



**FINANSTILSYNET**

THE FINANCIAL SUPERVISORY  
AUTHORITY OF NORWAY

# ANNUAL REPORT 2016

## Risk Outlook

Analyses of trends in the financial market are covered in the *Risk Outlook* report, which is published in June and November.

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## **REPORT BY THE CHAIR AND THE DIRECTOR GENERAL**

# REPORT BY THE CHAIR AND THE DIRECTOR GENERAL

Finanstilsynet's operations in 2016 were impacted by its adaptation to common European financial market legislation. The legislation is very comprehensive and detailed. This places added onus on the assistance Finanstilsynet provides to the Ministry of Finance in laying the groundwork for and drafting Norwegian law. The new European legislation also adds responsibilities to national supervisors since it brings new actors under supervision and requires extensive reporting of financial data to the European supervisory authorities. The latter are also developing new standards and recommendations to promote uniform European supervisory practices.

The EU regulations establishing joint supervisory authorities in the financial market were, with some modifications, incorporated in the EEA Agreement in autumn 2016. Finanstilsynet's status in the three European supervisory authorities for banking, insurance and markets respectively was formally changed from that of invited observer to non-voting member, and a framework was established for the exercise of supranational authority based on the two EEA pillars.

The transition from observer to member status has not per se led to major changes in Finanstilsynet's activity. It nevertheless put in place an agreed formal basis for Finanstilsynet's participation in the European supervisory regime. This was in any case necessary in order to incorporate recently adopted EU financial legislation into the EEA Agreement. Although Norway's financial legislation has largely been aligned with the comprehensive new EU legislation, the latter must crucially also become an EEA commitment in order to assure Norway's inclusion in the single market for financial services.

In 2016 Finanstilsynet generally discharged its tasks in line with the Ministry of Finance letter of allocation and the plans made for the year. However, the strong growth in Finanstilsynet's tasks posed a challenge. Finanstilsynet has fulfilled its assignments with no increase in its resources in the past few years. To some extent its operations have been streamlined by digitalisation and changed work processes. But the chief contribution to greater efficiency is a stricter prioritisation of the resource input in various areas. The growth in regulation has called for an increased effort on the part of Finanstilsynet, for example in assisting the Ministry

of Finance in drawing up consultation documents. In keeping with its strategy Finanstilsynet has however sought as far as possible to avoid devoting excessive resources to regulatory enforcement and development at the expense of supervisory activities.

Finanstilsynet's priorities are based on risk assessments and proportionality, ensuring that the agency contributes to the highest possible goal achievement. However, national and international commitments constrain Finanstilsynet's space for action. These commitments include extensive reporting of data to the European supervisory authorities, requiring a large portion of Finanstilsynet's ICT and staff resources to be devoted to meeting reporting requirements which would not have been given priority based on the contribution to goal achievement alone. Moreover, minimum requirements must be set for activity in all areas of supervision to ensure a supervisory regime of adequate quality.

Finanstilsynet's main goal is to contribute to financial stability and well-functioning markets. The financial markets and the real economy mutually affect each other. Much emphasis is therefore given to monitoring and analysing developments in the real economy and the markets as a basis for identifying and guarding against risk through supervisory activities and advice to the political authorities.

Norway's economy is impacted by the oil price fall. Activity levels in oil-related industries have fallen substantially. This, alongside considerable capacity growth, has contributed to a sharp impairment of profitability in this segment of business and industry. The offshore industry is particularly affected with a number of companies facing financial problems that have inflicted substantial losses on bond investors and banks. However, the oil price fall has had limited spillover effects to the wider Norwegian economy, where, among other factors, expansionary fiscal policy and low interest rates have helped to sustain activity levels.

House prices rose strongly in 2016 and growth in household debt continued to outstrip growth in household incomes. The debt burden accordingly rose further from an already unprecedented high level. The growth in house prices and household debt, which are closely related, has contributed to increased demand, but at the same time

heightens the risk of economic and financial instability that could result from a sudden and severe turnaround in the property market.

Finanstilsynet has accordingly made a point of monitoring banks' financial soundness and impaired exposures. Finanstilsynet has evaluated the banks' loss absorbing capacity under stress, both in relation to a possible general economic setback and to bank-specific risk factors. It has also set separate capital charges for the individual bank to capture risk that is not, or is only partially, captured in the general capital requirements.

Norwegian banks are well capitalised and achieved continued good results in 2016 despite somewhat weaker profits compared with preceding year due to heavier loan losses, mainly on exposures to the offshore sector. They were able to further improve their financial position through profit retention and are well prepared to withstand losses that could arise in the event of a severe economic setback.

Low interest rates and rising longevity call for larger reserves at life insurers and pension providers to ensure sufficient capacity to honour their pension promises under defined benefit pension plans. This is particularly true of paid-up policies which do not provide new premium income. Finanstilsynet has therefore kept a close eye on pension providers' financial position.

Pension liabilities and the risk present in pension insurance are captured more effectively under the new European solvency requirements, Solvency II, than under previous requirements. The new solvency requirements were introduced for insurers as from 2016, but with long-term transitional arrangements for pension insurance, as permitted under European rules. Although there are wide differences from one institution to the next, Norwegian life insurers overall have been in a position to meet new solvency requirements by an ample margin thanks to enlarged capital buffers, cost reductions and risk mitigating measures.

In order to give pension fund members the same protection as policyholders with insurers, Finanstilsynet has proposed the introduction of new solvency requirements for pension funds that are based on Solvency II requirements. This proposal is under consideration by the Ministry of Finance.

Good consumer protection is an important objective for Finanstilsynet and is reflected in all areas of supervision. In the area of market supervision Finanstilsynet has given particular priority to services of large significance for consumers. These include investment firms' investment services, mutual fund management, real estate agency and debt collection activities. Where detrimental market conduct is drawn attention to in supervisory observations and decisions are made to revoke licences and/or to enforce other sanctions, the entity in question has in many cases acted counter to its customers' interests and in a manner that is liable to weaken public confidence in the financial industry and the markets.

Finanstilsynet views with concern the strong growth in consumer lending and the extensive, and in part aggressive, marketing of such loans. Consumer loans have thus far been highly profitable for banks and finance companies, but the loss potential can easily be underestimated when the volume of such lending is climbing strongly. Moreover, this activity may involve a sizeable reputational risk for the individual lender and the financial industry as a whole. In its supervisory activity Finanstilsynet has focused both on the credit risk and the reputational risk posed by consumer lending. Finanstilsynet collaborates closely with other consumer authorities in this area.

In keeping with the priorities set by the Ministry of Finance, Finanstilsynet in 2016 expanded its oversight of institutions' compliance with the requirements for measures to combat money laundering and terrorist financing. Checks on institutions' compliance with these rules are an integral part of the supervisory activity in all areas, and work on risk assessments and providing guidance to supervised institutions has been stepped up.

