods in breach of the Securities Trading Act. Six of the investors accepted the order. One investor did not accept the order, prompting Finanstilsynet to bring civil action. The Oslo court of first instance concluded after an overall assessment of the case and of the investor's conduct that the investor had employed unreasonable business methods in breach of the prohibition of such methods in the Securities Trading Act. The judgment is not final and unappealable.

PROSPECTUS CONTROL – TRANSFERABLE SECURITIES

Finanstilsynet is responsible for approving EEA prospectuses in the case of public offers for subscription or purchase of transferable securities worth at least EUR 5,000,000 calculated over a period of 12 months that are directed at 150 or more persons in the Norwegian securities market. The same applies where transferable securities are to be admitted to trading on a regulated market in Norway, including where a company whose shares are already admitted to trading plans to increase its capital by more than 10 per cent calculated over a time period of 12 months.

About the prospectus control

All EEA prospectuses prepared by Norwegian issuers or by issuers from non-EEA countries that have selected Norway as their home state require Finanstilsynet's approval. Finanstilsynet has performed the vetting and approval of prospectuses since 1 May 2010. In 2011 additional requirements were introduced for prospectuses for oil, gas and mining companies. In July 2012 revised rules on prospectuses in the Securities Trading Act entered into force, including changes in threshold values triggering the prospectus obligation.

Prospectus vetting in 2012

2012 as a whole saw fewer applications for approval of share prospectuses than in 2011. The number of applications for approval of bond prospectuses was higher than normal, in particular prospectuses for admission to trading of bonds on Oslo Børs.

Finanstilsynet vetted prospectuses for several sizeable transactions in 2012, some relating to stock issues and new listings in connection with restructuring in various industries. This included for example approval of the prospectus for an initial public offering of Selvaag Bolig ASA and ensuing admission to trading on Oslo Børs.

A number of other prospectuses were vetted related to applications for admission to trading on Oslo Børs or Oslo Axess, including for Borregaard ASA, Veripos Inc. and Crudecorp ASA.

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TABLE 8: VETTED DOCUMENTS

	2008	2009	2010	2011	**2012**
Shares (listed shares in parenthesis)	125 (57)	102 (64)	105 (82)	100 (85)	**54 (45)**
Bonds	53	94	44	110	**146**
Warrants	10	15	9	14	**–**
Total	188	211	158	224	**200**

TABLE 9: DISCONTINUED PROCESSES AND OTHER DOCUMENTS

	2008	2009	2010	2011	**2012**
Discontinued processes	16	13	21	16	**6**
Supplements to prospectuses (shares)	31	2	17	11	**4**
"Equivalent" documents	14	4	4	7	**–**

A substantial number of documents were notified to and from competent prospectus authorities in the EU/EEA area. The documents were notifications of passported prospectuses.

Finanstilsynet started vetting of eleven prospectuses related to new admissions to trading in 2012. Of these, seven prospectuses were for IPOs on Oslo Børs or Oslo Axess, or for transfer of listing to Oslo Børs. A total of forty-five prospectuses for listed limited companies were vetted. A further six prospectuses for share issues by unlisted companies were vetted, along with four prospectuses related to equity instruments.

Regulatory framework

As from 1 July 2012 the thresholds triggering the obligation to prepare an EEA prospectus were raised to 150 persons and EUR 5,000,000. For national prospectuses the threshold of amount is raised to EUR 1,000,000. This permits the launch of private placings to a larger number of investors for a larger overall issue amount without the obligation to prepare a prospectus.

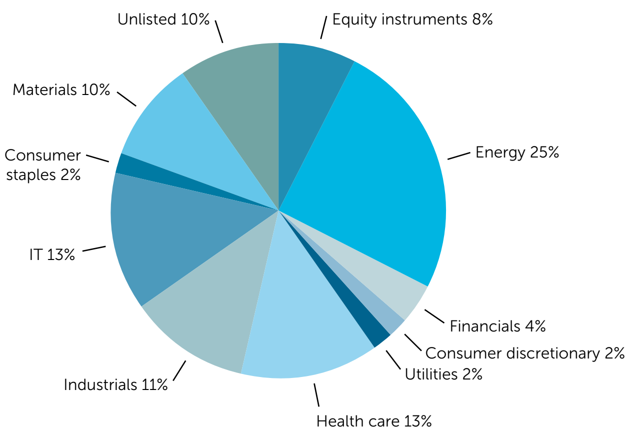
Finanstilsynet's competence to grant dispensation from the prospectus requirement for non-equity securities issued by credit institutions has been widened by raising the monetary threshold from EUR 50,000,000 to EUR 75,000,000. The threshold for exemption from the prospectus requirement in the case of securities with a minimum nominal value or subscription price was raised from EUR 50,000 to EUR 100,000. The increase, which is designed to protect non-professional investors, should be viewed in conjunction with the changes in general thresholds for the prospectus requirement.

A further important change is that all prospectuses must now be published electronically – on the issuer's, market place's or lead manager's website. This assures investors straightforward access to a prospectus.

Requirement for historical financial information in prospectuses – Finanstilsynet's guidance

Finanstilsynet has drawn up "Guidance on historical financial information and pro forma financial information in share prospectuses". The Authority has noted that preparing share prospectuses may pose a challenge in terms of meeting the requirements for historical and pro forma financial information. Against this background Finanstilsynet's guidance explains these content requirements in this respect. The guidance also explains how to meet the requirements regarding historical and pro forma financial information in prospectuses. The guidance is available (in Norwegian only) at Finanstilsynet's website under the tab "Noterte foretak – Prospekter".

CHART 4: PROSPECTUSES APPROVED BY FINANSTILSYNET IN 2012 – BY SECTOR



Source: Finanstilsynet

FINANCIAL REPORTING ENFORCEMENT – LISTED COMPANIES

Listed companies are required to use the International Financial Reporting Standards (IFRS) when preparing and presenting consolidated accounts. Finanstilsynet controls the financial reporting by Norwegian-registered companies that are listed on a regulated market in Norway or elsewhere in the EEA, as well as some foreign companies that are listed on a regulated market in Norway.

ENFORCEMENT OF FINANCIAL REPORTING

The enforcement covers annual accounts at group and company level, management reports and interim accounts, as well as other financial reporting by the supervision. State-owned enterprises that issue shares and/or bonds are included, but some debt-issuing municipal and intermunicipal enterprises are not covered.

At the end of 2012 258 companies were subject to Finanstilsynet's control of financial reporting. Of these, 33 were foreign. Just under 200 were issuers of shares and equity certificates. Several issuers of shares and equity certificates also issued bonds that are quoted on Oslo Børs. In the course of the year seven new companies were admitted to Oslo Børs, one to Oslo Axess. A total of 15 issuers were delisted, 13 from Oslo Børs and two from Oslo Axess.

Selection

Finanstilsynet applies criteria to select undertakings for review. Some are selected on the basis of signals given or by rotation, while others are picked out based on a risk assessments. Risk-based analyses are carried out based on reports received via the Altinn portal.