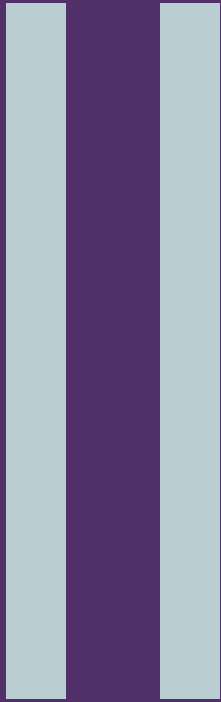
Oslo, 16 February 2017



**Endre Skjørestad**  
Board chair



**Morten Baltzersen**  
Director general



## **INTRODUCTION AND MAIN FIGURES**

## INTRODUCTION AND MAIN FIGURES

Finanstilsynet is responsible for the supervision of banks, finance companies, mortgage companies, e-money institutions, payment institutions, insurers, pension providers, insurance intermediaries, investment firms, securities fund management companies, managers of alternative investment funds, regulated markets (incl. stock exchanges), central counterparties (clearing houses) and securities depositories, real estate agencies, debt collection firms, external accountants and auditors. Finanstilsynet is also responsible for prospectus control and it oversees the financial reporting of listed companies and the conduct of securities market participants.

### Basis in law

Finanstilsynet's mission is set out in the Financial Supervision Act (section 3):

*"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."*

### Strategy

Every four years Finanstilsynet reviews the strategy underlying its activities. The strategy is an important basis for ongoing prioritisation and management of Finanstilsynet's activities and, together with the letter of allocation from the Ministry of Finance, is the basis for Finanstilsynet's annual activity plans. The strategy for 2015–2018 was established by Finanstilsynet's board of directors on 14 December 2014.

### Main mission

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

### Operational goals 2015–2018

In order to facilitate the operationalisation of the main mission and evaluation of activities, five operational goals have been formulated:

1. Financially sound and well-capitalised financial institutions
2. Robust infrastructure
3. Investor protection
4. Consumer protection
5. Effective crisis management

### Management

Finanstilsynet's Board of Directors has by law the overarching responsibility for Finanstilsynet's activities. The Board has five members. Members and alternates are appointed by the Ministry of Finance for a term of four years.

The day-to-day management is in the hands of the Director General who is appointed by the King in Council for a period of six years. The Director General confers with a management team consisting of the heads of the two supervisory departments and the administration department, the legal affairs director and the head of communications.





**Composition of the Board of Directors in 2016:**

Attorney-at-law

**Andre Skjørestad**  
*chair*

Professor

**Giuditta Cordero-Moss**  
*deputy chair*

Professor

**Mette Bjørndal**  
*board member*

Professor

**Lars Sørgard**  
*board member (to 29 January 2016)*

Director/chief economist

**Eirik Wærness**  
*board member (from 28 June 2016)*

Retiree

**Arne Skauge**  
*board member*

Professor

**Beate Sjøfjell**  
*first alternate (to 1 October 2016)*

Senior lecturer

**Thorunn Falkanger**  
*first alternate (from 1 October 2016)*

Attorney-at-law

**Kjetil Wibe**  
*second alternate*

Director, Norges Bank

**Sindre Weme**  
*observer*

Assistant director, Norges Bank

**Henrik Borchgrevink**  
*alternate observer*

**Board of Directors**

Two members elected by and from among the employees supplement the Board when administrative matters are dealt with. In 2016 the following represented the employees:

Senior supervisory adviser

**Anders S. Hole**

Senior supervisory adviser

**Gry Evensen Skallerud**

Their alternates were special adviser

**Inga Baadshaug Eide** and senior executive officer **Anne Nybohm**.

Eleven ordinary board meetings and one extraordinary board meeting by telephone were held in 2016. The Board dealt with 28 administrative matters and 71 supervisory matters. The Board received information in writing on a further 31 administrative matters and 42 supervisory matters. The Board also receives a verbal briefing on relevant matters.

From the left:

Gry Evensen Skallerud  
Arne Skauge  
Giuditta Cordero-Moss  
Mette Bjørndal  
Sindre Weme  
Thorunn Falkanger  
Andre Skjørestad  
Eirik Wærness  
Anders S. Hole  
Kjetil Wibe

Photo:

Jarle Nytingnes



## Finanstilsynet's management team

**Morten Baltzersen**

*Director General*

**Emil R. Steffensen**

*Deputy Director General, Banking and Insurance Supervision*

**Anne Merethe Bellamy**

*Deputy Director General, Capital Markets Supervision*

**Cecilie Ask**

*General Counsel*

**Gun Margareth Moy**

*Deputy Director General, Administration*

**Kjetil Karsrud**

*Communications Director*

From the left:  
Anne Merethe Bellamy  
Kjetil Karsrud  
Morten Baltzersen  
Gun Margareth Moy  
Emil R. Steffensen  
Cecilie Ask

Photo:  
Jarle Nytingnes

For further details see Chapter IV Management and control of Finanstilsynet's operations, page 59.

## Personnel policy and organisation

Finanstilsynet works continuously to further develop its organisation in keeping with national recommendations and its own needs. Priority setting, efficient case-handling/administrative procedures, the right expertise and flexible use of staff resources are key areas.

Finanstilsynet attaches importance to measures designed to recruit, retain and further develop capable staff members and managers. The Authority scores highly on popularity surveys among economics and law students. Measures to develop staff competence are in place, and in 2015-2016 a programme designed to develop a culture of employeeship was carried out.

Finanstilsynet's activities require both cross-disciplinary competence and spearhead competence in the various areas of supervision. Its departments have highly competent staff with good industry knowledge. The majority have their training in economics, business economics, law or auditing. In 2016 staff turnover measured 7.5 per cent compared with 5.9 per cent in 2015.

With its espousal of the Government-sponsored "IA Agreement" designed to promote inclusive employment, Finanstilsynet attaches importance to reducing sickness absence, to diversity and to a sound policy on older employees. Sickness absence was 3.9 per cent in 2016, the same as in 2015. In 2016 optional health checks were offered by the in-house health service, emphasising the importance of a healthy lifestyle.

**Table 1: Main figures**

Overall allocation, items 01-99	NOK 374,268,000
Utilisation ratio, items 01-99	98.65 per cent
Operating expenses	NOK 91,558,342
Salaries as a share of operating expenses	74.26 per cent
Salary expenses per FTE	NOK 1,000,808.42

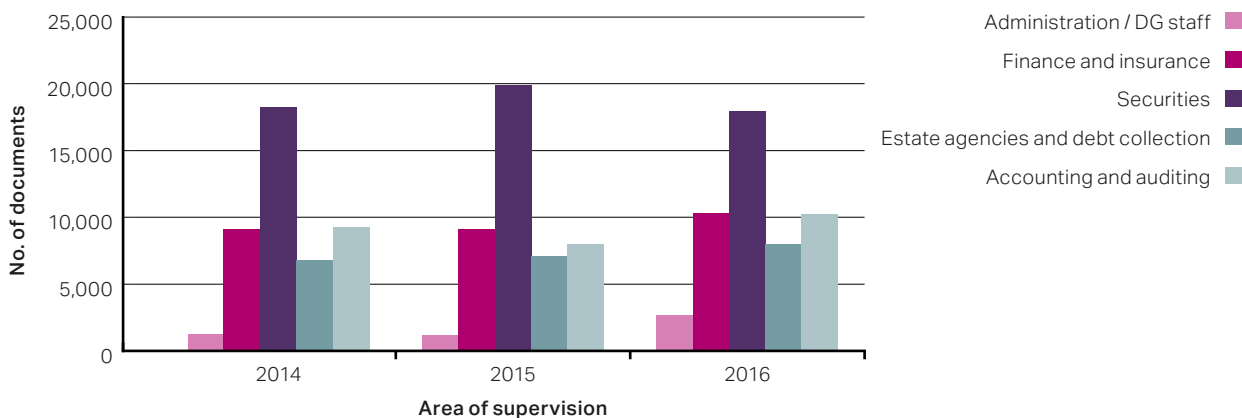
## Finanstilsynet: facts and figures

*The number of employees showed no change in 2016, and at year-end the permanent staff totalled 270. 53 per cent of the permanent staff are women. The management team comprised equal proportions of women and men at year-end. Women made up 52 per cent of all staff with managerial responsibilities.*

*The Director General's salary at the end of 2016 totalled NOK 1,545,000. Fixed annual remuneration to the Board Chair was NOK 262,000, to the Deputy Chair NOK 177,000, and to each board member NOK 153,000. Remuneration to the first alternate was NOK 129,000, and to the second alternate NOK 108,000.*

The number of incoming and outgoing documents registered rose by almost 4,000 from 2015 to 2016. The increase is due to several factors, among them a general increase in the number of licence applications processed in the estate agency area and in the number of complaints in the debt collection area. A larger number of external accountants' licences were deleted after a notification form for this purpose became available on the Altinn internet portal. The number of registered case documents related to securities funds also continued to rise in 2016. This is due to the expansion of Finanstilsynet's remit in the securities area to include supervision of managers of alternative investment funds (AIFs). Moreover, a large increase in electronic submissions via Altinn generates a larger number of automatic replies to senders, also contributing to the increased number of case documents.

**Chart 1: Document processing**



	2014	2015	2016
Total case documents	44,518	45,195	49,143

**Table 2: Overview of supervised entities as at 31 December 2016**

	2012	2013	2014	2015	2016
Savings banks	109	106	105	104	125
Commercial banks	17	18	19	22	
Finance companies	52	54	55	57	25
Mortgage companies**					34
Foreign branches of Norwegian banks and other credit institutions	16	17	18	7	18
Norwegian branches of foreign banks and credit institutions	42	42	40	41	39
Savings bank foundations and financial foundations	23	25	25	25	30
Payment institutions	22	21	14	15	15
E-money institutions	2	2	3	4	6
Life insurers	12	12	13	13	13
Non-life insurers, incl. local fire insurance associations***	62	59	59	60	59
Local marine insurance associations	12	11	10	9	6
Norwegian insurers' branches abroad	16	15	15	13	13
Foreign insurers' branches in Norway	36	34	31	32	29
Insurance intermediaries <sup>1</sup>	96	97	102	102	107
Private pension funds	56	51	52	49	48
Municipal pension funds	32	33	38	39	39
Defined benefit pension providers				1	1
Pension funds	5	5	4	4	4
Holding companies	12	12	11	14	17
Investment firms	136	129	106	114	107
Norwegian branches of foreign investment firms	23	21	22	22	19
Fund management companies	32	31	30	30	31
Alternative investment fund managers (AIFMs)				15	35
Central counterparties****	3	3	4	3	4
Norwegian Central Securities Depository	1	1	1	1	1
Regulated markets, incl. stock exchanges	4	4	5	5	5
Auditors	6,704	6,973	7,191	7,380	7,570
Audit firms	600	563	533	516	488
External accountants	11,128	11,611	11,500	11,558	11,185
External accounting firms	2,862	2,853	2,858	2,835	2,785
Estate agency firms	517	508	499	500	503
Lawyers' practices that include estate agency	1,329	1,325	1,278	1,238	1,164
Debt collection agencies	94	98	98	100	103
Debt purchase businesses	4	5	4	4	3

<sup>1</sup> Insurance agent firms that distribute insurances exclusively for insurers with offices in Norway are not included in this overview, nor are entities engaged in accessory insurance agent business.

\* As from 2016 commercial banks and savings banks are combined in the category 'banks'.

\*\* As from 2016 the category finance and mortgage companies is split into separate categories.

\*\*\* As from 2016 local fire insurance associations are included in the category non-life insurers.

\*\*\*\* Central counterparties correspond to clearing houses.

Finanstilsynet also oversees the financial reporting of 259 listed firms and supervises 412 securities funds. It also maintains limited supervision of 69 registered AIFMs.



**Table 3: Number of on-site inspections by type of institution - incl. IT inspections**

	2012	2013	2014	2015	2016
Banking/finance	51	63 <sup>1</sup>	67 <sup>2</sup>	54 <sup>3</sup>	53 <sup>4</sup>
Payment institutions and e-money institutions	–	–	1	1	3 <sup>5</sup>
Insurers	8	8	13	9	12 <sup>6</sup>
Insurance intermediaries	3	5	3	2	3
Pension providers and funds	6	5	3	2	2
Investment firms	17	12	11	17	8
Other securities institutions <sup>7</sup>	3	3	3	2	2 <sup>8</sup>
Infrastructure	2	–	–	1	4 <sup>9</sup>
Auditors	48	55	29	40	32 <sup>10</sup>
External accountants	60	46	50	43	40
Estate agencies	43	43	32	37	29 <sup>11</sup>
Debt collection agencies	11	11	3	6	7
Data processing centres / IT providers	3	1	2	–	–

<sup>1</sup> 47 ordinary inspections, 6 IT inspections and 10 inspections connected to IRB

<sup>2</sup> 45 ordinary inspections, 13 IT inspections and 9 inspections connected to IRB

<sup>3</sup> 32 ordinary inspections, 11 IT inspections and 11 inspections connected to IRB

<sup>4</sup> 34 ordinary inspections (of which 7 were thematic inspections of operational risk, 6 were IRB inspections and 13 were IT-related inspections)

<sup>5</sup> One inspection was a pure IT inspection of a payment institution

<sup>6</sup> One inspection was a pure IT inspection, and four were on-site inspections at life insurers. Three of the latter concerned technical provisions under Solvency II