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Results of the enforcement

In 2012 Finanstilsynet reviewed all or parts of the financial reporting of 50 companies. Particular attention was given to issuers of equity instruments. Finanstilsynet also reviewed the audit reports of all listed companies. Eight cases were given closer scrutiny; several had yet to be finalised at year-end.

No information was received in 2012 from the companies, their elected officers, senior employees or auditors to indicate that the financial reporting of the issuers failed to provide a true and fair view in conformity with the provisions of the Securities Trading Act.

Norwegian Car Carriers ASA

Norwegian Car Carriers (NOCC) acquired in July 2010 all shares of Dyvi Shipping. By this transaction Dyvi Shipping transferred its car carrier investments to NOCC. The sale was settled in shares issued by NOCC. In its annual accounts for 2010 NOCC recorded the transaction as a purchase of a group of assets, not as a business acquisition.

In Finanstilsynet's view the transaction should have been accounted for as a business acquisition. The company disagreed, but opted on the basis of an overall assessment to revise its accounting in keeping with Finanstilsynet's assessment.

DOF ASA

At issue was the company's calculation of vessels' residual value. Vessels must be recognised in the balance sheet at acquisition cost less accumulated depreciation and any accumulated value impairment loss. The depreciable value of an asset is determined after deduction of the asset's residual value. Residual value is the estimated amount for which the company could have sold the asset today, provided that the asset was of the age and condition expected of it at the end of its useful life. DOF ASA's policy is to own ships for 20 years. Useful lifetime is accordingly 20 years, whereas the ships' actual lifetime is 30 years.

DOF stated that residual value was set at 50 per cent of acquisition cost. Finanstilsynet did not agree with the company's use of acquisition cost as a basis for calculating residual value. In Finanstilsynet's view residual value must equal the market value (less cost of sale) of corresponding 20 year old vessels. Where such vessels are non-existent, residual value must be derived from a relevant market value. DOF stated its intention to revise its model for calculating residual value by using a broker estimate or market value. This was done in the fourth quarter interim report 2011.

Cecon ASA

Finanstilsynet questioned the company's depreciation assessment of three vessels under construction. In Finanstilsynet's assessment several of the assumptions underlying the calculation of value-in-use of vessels under construction were poorly substantiated and documented. Finanstilsynet considers that greater weight should be given to external evidence, such as broker estimates.

In 2011 the company based its depreciation assessment on broker estimates and completed transactions, and the vessels were written down further in the 2011 annual accounts. Based on this, and on the fact that it appeared difficult subsequently for the company to document the assumptions employed in the 2010 assessment, Finanstilsynet did not pursue the matter further in the 2010 accounts.

Amortisation of goodwill and other intangible assets

In autumn 2012 the European Securities and Markets Authority (ESMA) surveyed and analysed accounting practices related to amortisation of goodwill and intangible assets, and appurtenant note disclosures. The survey was prompted by the question of whether the level of depreciation in 2011 was sufficient when viewed in light of the economic crisis in Europe. The 2011 annual accounts of 235 European companies were reviewed. Finanstilsynet took part in this process. One conclusion was that note disclosures were in many instances inadequately tailored to the companies, and that sensitivity analyses were deficient. Further, a number of companies were observed to be employing unrealistic growth rates in their value-in-use calculations and several disclosed only the average discount rate and not a specific discount rate for each significant cash-generating unit. Finanstilsynet will also in 2013 focus on depreciation assessments and appurtenant note disclosures.

Violation charge for late publication of periodic financial reports

Finanstilsynet's enforcement of periodic reporting includes checking that reports are published within the statutory deadlines. Failure to observe a deadline normally attracts a violation charge.

Three issuers were censured for late publishing of annual reports for 2011 while violation charges were imposed on a further nine issuers.

Expert Panel on Accountancy

An important complement to Finanstilsynet's resources is the Expert Panel on Accountancy. The panel was appointed by the Ministry of Finance on 13 October 2005. Finanstilsynet is secretariat to the Expert Panel.

The Expert Panel met six times in 2012, and had eight matters referred to it for comment or discussion. Some were considered several times. The panel's statements are enclosed with letters to companies that are published on Finanstilsynet's website.

The Expert Panel in the period 1 January - 31 December 2012

Frøystein Gjesdal (chair)
Aase Aa. Lundgaard (deputy chair)
Stig Enevoldsen
Signe Moen
Kjell Magne Baksaas
Nina Rafen
Geir Moen
Karina Vasstveit Hestås (alternate)
Roar Inge Hoff (alternate)
Reidar Jensen (alternate)

AUDITING

Finanstilsynet's oversight of auditors comprises approval or licensing of individuals and firms, registration and supervision. Finanstilsynet checks that auditors maintain their independence, and that they discharge their assignments in a satisfactory manner and in compliance with law and good auditing practice.

TRENDS

While the industry includes a small number of large firms, it still features numerous small businesses. Even so, there is a tendency towards increased concentration, probably due to the lapse of the statutory audit obligation for smaller limited companies. Audit industry incomes continue to grow.

Auditors now market attestations and statements for special purposes to companies that have dispensed with the audit but are required to present such documents to public authorities, for example in connection with applications for funding. Some larger audit firms acquire accounting firms in order to be able to offer accountancy services to clients other than audit clients.

The EU Commission's proposals for changes to the Audit Directive and for a new Regulation have met with opposition, including from the audit industry and from several countries' audit supervisors. The proposals are under consideration by EU bodies, and it is not clear when new rules will pass into Norwegian law.

SUPERVISION AND MONITORING

Market participants' confidence in the companies' financial reporting is key to a well-functioning market. This is particularly true for reporting by public interest entities, i.e. banks and other credit institutions, insurers and listed companies. Good audit quality supports that confidence. In order to properly perform the role of representative of the general public, the auditor must be independent and perform the audit in conformity with the requirements of the Auditors Act.

Finanstilsynet checks compliance with the requirements on auditing activities as such, that requirements on auditor independence are met and that the quality of audits performed is satisfactory. Checks are also made to ensure that the anti-money laundering legislation is complied with, and that auditors and audit firms submit their own financial statements and tax returns on time.

Finanstilsynet carries out supervision based on its own risk assessments, reports received and other signals, for example in the media. Matters that come to light in other areas supervised by Finanstilsynet may also prompt scrutiny of the work of an auditor. Moreover, periodical quality assurance reviews of auditors of entities subject to statutory audit is required at least every sixth year, while audit firms that audit public interest entities are subject to periodical audit firm inspections at least every third year.

The periodical quality assurance reviews are coordinated with the reviews conducted by the Norwegian Institute of Public Accountants (DnR) of its members. Should the DnR bring to light circumstances that may prompt withdrawal of an auditor's licence, the matter is referred to Finanstilsynet for further action. The DnR's report for 2012 is reproduced on page 67. Where public interest entities are concerned, responsibility for all supervisory activities rests with Finanstilsynet.

Finanstilsynet receives each year between 80 and 90 reports of possible audit flaws. The number is fairly constant. In 2012 87 reports were received from the DnR, the tax authorities and bankruptcy administrators et al. possibly indicating deficient audit practice. Cases not given priority by Finanstilsynet may conclude with the auditor being asked to assess whether its audit practice should be modified for the future. Such assessments must be documented.

Forty-eight on-site inspections were conducted in 2012 in addition to other supervisory matters. Some of these matters will reach completion in 2013. Three on-site inspections focused on the IT audit.

TABLE 10: REVOCATION OF AUDITORS' LICENCES

	2008	2009	2010	2011	**2012**
State authorised auditors, licences revoked	3	1	10	1	**19**
Registered auditors, licences revoked	9	4	13	2	**17**
Audit firms, licences revoked	0	3	1	0	**0**

The number of licence revocations is higher the year after off-site supervision has been carried out since it includes entities that fail to respond to the questionnaire after a reminder is sent warning them of possible revocation. Individuals' compliance with the requirement for continuing education is checked based on their reply to this question. Three decisions to revoke licences in 2012 were reached after on-site inspections were carried out. The other decisions were based on off-site supervision.

Supervision of audit firms

In addition to meeting the audit legislation's formal requirements for licensing, audit firms must designate a statutory auditor responsible for each audit assignment taken on by the firm. At inspections Finanstilsynet checks that the firm has in place adequate systems for internal quality control of the audit practice, including policies and procedures with regard to independence, confidentiality and money laundering. Finanstilsynet reviews selected audit engagements to check compliance with the audit legislation and internal policies and procedures.

Thirteen inspections of audit firms were conducted in 2012, nine of which at firms that audit public interest entities. At such inspections at least one audit engagement is reviewed against the audit legislation.

Audit firms eligible to audit companies listed on a US stock exchange are also subject to oversight by the Public Company Accounting Oversight Board (PCAOB) in the US. Finanstilsynet and the PCAOB conducted a joint on-site inspection of Ernst & Young AS in 2011 and of KPMG and Deloitte in 2012.

Joint inspections are headed by Finanstilsynet. Audit firms' internal policies are checked on a joint basis. The PCAOB reviews audit engagements for companies that are listed on a US stock exchange, or that are significant subsidiaries of such companies. The PCAOB also checks that US standards are adhered to.

In 2012 Finanstilsynet issued final inspection report to Ernst & Young following the joint inspection in 2011. There were no findings of a serious nature. One engagement review brought to light a question of principle regarding whether an auditor must state an exact amount in the audit report if he or she disagrees with the company's valuations. Finanstilsynet will examine the matter more closely.

Other individual cases

Finanstilsynet followed up on the auditors of Touchpay AS, a company that carried on licensable business without the requisite licence. The initial auditor had looked into the licensing obligation, but did not consider a licence necessary. The auditor who took over the assignment did not consider the licence issue, and had not commenced the audit. Finanstilsynet underscores that the auditor of a business that receives funds on behalf of others must clarify the question of the licensing obligation with the client. If the company is not licensed for such activity, the auditor must obtain documentation that a licence is not needed. The auditor must step down if the client fails to bring the business into line with the legal requirements. See also the account of Touchpay in "Banking and finance" on page 36.

Finanstilsynet also examined the audit of Holst Group AS, which operated in the same manner as Touchpay AS. In cases where the client has right of disposition over the assets of others (client assets), particular care is required on the part of the auditor.

Finanstilsynet conducted an on-site inspection of BDO, the auditor of Lunde Gruppen AS. The audit was prompted by the bankruptcy, reported on in the media, of the parent company and a number of subsidiaries. The matter is under review.

Finanstilsynet revoked the licence of an auditor who had breached the confidentiality requirement under the anti-money laundering legislation. The auditor had told his audit client that the previous auditor had filed a money laundering report on that client.

When Finanstilsynet uncovers deficiencies in the audit of supervised entities, or in assurance reports obtained by the supervised entity at Finanstilsynet's request, Finanstilsynet takes up the matter with auditor concerned. Upon the start-up of a new bank, the auditor is normally required under the terms of the licence to issue a report regarding the bank's compliance with the legislation. PwC issued such a report with regard to Warren Bank AS. Finanstilsynet commented on a general basis that if it is not clear what the auditor can express an opinion on, on what basis and on what assurance level, the auditor must assess the purpose of his report and fulfil this purpose in the best possible manner. The auditor must refrain from issuing a report if there is any confusion concerning the auditor's procedures to obtain the appropriate assurance. These matters must have been attended to in order for the report to be compliant with good auditing practice.

Because Storebrand Livsforsikring AS had filed incorrect reports after failing to take note of changes in the legislation governing the reporting of consolidated figures, Storebrand's auditor, Deloitte was contacted. The auditor/audit firm must have procedures in place to ensure that the auditor is updated on the legislation.

Auditors of payment institutions are reviewed against the background of deficient reporting by such institutions and other deficiencies in their business. The auditors in question were instructed to present documentation showing their awareness of the legislation and licence terms applying to this type of entity. The auditors were also required to demonstrate that they and the accountant had made assessments in compliance with the money laundering legislation et al.

Finanstilsynet finalised a report previously submitted by Tax Region East. Several auditors had attested income tax returns even though their audit reports contained qualified opinions and emphasis of matter paragraphs on matters of relevance for tax calculation. As a result of the investigations, comments were directed at 21 auditors explaining what is meant by good auditing practice in this area and expecting the auditors to duly comply.

Thematic inspections

Each year Finanstilsynet conducts a thematic round of inspections in the audit field. In 2012 the theme was "Audit of revenue recognition and business understanding". The inspection covered 25 audit firms and 50 audit assignments. The deficiencies brought to light relate to poor understanding of the business in question, inadequate overview of processes and identification of risk, choice of audit strategy, and deficient audit procedures and audit evidence. The thematic inspection report is published on Finanstilsynet's website.

Off-site supervision

All auditors and audit firms are subject to off-site supervision every second year. The latest round of off-site supervision was in autumn 2011. Follow up of auditors and audit firms that failed to respond to the off-site supervision was completed in 2012. A report containing tables showing developments in the industry since the last off-site supervision conducted in 2009 can be downloaded from Finanstilsynet's website. Finanstilsynet has also followed up on individual auditors based on responses received, with a particular focus on compliance with the continuing education requirement.

LICENSING

TABLE 11: NUMBER OF APPROVED AUDITORS AND AUDIT FIRMS AT 31.12.2012

	2009	2010	2011	**2012**	**Licensed in 2012**
State authorised auditors	2,826	2,984	3,165	**3,339**	**219**
Registered auditors	3,117	3,226	3,319	**3,365**	**153**
Of which: statutory auditors	–	–	1,891	**1,840**	**80**
Audit firms*	820	776	674	**600**	**20**

**Recent years' decline is probably related to the fact that a company that owns audit firms no longer needs to be an approved audit firm itself.*

Finanstilsynet authorises auditors as either registered or state authorised auditors. State authorised auditors are subject to higher education requirements than registered auditors. In addition to statutory minimum education requirements, a practical examination has to be passed to qualify for authorisation. The examination is prepared by an examination board and is organised by The University of Agder on behalf of Finanstilsynet. 293 candidates passed the examination in 2012.