<sup>7</sup> Includes fund management companies and AIFMs

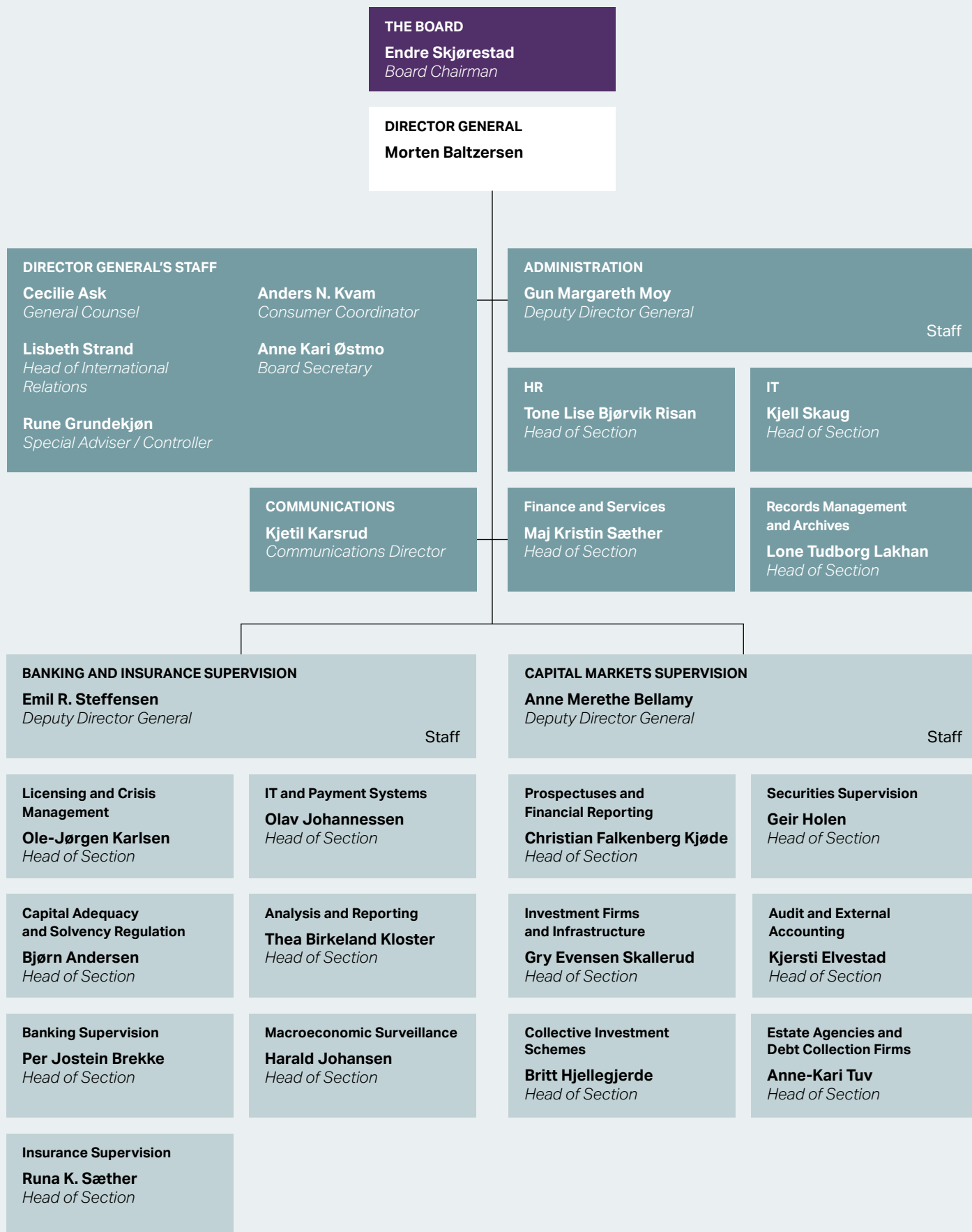
<sup>8</sup> One inspection was a pure IT inspection

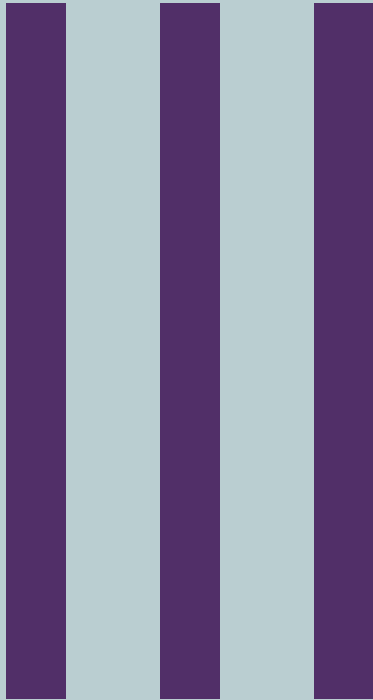
<sup>9</sup> Exclusively IT inspections

<sup>10</sup> One inspection was conducted jointly with the PCAOB

<sup>11</sup> Of these, 4 were inspections of lawyers. Three inspections were pure IT inspections

# Finanstilsynet's organisation





## **THE YEAR'S ACTIVITIES AND RESULTS**

**Consumer protection**

**Money laundering**

**Information and communication**

**International cooperation**

**Report from the supervised sectors:**

Banking and finance

Supervision of ICT and payment systems

Insurance and pensions

The securities area

Investment firms

Mutual funds and collective investment schemes

Market infrastructure

Market conduct rules

Prospectus control – transferable securities

Financial reporting enforcement – listed companies

Auditing

# THE YEAR'S ACTIVITIES AND RESULTS

## Mission achievement

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 to support each intermediate goal in the strategy. Tasks prioritised by the Ministry of Finance are also covered by these measures and tasks.

Finanstilsynet's strategy for 2015–2018 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. Their attainment will depend on decision takers and factors additional to the instruments that are available to Finanstilsynet.

Implementing the various measures and tasks that are described in the plan of operations provides an important basis for gauging mission achievement. This is the subject of a separate report to the Ministry of Finance. Finanstilsynet has in the main implemented the measures and tasks that were planned for 2016.



# Consumer protection

Consumer protection is an important factor in the development of rules for the financial market and in the supervision of financial services providers. Regulatory development and supervision are designed to safeguard the interests of consumers who purchase financial services.

Consumer protection is at centre-stage in the statutory regulation of the financial market and in the supervision of various financial services providers in the banking, insurance and securities markets. Solid, well capitalised financial institutions and well-functioning financial markets are fundamental consumer interests, both for the community and for the individual. At the same time it is important for consumers to be well protected when purchasing and selling financial products and property, and to be able to base their decisions on good information and neutral advice.

Finanstilsynet works with the Consumer Ombudsman, the Consumer Council and the Competition Authority to achieve better consumer protection in the financial sector.