Finanstilsynet regularly checks compliance with statutory requirements, particularly those relating to continuing education. Finanstilsynet's circular no. 10/2012 and no. 11/2012 on the continuing education requirement are available at Finanstilsynet's website. The circulars set requirements for the course organisers.

A body to deal with appeals against Finanstilsynet's decisions related to auditors and accountants was set up with effect from 1 February 2012. The appeals board reviewed 17 cases in 2012.

In 2012 Finanstilsynet took into use a form provided by the Norwegian public reporting portal, Altinn, to collect turnover figures from audit firms as a basis for apportioning the annual levy payable to Finanstilsynet.

Register of Auditors

Finanstilsynet is responsible for the Register of Auditors and the Register of Accountants, both of which are part of Finanstilsynet's licence registry. The Audit Directive requires the registration of certain information in the Register of Auditors. In 2012 Finanstilsynet established a solution in Altinn whereby audit firms themselves register information which cannot be obtained from Finanstilsynet's own systems or other public registers. Finanstilsynet will follow up on any inadequate registration in 2013.

Auditor statements to Finanstilsynet

Finanstilsynet and the Norwegian Institute of Public Accountants have collaborated on clarifying the content of reports that entities under Finanstilsynet's supervision are required to obtain from their auditor under legislation administered by Finanstilsynet. This work continues in 2013.

REGULATORY DEVELOPMENT

As proposed by Finanstilsynet, the Ministry of Finance circulated for comment amendments proposed to the Auditors Act. They include an amendment to the scope of application of the Auditors Act since small private limited companies are no longer subject to the audit obligation, and a proposal for a legal basis for Finanstilsynet, in special cases, to consent to the transfer of audit engagements without the audit client having decided to change auditor.

INTERNATIONAL TASKS

Finanstilsynet is following the progress of the EU Commission's proposal for changes to the Audit Directive and a new Regulation by participating in various groups as observer. Finanstilsynet also maintains contact with the other Nordic audit supervisors.

Beyond the work done under EU Commission auspices, European supervisory authorities have on their own initiative formed a group to develop and harmonise the conduct of inspections. The working group European Audit Inspection Group (EAIG) is setting up a common European database for inspection findings. The working group is also helping to obtain and coordinate member countries' views on proposals for new auditing standards to be established by the industry.

The global collaboration between supervisory authorities takes place through the International Forum of Independent Audit Regulators (IFIAR). Forty-four countries, including Norway, are represented on the IFIAR.

The audit authorities have also established colleges for Ernst & Young and KPMG as a result of structural changes made by both audit groups a couple of years ago. Ernst & Young have a company in the United Kingdom which owns the national firms in the network. In the KPMG network some audit firms still have local owners. Finanstilsynet attends meetings of these colleges which discuss what themes should be followed up on and how global policies and procedures should be inspected. Ernst & Young and KPMG's top managements also attend.

INFORMATION AND COMMUNICATION

Finanstilsynet holds half-yearly contact meetings with the Norwegian Institute of Public Accountants. Finanstilsynet also attends the Institute's meetings of controllers at which various topics related to the quality assurance review are dealt with. Annual meetings are held with the management of the five largest audit firms as part of the supervisory effort. Finanstilsynet also contributes by giving presentations etc. at courses and in other contexts.

Finanstilsynet
Postboks 1187 Sentrum
0107 Oslo

Oslo, 24 January 2013

DNR QUALITY ASSURANCE REVIEW – ANNUAL REPORT 2012

With reference to the "Guidelines for periodic quality assurance reviews of auditors and audit firms", 2.3(k), the Board of the Norwegian Institute of Public Accountants (DnR) hereby presents a summary of the quality assurance reviews conducted in 2012.

Organisation of the quality assurance review

The quality assurance review is described in "Details of the quality control programme 2012" as posted at www.revisorforeningen.no. It is designed to test compliance with good auditing practice, including International Standards on Auditing, in addition to compliance with the provisions of the Auditors Act concerning independence, indemnity insurance and continuing education, and the auditors' capabilities to fulfil their financial obligations.

The review team comprised 24 state authorised and registered auditors, all with a broad professional background.

Selection of auditors for quality assurance reviews

In 2012 the quality assurance programme included 905 statutory auditors. 159 of these were selected for ordinary quality assurance review. Upon being notified that they had been selected for review three statutory auditors announced that they would wind up their business or retire as statutory auditors in the course of 2012. In addition, four statutory auditors were deselected because they had undergone reviews by Finanstilsynet. This left a total of 152 statutory auditors to undergo ordinary reviews in 2012. One of these reviews was not carried out since the auditor concerned is no longer a member of the DnR. Five reviews were deferred to 2013 due to long term illness. In addition to the ordinary reviews 29 statutory auditors were subject to follow-up reviews, resulting in a total of 175 conducted reviews in 2012.

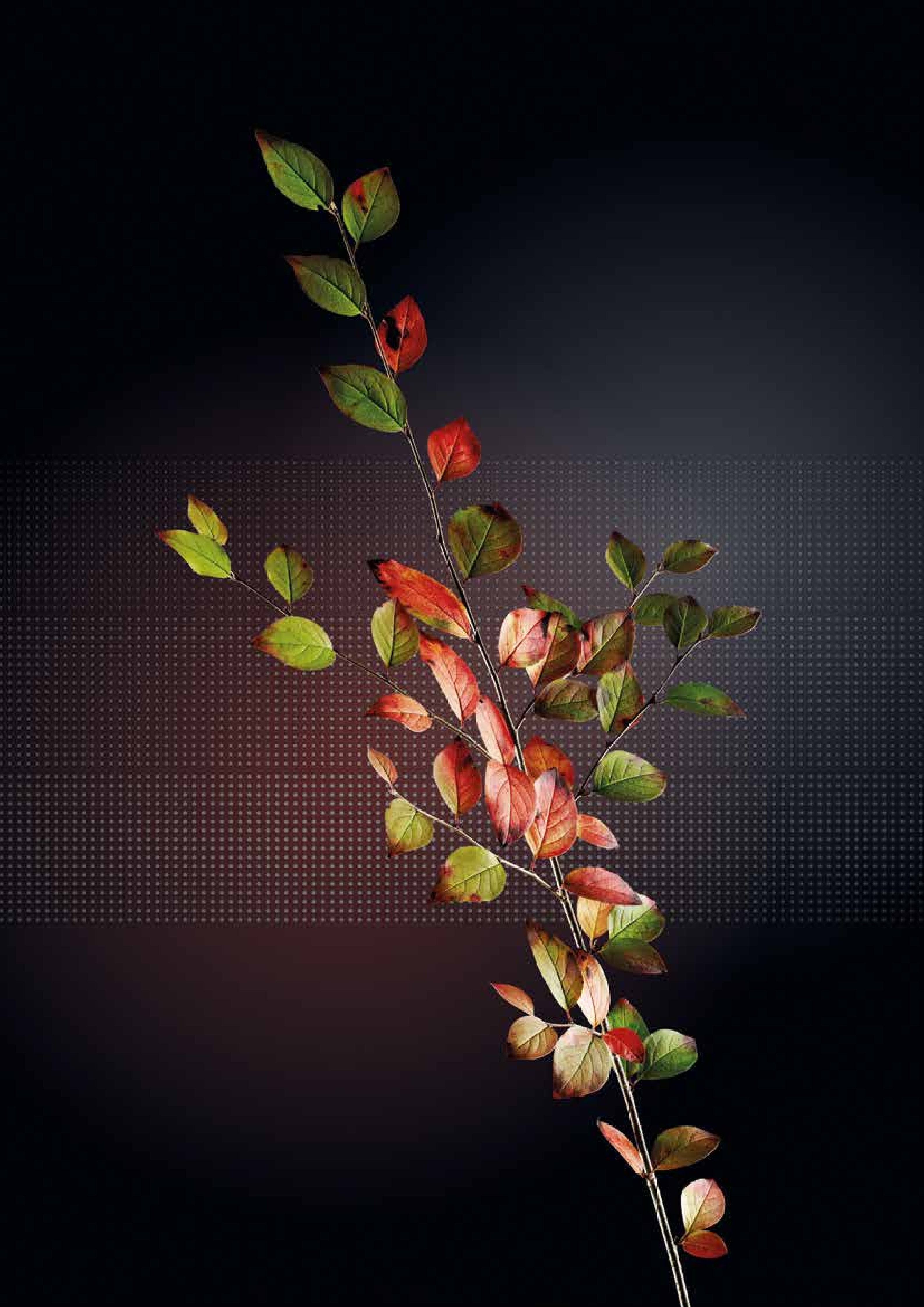
Result of the quality assurance reviews

It is our opinion that Norwegian statutory auditors maintain a high professional standard, and that their work is of high quality. Nevertheless, it is a continuing goal for DnR to reduce the number of incidents in which follow-up measures are required. We will seek to achieve this by delivering technical information, guidance and courses to our members.

	Number	%
Approved	136	77.7
Audit flaws and/or other shortcomings – action plan and follow-up review	38	21.7
Submitted to Finanstilsynet for further action	1	0.6
Total number of reviews conducted	**175**	**100**

Yours sincerely

(sign.)
Ingebret Grude Hisdal
Chair
Norwegian Institute of Public Accountants



SUPERVISION OF IT AND PAYMENT SYSTEMS

IT supervision includes checking that institutions operate in a satisfactory manner, with an acceptable level of risk and in compliance with the ICT regulations and other rules. Supervision of payment systems is designed to ensure that payment services are performed in a sound, coordinated and rational manner and with an acceptable level of risk.

TRENDS

More crime targeting payment services

Internet banks were subjected to more attacks in 2012 than the previous year. The attacks are increasingly targeted and sophisticated. Overviews and information gained via one method are often used in another. Trojan attacks on banks are ever increasing, and in a variety of guises (SpyEye, Zeus Torpig, Citadel, Hermes). 2012 saw a particular increase in DDOS[1] attacks. Oslo Børs and the Central Securities Depository were victim to a comprehensive attack in 2012. Attacks were also directed at banks' data centres and paralysed internet banking for brief periods.

Losses are still relatively low despite the increase over 2011. In Finanstilsynet's view this is mainly due to the banks' investments in countermeasures designed to limit their losses and at the same time maintain confidence in their internet bank solutions. This is done in cooperation with banking professional bodies and the suppliers. The heaviest losses still relate to the use of debit cards and various methods of defrauding the cardholder.

Stolen card data used outside Norway account for the highest losses, but are levelling off somewhat. The banks and their professional bodies remain very concerned to upgrade cash dispensers and EFT/POS terminals to remove vulnerable points. Introduction of chip-enabled debit and credit cards is an effective measure, but will only be fully effective once all relevant countries have made the switch, enabling removal of the magnetic stripe. Should losses rise sharply, it may be necessary to consider measures such as ceasing to issue combined cards.

Unintended operational events

There were many unintended events in ICT operations in 2012, particularly in communication solutions and distributed digital services. Each individual event was of limited scope and was not serious enough to threaten financial stability. These events could have been avoided by more systematic management and oversight and greater emphasis on quality measures over time. Banks and relevant providers have put in place measures that are expected to have an effect. The banks must continue to prioritise risk, quality and accessibility.

[1] Denial of service, DOS, or distributed denial of service, DDOS, are terms used in information and IT security to describe an attack that prevents someone or something (for example an individual or system) from accessing information or resources they are meant to have access to. A successful denial-of-service attack will render the information/resource inaccessible.

Outsourcing to low-cost countries and use of cloud computing

Outsourcing ICT services to low-cost countries is a trend in high-cost countries such as Norway. Moving to countries that lack infrastructure in the area of regulation and do not have a tradition of honouring agreements may represent a high risk. The trend may be intensified if the local suppliers exploit a dominating position or are unable to deliver quality at acceptable prices. Some actors are also considering using cloud computing for all or some ICT systems. Finanstilsynet is keeping a close watch and is drawing up guides in this area. Use of cloud computing is growing outside the financial sector.

New payment products

New payment products using wireless technology are constantly being launched, both smartphones and credit cards. International debit cards make use of near field communication. Reading devices are deployed at a number of commercial sites, and some banks are using pilot groups to try out the technology in practice. Banks and telecom operators are also collaborating on use of smartphones for money transfers, both in commercial situations and between private individuals. The products also address small payments, at any rate in the initial phase. Finanstilsynet is working to gain an overview of possible risks faced when using such technology. Internet bank solutions are also being developed to enable smartphones to carry Internet bank functions with the aid of specially developed applications.

Increasing use is being made of internet banking solutions, both in terms of transaction numbers and number of users.

SUPERVISION AND MONITORING

IT inspections

In 2012 Finanstilsynet focused on specific themes at entities with a critical social function. This was based on experience gained from general IT inspections, events in 2011 and a desire to give greater emphasis to risk when selecting entities for inspection and appropriate themes. The following themes were selected:

- Disaster and preparedness planning
- Electronic payment services
- Management and oversight of ICT (with a basis in best practice / IT governance standards)
- Risk assessment of agreements / outsourcing arrangements (offshoring and variants of cloud computing)
- ICT infrastructure

The work was more resource-demanding than ordinary inspections, and for that reason fewer inspections were carried out in 2012 than recent years' average of around 25 inspections per year. In 2012 Finanstilsynet conducted 17 IT inspections, including five thematic inspections in the banking and finance sector. Payment services were also covered. A further 45 simplified IT inspections were carried out.

Payment systems

A theme selected in 2012 focused on use of electronic payment services. One major bank was selected for inspection. Much of the event-related work concerned payment services. Collaboration with Norges Bank in the payment systems area continues. There is also close dialogue with Finance Norway, the Norwegian Banks' Standardisation Office and BankID Norway on joint solutions for banks. Risk assessment of new services and technologies is resource-demanding, especially in the area of overlay payment services[2] and illegal financial services that are offered via the net. Finanstilsynet was heavily involved in investigations in connection with illegal activity of entities operating in the EFT/POS area.

[2] In overlay payment services, third parties act as intermediaries between consumer and bank in online shopping transactions.

Collaboration with the Data Inspectorate on ID theft related to payment services continued in 2012, and steps were taken in several identified problem areas.