Consumer protection is also an important task of financial supervision in other countries and in international activities, and Finanstilsynet works closely with the European supervisory authorities in developing new consumer-related regulations.

## Topical consumer issues:

### **PRIIPs**

Finanstilsynet, on commission from the Ministry of Finance, has drawn up a consultation document proposing rules governing key information to be provided to investors in packaged retail and insurance-based investment products (PRIIPs). The rules will apply to the banking, insurance and securities sector and will implement common European rules.

### **Invoicing of credit card debt**

In spring 2016 Finanstilsynet's guidelines for invoicing of credit card debt were revised and tightened. Finanstilsynet announced at the same time that if institutions failed to comply, Finanstilsynet would start the process of enshrining the guidelines in regulations. A thematic series of inspections in autumn 2016 revealed that many institutions were not complying with the guidelines' requirement to enter the total credit outstanding in the invoice payment field. To improve compliance monitoring, Finanstilsynet recommended adopting the guidelines as regulations. The Ministry of Finance circulated the proposal for comment with the deadline for response set at 9 January 2017.

### **Settlement of property transactions**

On commission from the Ministry of Finance a working group headed by Finanstilsynet looked into the risk inherent in the settlement arrangements presently employed by estate agencies and recommended rule changes.

### **Life insurance/pensions – circular on information and advice to policyholders**

Finanstilsynet's circular 14/2016 clarifies insurers' obligations to policyholders in terms of information and advice, including advice regarding conversion to unit-linked paid-up policies.

### **Reporting of forbearance**

Finanstilsynet conducted a thematic series of inspections to chart banks' use of forbearance. See page 29.

### **Market warnings**

Finanstilsynet published six warnings on its website against foreign entities that had provided financial services in Norway without the requisite authorisation, and 434 warnings from foreign supervisory authorities.

### **Thematic inspection of the CFD market**

Finanstilsynet conducted eight inspections at investment firms whose main business was the marketing and sale of financial contracts for difference (CFDs). Finanstilsynet considers such instruments to be little suited to consumers. Two institutions lost their licence. For further details see page 44.

# Money laundering

## General

Based on its assessment of the risk of money laundering and terrorist financing through supervised institutions, Finanstilsynet published a new guidance on the obligations imposed by the anti-money-laundering legislation on financial institutions, investment firms and asset management companies. Relevant industry organisations contributed inputs. A separate guidance has been published for estate agents.

Finanstilsynet in conjunction with the Ministry of Foreign Affairs, the Norwegian Police Security Service, the National Authority for Investigation and Prosecution of Economic and Environmental Crime (ØKOKRIM) and the financial industry have prepared a guidance on financial sanctions. The guidance covers the financial restrictions in Norwegian legislation that build on sanctions from the UN Security Council and restrictive measures from the EU.

## Law commission

The Ministry of Finance appointed in 2015 a commission to review the anti-money-laundering legislation to ensure that it complied with EEA legislation and international standards. Finanstilsynet was represented on the commission. The commission's remit came to a close with the delivery of its second interim report on 16 December 2016.

## Supervision

Institutions' compliance with the anti-money-laundering (AML) legislation is an integral concern of all ordinary on-site inspections in the banking area. The results from the inspections show that banks' ICAAP processes are paying increasing attention to the risk of money laundering and terrorist financing. Even so, inadequate compliance with internal policies is frequently uncovered. In 2016 an additional, special, inspection was conducted at a bank focusing on compliance with the anti-money-laundering legislation. The result of the inspection will be presented in 2017.

Compliance with the AML legislation was an aspect of on-site inspections held at five non-life insurers and three insurance intermediaries in 2016. The inspections brought to light flaws in the institutions' risk assessments and procedures.

Finanstilsynet has followed up investment firms' compliance with the regulations. Finanstilsynet's growing attention to money laundering issues has uncovered deficiencies and weaknesses related to the carrying out and documentation of risk assessments, documentation of customer due diligence, and investigation and reporting of suspicious transactions.

Though its work on business conduct cases in the securities market, deficiencies were brought to light by AML checks on some new accounts opened with the Norwegian Central Securities Depository (the VPS). This was followed up on by the VPS through letters to the account operators concerned.

In 2016 a survey was conducted of auditors' and external accountants' compliance with the AML legislation. The result of the survey will be reflected in a guidance to auditors and external accountants in the AML area. The guidance will be completed in 2017.

Finanstilsynet carried out in December 2016 special inspections addressing estate agency firms' compliance with the AML legislation. Such inspections were carried out at eleven estate agencies. The inspections will be brought to completion in 2017.

Finanstilsynet also carried out on-site inspections at two payment institutions and one e-money institution. Compliance with the AML legislation was the theme on all three occasions. These inspections will be brought to completion in 2017.

## Information and communication

Information and communication are one of four strategic instruments of the supervisory regime, along with supervision, monitoring and control, licensing and regulatory development. The information effort is directed in the first instance at entities and sectors under supervision but also the media and the general public.

Finanstilsynet has many areas of responsibility featuring extensive bodies of rules and complex issues that require a pro-active approach to information provision. The information and communication effort is based on the principles guiding the central government communication policy, and is accordingly a management responsibility in each area of supervision. A separate strategy for external communication is also a part of the basis for the communication effort.

### Communication directed at entities and sectors

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

A key channel of communication with supervised entities and individuals is letters written and distributed by Finanstilsynet each year. A total of 18,378 letters (outgoing documents) were sent in 2016 compared with 15,377 in 2015. A central aim is to communicate and inform in a clear and comprehensible language.

Rule clarifications, report-filing requirements and matters which entities and sectors must take on board are usually communicated in the form of circulars. Finanstilsynet issued 24 circulars in 2016 (18 in 2015). Finanstilsynet's circulars are also published on Lovdata Pro, operated by Lovdata (Norway's law database).

### Seminars and presentations

Seminars and presentations are an important part of Finanstilsynet's communication with sectors under supervision. Each year, for example, Finanstilsynet organises a seminar for investment firms and asset management companies. Managers and staff at Finanstilsynet also give presentations at seminars and conferences under the auspices of supervised entities, trade organisations etc.

### Collaboration

Finanstilsynet has an extensive network of contacts, and meets regularly with collaborating public authorities in Norway and elsewhere, and with trade and professional organisations. See an overview of Finanstilsynet's key relations on page 21. Finanstilsynet conducts user surveys at regular intervals, none in 2016.

### General information activity

Twenty-eight press releases were issued over the course of the year (16 in 2015). Three press conferences were held, which were broadcast on internet TV. In June Finanstilsynet presented *Risk Outlook I 2016* and in December *Risk Outlook II 2016*. These reports analyse and review trends and risk in the financial market and potential sources of future stability problems in the Norwegian financial sector. In April Finanstilsynet presented the report *Risk and Vulnerability Analysis* on the use made of information and communication technology in the financial sector.