Nets Norway AS and Evry ASA, which deliver systemically important technical solutions to Norwegian financial institutions, are not under direct supervision by Finanstilsynet but are relevant to Finanstilsynet's supervisory activity.

Risk and vulnerability analysis (RAV)

The 2011 RAV analysis was finalised in April 2012. Finanstilsynet collaborates with Norges Bank on the RAV analysis and Norges Bank's annual report on payment systems.

Much effort was devoted to the receipt, treatment and follow-up of events in 2012. Finanstilsynet received a total of 150 event reports distributed on 500 e-mails.

The major banks and their joint bodies are considering a move to establish a computer emergency response team known as FinansCERT, a joint body to deal with attacks against the financial infrastructure. This will be linked to NorCERT, an entity within the Norwegian National Security Authority (NSM). It is important for the entity to be assured close proximity to the financial community, and to constitute a joint resource, while at the same time collaborating fruitfully with NorCERT. Finanstilsynet supports this move and considers it both relevant and necessary.

Licensing and regulatory development

In 2012 Finanstilsynet conducted a comprehensive review of documentation that the banks were required to submit by Finanstilsynet's circular no. 20/2011 in the wake of the considerable operational problems experienced in Easter 2011. After reviewing the documentation Finanstilsynet wrote to each bank individually. Many asked questions about payment services which were also duly answered.

Finanstilsynet is working on guides on security and outsourcing in the ICT regulations. With a basis in the Payment Systems Act a start has been made to considering the need for more specified requirements for payment services and risk. This work is continuing in 2013 in conjunction with the trade organisations.

Consumer protection

In 2012 Finanstilsynet examined the level of risk in payment services. In conjunction with Finance Norway Finanstilsynet organised the reporting of loss figures related to individual services and loss types as a basis for assessing the need for action to be taken. Action was considered to protect internet bank facilities against criminal attack. The various payment systems are explained more closely on Finanstilsynet's website under "Consumer information".

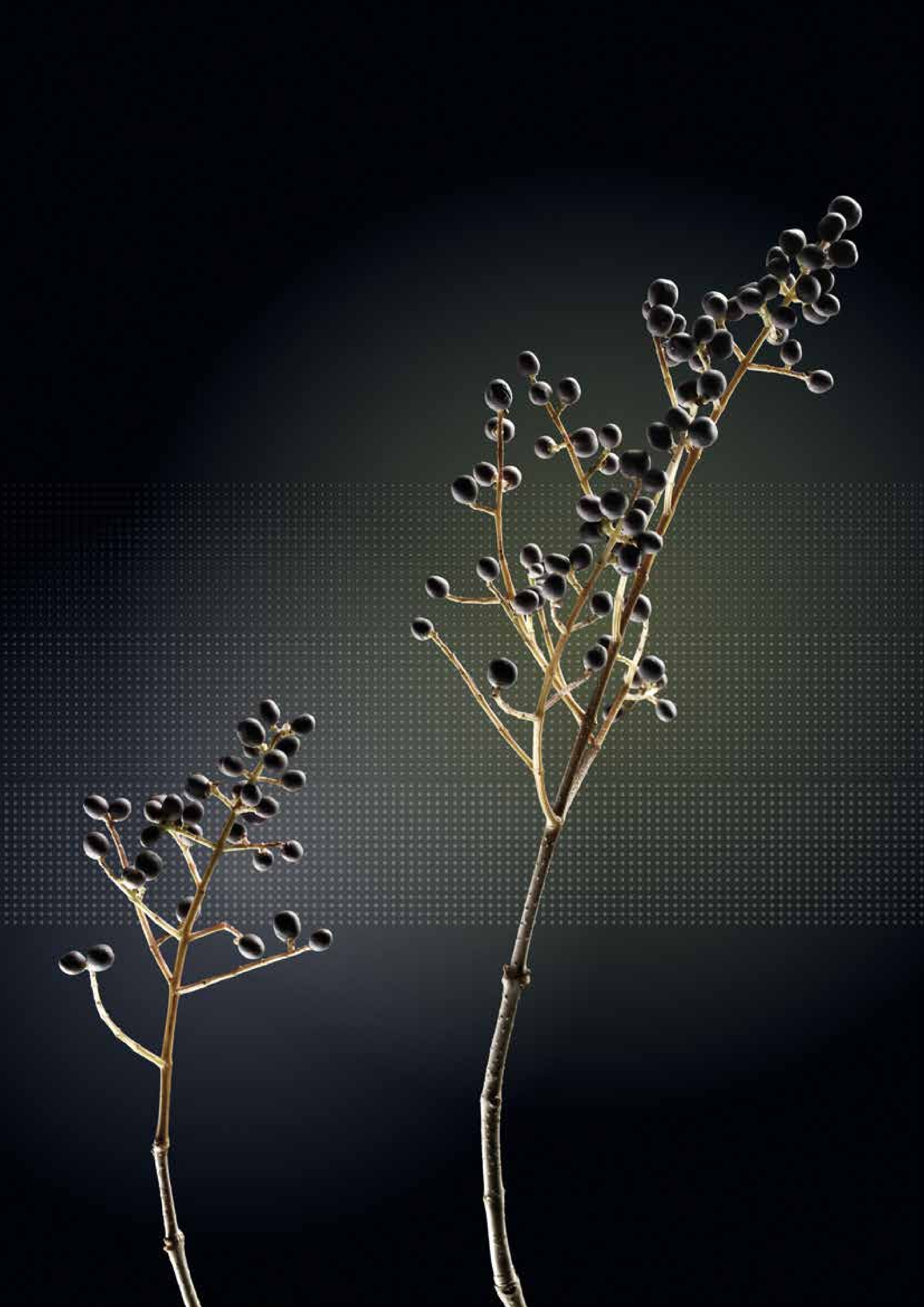
Information and communication

Seventeen external presentations on Finanstilsynet's supervision of IT and payment systems were given in 2012 at the request of trade organisations, individual undertakings and other relevant interest organisations. Active use is made of Finanstilsynet's website to provide access to supervisory modules, guides and other relevant information. Finanstilsynet also organised external seminars on the RAV analysis and event reporting.

Emergency preparedness

Finanstilsynet is secretariat to, and heads, the Financial Infrastructure Crisis Preparedness Committee (BFI). Three meetings and two emergency preparedness exercises were held in 2012.

Finanstilsynet participated in 2012 in the project "Protecting critical infrastructure and critical social functions", initiated by the Directorate for Civil Protection and Emergency Planning. Stage 3 of the project deals with the financial sector.



INTERNATIONAL ACTIVITIES

Turmoil in financial markets and uncertainties in the world economy have since 2008 prompted a number of initiatives to strengthen supervision and regulation of financial markets. Sound rules and oversight promote well-functioning financial markets and ensure that potential risks to financial stability are duly addressed.

Principles have been established at the global level for solid financial institutions and improved supervision and, based on these principles, the EU and other countries and regions have developed their respective national rules. The EU initiatives address capital requirements, supervision of systemically important banks, crisis management and a joint banking supervisor for the euro area through the European Central Bank and the establishment of a banking union. See "Banking and finance", page 34.