Media coverage of Finanstilsynet in 2016 reflected the strong increase in consumer lending and in the number of banks offering such loans. References to household debt and house prices continued throughout 2016. The situation of the paid-up policy company Silver also attracted attention. The media monitoring company Opoint registered 6,385 media entries in 2016 with references to Finanstilsynet (4,677 in 2015).

### Document access at Finanstilsynet

Finanstilsynet received a total of 2,116 requests for document access in 2016. 714 documents were not released since their entire content was barred from publication. This figure is slightly lower than the previous year. Most access requests are received via the public electronic mail journal (OEP), used by all central government agencies.

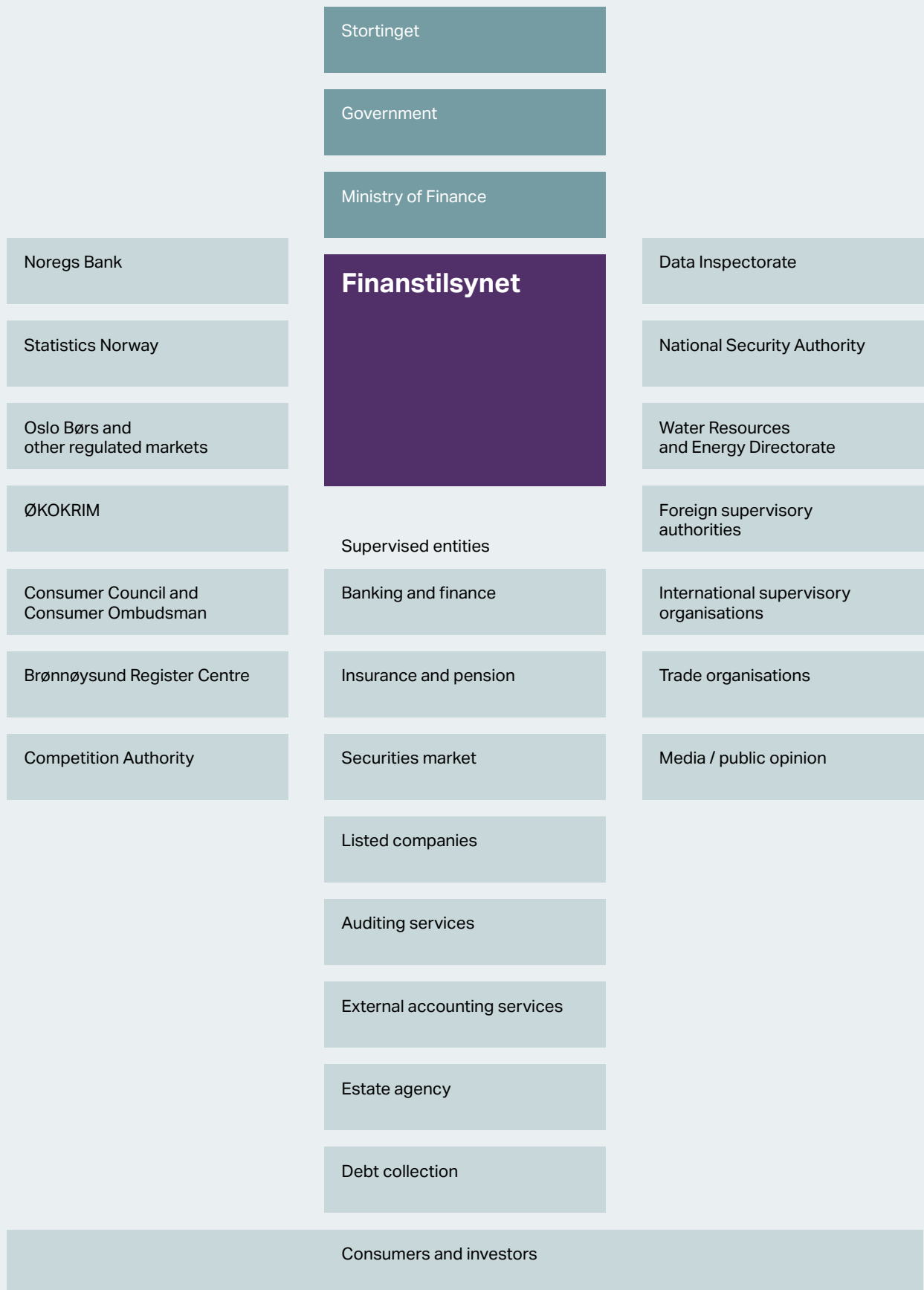
**Table 4: Requests for document access**

	2014	2015	2016
Orders placed	2,737	2,615	2,116
Not released	480	520	714

## 30th anniversary

Finanstilsynet marked its 30th anniversary in 2016. The anniversary featured inter alia a seminar drawing international and Norwegian speakers on 20 October 2016. *Learning from Crises*, a book authored by Finanstilsynet's previous Director General, Bjørn Skogstad Aamo, was launched in conjunction with the seminar. Finanstilsynet sponsored the publication of the book.

## Finanstilsynet's key relations



## International cooperation

Finanstilsynet and Norway are impacted by principles and rules in effect in the EU and across the world. Finanstilsynet also collaborates on supervision in the global and the EEA context. An important aim of cross-border supervisory cooperation is to identify risk factors present in firms and markets in the international financial market at an early stage. The supervisory cooperation also enables coordinated risk management measures to be put in place. An overview of Finanstilsynet's participation in international organisations can be found on page 24.

### Global collaboration

Global collaboration brings together countries and authorities to develop principles for regulation and supervision. After the financial crisis global institutions, headed up by the G20 countries, took the initiative in and coordinated principles for financial market reforms. The Financial Stability Board (FSB) monitors the implementation of the reforms.

In Europe the FSB has established the advisory body FSB Regional Consultative Group for Europe in which Finanstilsynet participates together with the Ministry of Finance and Norges Bank. Finanstilsynet has also contributed to the development of principles for regulations and supervision established by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO). Where auditor supervision is concerned, Norway participates in the global collaboration under the International Forum of Independent Audit Regulators (IFIAR).

### Framework for financial supervisory collaboration across the EEA

Collaboration on supervision and regulatory development in the financial sphere is largely administrated by the EU financial supervisory authorities:

- EBA – European Banking Authority
- ESMA – European Securities and Markets Authority
- EIOPA – European Insurance and Occupational Pensions Authority
- ESRB – European Systemic Risk Board (macroprudential supervision)

The EBA, ESMA, EIOPA and ESRB were established in 2011 as independent authorities. They help to coordinate the member states' exercise of financial supervision, monitor and manage risks, develop supervisory practices, draft proposals for relevant bodies of rules and coordinate and enforce those rules.