Norway is tightly linked to the EU through the EEA agreement. In most areas overseen by Finanstilsynet, the Norwegian legislation is largely a transposition of EU legislation.

Finanstilsynet and Norway are affected by principles and rules in effect in the EU and across the world. Finanstilsynet also collaborates on supervision, both in the global and the EEA context. An important aim of cross-border supervisory cooperation is to identify at an early stage risk factors present in firms and markets in the international financial market. Supervisory cooperation also enables the launching of coordinated risk management measures. To promote a level playing field across the open market in the EEA, joint rules need to be enforced in a consistent and predictable manner.

SUPERVISORY COLLABORATION ACROSS THE EU/EEA

Finanstilsynet's collaboration with EU financial supervisors

The EU has three supervisory authorities (ESAs) in the financial area:

- EBA – European Banking Authority
- ESMA – European Securities and Markets Authority
- EIOPA – European Insurance and Occupational Pensions Authority

The ESAs' mission is to support effective regulation and effective supervision across the single market. They aim to promote well-functioning markets and a level playing field, prevent supervisory arbitrage and improve consumer protection. The three bodies collaborate in a joint committee on cross-sectoral matters, such as anti-money laundering and oversight of financial conglomerates.

The EU also has a European Systemic Risk Board (ESRB) with overarching responsibility for macro-prudential surveillance of the EU's financial system. Its mission is to contribute to the prevention of systemic risks to financial stability that arise from developments in the financial system.

Finanstilsynet has since 2011 been invited to attend meetings of the Boards of Supervisors of the supervisory authorities (apart from the ESRB) as Norway's observer and it participates in the work of the boards' subgroups, both as regards regulatory development and supervision of markets and firms. From 2013 onwards Finanstilsynet and Norges Bank will attend meetings of the ESRB's Advisory Technical Committee as observers.

The supervisory authorities have certain supranational powers in the EU which are difficult for the EFTA/EEA countries to accept. Among them is the power to settle disputes between national supervisors and to issue an order to a national authority, or in some cases to a financial institution. For Norway to allow an international body, of which Norway is not a member, to take decisions directly affecting Norwegian firms or individuals, would violate the Norwegian constitution. Norway, Iceland and Liechtenstein are negotiating with the EU Commission on how these difficult issues should be dealt with. Until a way forward is reached, the EFTA/EEA countries' relationship to the EBA, ESMA and EIOPA will not be incorporated in the EEA agreement.

Although the legislation governing the EU supervisory authorities is not part of the EEA agreement, other sectoral bodies of rules will be incorporated in Norwegian law in line with the EEA agreement. Where the interpretation of EU rules and the exercise of supervision is concerned, Finanstilsynet takes account of guidelines and recommendations issued by the EU supervisory authorities. Finanstilsynet's follow-up of the guidelines recommendations is reported on Finanstilsynet's website.

REGULATORY DEVELOPMENT IN THE EU AND TRANSPOSITION INTO NORWEGIAN LAW

Norway is part of the EU's single market by way of the EEA agreement and is accordingly obliged to implement rules adopted by the EU that are EEA-relevant.

The EU Commission is responsible for proposing new EU legislation. Norway participates in expert groups that provide advice to the EU Commission in various areas. In the financial area the Commission is often assisted by the EU's financial supervisory authorities when drafting legislation. These authorities can also make guidelines and recommendations regarding interpretation of the legislation.

Finanstilsynet's and Norway's greatest opportunity to participate in and contribute to legislative drafting is through the work done under the auspices of the EU financial supervisors.

Finanstilsynet participates in a number of working groups under the EU supervisors that prepare regulatory documents. It does so in order to build up the competence needed to transpose new rules into Norwegian law, to identify and promote Norwegian interests and to play a part in producing sound, relevant legislation.

Once adopted by the EU, rules governing the financial area must be incorporated in the EEA agreement before they are transposed into Norwegian law. Finanstilsynet, along with the Ministry of Finance and Norges Bank, participates in EFTA's financial services working group. This group coordinates the EFTA countries' views on the incorporation of legislative acts in the financial area into the EEA agreement.

Topical, concrete EU legislative issues receive further comment in the chapters covering the respective areas of supervision. See also a separate box explaining EEA papers.

EEA PAPERS – INFORMATION ABOUT EU LEGISLATION

The government publishes EEA papers on EU regulatory initiatives at www.europaportalen.no in "EØS-notatbasen". The papers provide a good overview of rules under preparation in the EU, both of their content and relevance to Norway. The portal also explains how legislative acts, where appropriate, are to be implemented in Norway. Most papers of relevance to finance, insurance, securities and auditing are available by selecting "Søk i EØS-notatene in the left hand menu, and then selecting "Kapitalbevegelser og finansielle tjenester" under "Spesialutvalg" on the right hand side. The portal is not available in English translation.

SUPERVISORY PRACTICES

The EEA agreement sets the stage for banks, insurers and investment firms to operate across national borders with fewest possible impediments. Many foreign entities operate in Norway, and many Norwegian entities operate elsewhere in the EEA. To ensure well-functioning markets, not only the legislation but also its enforcement and supervisory practices must be consistent.

Not least, close collaboration is needed with other national supervisors in Europe in order to identify risks present in markets and firms.

By participating in the Boards of Supervisors and working groups under the EU supervisory authorities' auspices, Finanstilsynet contributes to the development of good supervisory practices. For the supervision of individual groups, colleges have been established. Each college includes the national supervisors in countries where a particular international group is established, and the relevant EU supervisory authority. Finanstilsynet heads the supervisory colleges for, among others, DNB, Storebrand and Gjensidige. It also participates in a number of colleges for international groups established in Norway including If, Nordea and Santander.

NORDIC AND NORDIC-BALTIC COOPERATION

The financial market in the Nordic region is well integrated, and many financial institutions sell services in other Nordic countries through subsidiaries and branches. The extensive cross-border activity in the region means close cooperation is needed to assure well-functioning markets and financial stability. The cooperation covers supervision of the respective financial institutions, monitoring of risks that pose a threat to financial stability, regulatory development and development of supervisory practices.

The Nordic countries meet annually at director general level, and hold regular meetings at departmental level for the various areas of supervision. In 2012 Finanstilsynet hosted the meeting at director general level.

Nordic-Baltic collaboration has been strengthened since the financial crisis. The Nordic-Baltic Stability Group was established in 2010 drawing representatives from the finance ministries, central banks and financial supervisors in the Nordic-Baltic countries. The group has drawn up a framework for coordination of cross-border measures in the event of a crisis situation in systemically important, cross-border financial institutions.

2011 saw the establishment of the Nordic-Baltic Macroprudential Forum. The Forum brings together the top management at central banks and financial supervisors and discusses macroprudential surveillance and supervisory follow-up in the Nordic-Baltic area. Similar Nordic collaboration has been established in the audit area where regulatory development and development of supervisory practices are at centre stage.