The EU and the EEA/EFTA countries have for several years negotiated on the EU supervisory authorities' formal role and powers within the framework of the EEA Agreement. A solution was arrived at in summer 2016, and on 30 September 2016 the EU Regulations that founded the new EU financial supervisory authorities were incorporated in the EEA Agreement.

Finanstilsynet is now a member of the three supervisory authorities in the EU for banking, insurance and securities supervision, and has the same rights and obligations as the national financial supervisory authorities of the EU states, but no voting rights. Finanstilsynet participates on an equal footing with other members in supervisory cooperation and regulatory development. The EU's financial supervisors can make recommendations and provide guidance to authorities and private market actors in the EEA/EFTA states. They may not, however, adopt binding decisions on authorities and market actors in the EEA/EFTA states. Any supranational resolutions are to be adopted by the EFTA Surveillance Authority.

The European Systemic Risk Board (ESRB) has overarching responsibility for macroprudential surveillance of the EU's financial system. Its mission is to ensure that risk build-up in the financial system does not threaten financial stability. Finanstilsynet has attended meetings of the ESRB's Advisory Technical Committee (ACT) as observer. The ACT is an advisory body to the ESRB's General Board. Following the EEA Joint Committee's decision of 30 September 2016, Norges Bank and Finanstilsynet are invited to attend meetings of the ESRB General Board subject to certain delimitations.

## Supervisory collaboration across the EEA

In 2016 Finanstilsynet participated in supervisory activities and regulatory development under the auspices of the EBA, ESMA and EIOPA. This involved inter alia gathering and analysing information from institutions and markets, preparing recommendations and participating in supervisory colleges that oversee large cross-border conglomerates.

Finanstilsynet has also played its part in the European supervisory authorities' peer reviews.

## Regulatory development in the EEA

The EBA, EIOPA and ESMA assist the EU Commission in developing rules for the financial area. This includes drafting technical standards that the EU Commission can subsequently adopt as Regulations. Finanstilsynet participated in this work in 2016 as previously.

More than 200 EEA-relevant Directives and Regulations adopted in the financial markets area are not yet part of the EEA Agreement. Now that a solution is in place in the EEA Agreement, the backlog of rules can be incorporated in the EEA Agreement under normal procedure. The EU and EFTA started this process in the final quarter of 2016 and will continue in 2017. Topical EU regulatory issues receive further attention in the chapters on the respective supervisory areas in this annual report.

The EU financial supervisory authorities adopted several guidelines in 2016. Finanstilsynet has published the guidelines on its website.

## Nordic and Nordic-Baltic cooperation

The Nordic region has an integrated financial market, and a number of financial institutions offer services in other Nordic countries through subsidiaries and branches. The Nordic countries meet annually at director general level, and hold regular meetings at departmental level for the various areas of supervision.

Finanstilsynet participates in the Nordic-Baltic Stability Group which draws 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 at systemically important cross-border financial institutions.

Finanstilsynet also participates in the Nordic-Baltic Macroprudential Forum (NBMF) and NBMF subgroups. The forum brings together the top management at central banks and financial supervisors and discusses macroprudential surveillance and other supervisory work in the Nordic-Baltic area. A corresponding Nordic collaboration has been established in the audit area where regulatory development and development of supervisory practices are at centre-stage.

**Table 5: International organisations and EU/EEA related committees in which Finanstilsynet participates or attends as an observer**

**Cross-sectoral meetings**

- Financial Stability Board (FSB) – Regional Consultative Group Europe
- European Systemic Risk Board – General Board and Advisory Technical Committee
- EU Commission Expert Group on Banking, Payments and Insurance
- EFTA Working Group on Financial Services
- Nordic supervisory meetings at director general level
- Nordic-Baltic Macroprudential Forum
- Nordic-Baltic Stability Group
- FinCoNet – Financial Consumer Network
- Project Link, the UN’s annual macroeconomic meeting
- Integrated Financial Supervisors Conference

**Banking/finance**

- Basel Consultative Group
- Macroprudential Supervision Group (Basel Committee)
- International Conference of Banking Supervisors (ICBS) – arranged by the Basel Committee every two years
- OECD’s Financial Markets Committee
- European Banking Committee (EBC)
- European Banking Authority (EBA)
- Nordic meetings on banking supervision

**Insurance**

- International Association of Insurance Supervisors (IAIS)
- European Insurance and Occupational Pensions Committee (EIOPC)
- European Insurance and Occupational Pensions Authority (EIOPA)
- International Forum of Insurance Guarantee Schemes (IFIGS)  
– Finanstilsynet attends as secretariat for the Guarantee Scheme for Non-Life Insurance
- Nordic supervisory meetings for insurance

**Securities and prospectuses**

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

**Accounting and auditing**

- International Forum of Independent Audit Regulators (IFIAR)
- Committee of European Auditing Oversight Bodies (CEAOB)
- Audit Regulatory Committee (AuRC)
- European Securities and Markets Authority (ESMA)
- Nordic collaboration

**Money laundering and financing of terrorism**

- Financial Action Task Force (FATF) – the international forum for measures for combating money laundering and the financing of terrorism, with its secretariat in the OECD
- Joint Committee’s Subcommittee on Anti-Money Laundering – a collaboration between the EBA, ESMA and EIOPA

**ICT supervision**

- Information Technology Supervision Group (ITSG)
- 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
- European Central Bank – SecuRe Pay (mobile payment security)
- European Banking Authority – project groups
- Nordic supervisory meetings for IT



## Report from the supervised sectors

# 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. The provision of financial services must be compliant with the regulatory framework and in the best interest of society and the users of financial services.

## Developments

Growth in the world economy has abated in recent years. Although growth is expected to pick up, the likely path of development is highly uncertain. Weak government finances in many countries provide little leeway for measures that can contribute to increased growth, and the scope for action in monetary policy is limited. Extraordinary monetary policy measures have brought a large liquidity injection and base rates are close to or below zero in several countries. Much of the liquidity is invested in financial and property markets and has helped to maintain or increase prices of property, stocks and bonds. Low interest rates have stimulated debt incurrence in the private and public sector alike. A protracted low interest rate could increase the financial imbalances.

Economic developments in Norway reflect reduced activity levels in the oil sector and in oil-related business. The oil price is considerably lower than prior to the onset of the price decline in 2014. The sharp fall in the oil price has brought a substantial weakening of profits and capital positions of businesses in oil-related industries. Business and industry in Mainland Norway apart from the south west are so far less affected, and much of the Norwegian economy shows sound growth. However, the debt servicing ability of companies in the mainland economy is not significantly better than during the financial crisis in 2008, and credit risk appears also to have risen in non-oil-related parts of business and industry.