COLLABORATION WITH OTHER SUPERVISORS ON THE GLOBAL STAGE

In the wake of the financial crisis of 2008–2009 the G20 countries drew up principles for financial market reform. The Financial Stability Board (FSB) oversees the implementation of the reforms. In addition, both the Basel Committee and the International Association of Insurance Supervisors (IAIS) have revised their principles for the supervision of banks and insurers.

In order to keep abreast of developments in markets and the development of principles and legislation, Finanstilsynet participates in global supervisory organisations covering most of Finanstilsynet's areas of responsibility. They include the FSB Consultative Group Europe, the Basel Consultative Group, the International Association of Insurance Supervisors (IAIS), the International Organisation of Pension Supervisors (IOPS), the International Organization of Securities Commissions (IOSCO) and the International Forum of Independent Audit Regulators (IFIAR). In the combating of money laundering and the financing of terrorism, Finanstilsynet participates along with the Ministry of Finance in the Financial Action Task Force (FATF), of which Norway took over the presidency in 2012.

In 2012 Finanstilsynet attended meetings and participated in working groups under the above organisations' auspices and played its part in the development of global supervisory standards and supervisory practices. An overview of Finanstilsynet's participation in international organisations can be found on page 77.

TABLE 12: INTERNATIONAL ORGANISATIONS AND EU/EEA RELATED COMMITTEES IN WHICH FINANSTILSYNET PARTICIPATES OR ATTENDS AS AN OBSERVER

Cross-sectoral meetings

- FSB, Financial Stability Board
  – Regional Consultative Group Europe
- Integrated Financial Supervisors Conference (annual conference)
- FinCoNet – Financial Consumer Network
- Project Link, the UN's annual macroeconomic meeting
- Nordic supervisory meetings
- Nordic-Baltic collaboration

Banking/finance

- ICBS, International Conference of Banking Supervisors, arranged by the Basel Committee every two years
- Basel Consultative Group
- OECD's Financial Markets Committee
- EBC, European Banking Committee – Level 2
- EBA, European Banking Authority
- Nordic meetings on banking supervision
- Nordic-Baltic collaboration

Insurance

- IAIS, International Association of Insurance Supervisors
- IOPS, International Organisation of Pension Supervisors
- OECD's Working Party on Private Pensions (Task Force on Private Pensions)
- EIOPC, European Insurance and Occupational Pensions Committee – Level 2
- EIOPA, European Insurance and Occupational Pensions Authority
- Nordic supervisory meetings for insurance

Securities and prospectuses

- IOSCO, International Organization of Securities Commissions
- ECG, Enlarged Contact Group on Supervision of Collective Investment Funds
- ESMA, European Securities and Markets Authority
- Nordic supervisory meetings for securities

Accounting and auditing

- IFIAR, International Forum of Independent Audit Regulators
- ARC, Accounting Regulatory Committee
- AuRC, Audit Regulatory Committee
- EGAOB, European Group of Auditors' Oversight Bodies
- EAIG – European Audit Inspection Group
- IAIS sub-committee on accounting
- ESMA, European Securities and Markets Authority
- Nordic collaboration

Money laundering and financing of terrorism

- FATF, Financial Action Task Force – the international forum for measures against money laundering and the financing of terrorism, with its secretariat in the OECD
- CPMLTF, Committee on the Prevention of Money Laundering and Terror Financing – Level 2
- Joint Committee's Sub-Committee on Anti-Money Laundering – a collaboration between the EBA, ESMA and EIOPA

ICT supervision

- ITSG, Information Technology Supervision Group
- Security working group under the International Federation for Information Processing IFIP
- ETSI ESI – Groups working on international standardisation in banking and security and on the standardisation of electronic signatures
- Financial Information Sharing and Analysis Center (FI-ISAC) – forum where the banking sector, prosecuting authorities and computer emergency response teams (CERTs) share information on cybercrime in the financial sector
- Nordic supervisory meetings for IT

EFTA

- EFTA Working Group on Financial Services

FINANSTILSYNET'S ORGANISATION

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Chairman

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Wilhelm Mohn Grøstad
Head of Section

Organisation as of 1 June 2013

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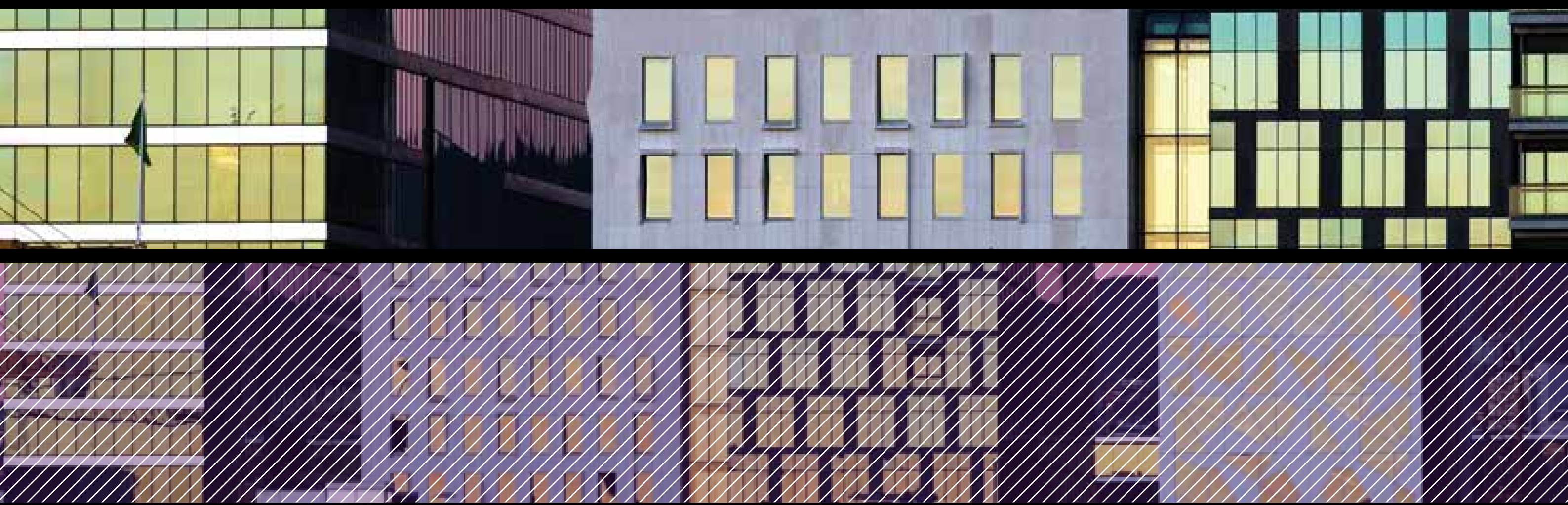
Risk Outlook 2013: The Financial Market in Norway

Since 1994 Finanstilsynet 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 Finanstilsynet's ongoing supervision of individual institutions. Much of the assessment of individual institutions' profitability, financial strength and risk needs to be carried out in light of the general state of the financial market. As from 2003 Finanstilsynet 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, and assesses risks facing banks and other institutions in the Norwegian financial market and potential sources of future stability problems in the Norwegian financial system. Finanstilsynet publishes the report **Risk Outlook** in the spring and **Financial Trends** in the autumn.



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