Norwegian households' debt burden is at an historically high level and is high compared with other countries. House prices continued to rise steeply in 2016. Expectations of lasting low interest rates may contribute to continued high growth in house prices and indebtedness in the next few years, allowing a further increase in the debt burden. The historically low interest rate level entails a moderate interest burden for households. However, the interest burden will rise markedly should the interest rate level rise. The effect of higher interest rates is especially large when indebtedness is high. The longer debt accumulation lasts and the higher house prices rise, the greater the potential fall in the Norwegian economy. A sharp interest rate increase and a turnaround in households' expectations could produce large negative spillover effects to the economy.

## Consumer loans 2016

Loans to Norwegian households are largely residential mortgages. Consumer loans accounted for about 3 per cent of aggregate lending to households at the end of 2016, but increased significantly faster than households' overall debt.

At the end of 2016 twelve-month growth was 15.3 per cent compared with 10.0 per cent at the end of 2015. A small proportion of consumer lending goes to the under-30s. The share of consumer loans to this group was just over 8 per cent and has been relatively stable in recent years. Borrowers in the 40-49 age group accounted for the largest share of consumer loans, at close to 30 per cent. More than half of consumer loans went to borrowers between age 40 and 60.

Consumer loans are offered in the form of various products and include both card-based loans and other unsecured loans. The effective interest rate varies widely, depending on loan amount and repayment period, but is generally high. Good profits over a long period have made consumer lending a focal area for

a number of established companies. Consumer lending is also an attractive segment for new providers. Growth in consumer lending has outstripped the general growth in credit to personal customers in recent years.

Banks and finance companies refuse many loan applications. Refusal statistics for 2016 show that 61 per cent of 2.8 million applications were turned down. For credit cards the refusal rate was close to 40 per cent, whereas for other consumer loans it was 80 per cent. Even so, the strong lending growth gives grounds for concern.

Consumer loans account for a small portion of household borrowing, but may entail a heavy burden for individuals who take out such loans. Lenders should not underestimate the risk of loss. Defaults and losses on consumer loans must be expected to rise in the event of an increase in unemployment and necessary consolidation among households. Moreover, heavy involvement in consumer finance entails a reputational risk for banks and finance companies.

## Supervision and monitoring

### Monitoring and analysis

Finanstilsynet conducts regular analyses of developments in the financial industry, the markets and the real economy. In macroeconomic surveillance importance is attached both to the risk facing banks as a result of macroeconomic developments and the risk that the banks as a whole pose to the financial system and the economy. Finanstilsynet performs analyses of financial positions and credit and liquidity risk for finance companies, individual banks and the banking sector as a whole. Quarterly press releases summarise these analyses, which are also published in *Report for Financial Institutions* (Norwegian only) on Finanstilsynet's website. Each spring and autumn Finanstilsynet presents analyses of developments in financial institutions, markets and the real economy and other trends which may pose a risk to financial stability in the Norwegian market. The *Risk Outlook I* report was published in June 2016, and the *Risk Outlook II* report in November 2016. 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 banks, mortgage companies and finance companies in Norway report to ORBOF (a database for accounting information from banks, mortgage companies and finance companies) on which Finanstilsynet collaborates with Norges Bank (the central bank) and Statistics Norway. In addition, credit institutions report capital adequacy and liquidity positions etc. to Finanstilsynet under the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR). Finanstilsynet also obtains reports from savings bank foundations and financial foundations, payment institutions and electronic money institutions.

Reporting under CRD IV, which is fully harmonised, was introduced in Norway as from July 2014. CRD IV covers – in addition to capital adequacy reporting – financial reporting (FINREP), reporting of liquidity ratios (LCR, NSFR and ALMM), large exposures, leverage ratios and encumbered assets. The reporting requirements are constantly changing, and new reporting areas are added. This requires continuous adaptation and further development of the reporting material.

In recent years the European Supervisory Authorities have 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 collects data for Norwegian institutions, and is responsible for reporting on the situation among Norwegian institutions to the EBA.

## Facts

*At the end of 2016, 125 banks, 34 mortgage companies and 25 finance companies were licensed to operate in Norway. In addition Norwegian credit institutions had 18 branches abroad and foreign credit institutions operated 39 branches in Norway. 29 savings bank foundations and 1 financial foundation, 15 payment institutions and 6 electronic money institutions held a licence at year-end.*

Ongoing impact studies, in which Norwegian institutions participate, are conducted under EU auspices to assess the effect of the new regime and to tailor the final requirements.

### Financial soundness and profitability of Norwegian banks

Bank earnings in 2016 were lower than in the previous year, with return on equity down from 12.2 to 10.9 per cent. The decline in profit was primarily due to higher loan losses incurred by some of the largest banks. Substantial losses on loans to the offshore industry brought the level of losses for banks as a whole to 0.36 per cent of all outstanding loans, double the 2015 level. For medium-sized and small banks, which have negligible direct exposure to oil-related industries, loan losses were low, and only marginally higher than the previous year. Banks' net interest revenues showed an improvement compared with the previous year, mainly due to lower costs of funding, both securities funding and deposit funding. The decline in banks' financial results was dampened by substantial gains on the disposal of shares in Visa Europe in 2016.

The banks' overall common equity Tier 1 (CET1) capital adequacy ratio was 16.0 per cent at the end of 2016, up 1.3 percentage point from 2015. The increase from last year is due to an increase in CET1 capital resulting from profit retention and stock issues. The banks' aggregate risk-weighted assets showed virtually no change over the past year.

### Liquidity monitoring

Large Norwegian banks and mortgage companies obtain much of their funding in international money and credit markets. Conditions in these markets are liable to change rapidly, and refinancing during a crisis of confidence may be both costly and difficult. 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 scarcer liquidity. Covered bond issuance has played a part here.

Norwegian banks enjoyed good access to both short-term and long-term market funding in the past year. Risk premiums rose somewhat in periods of turbulence in international money and capital markets in 2016, inter alia in connection with the UK referendum on continued EU membership, and stabilised towards year-end at a level below that in effect at the start of 2016. However, on average risk premiums were higher in 2016 than in 2015.

Financial institutions that report weak liquidity and funding indicators are followed up on by Finanstilsynet, and in serious cases also through on-site inspections. Banks with poor indicator values in 2016 were after closer assessment followed up either directly or as part of the SREP process (see separate theme article).

## The SREP process

The Financial Institutions Act 2015 requires all financial institutions to perform an internal capital adequacy assessment (ICAAP) at least once each year. The intention is to ensure that financial institutions at all times have capital adequate to the risk and scale of the business. Institutions are required as a part of this process draw up a capital plan showing how their capital needs are to be met in the short and long term. The process itself and the results of the process must be documented in writing and reviewed by the board of directors.

The Financial Institutions Act 2015 also requires Finanstilsynet to review financial institutions' risk and capital needs. This is termed the supervisory review process (SREP). Finanstilsynet's circular no. 12/2016 from June 2016 describes the main elements in the SREP process. The circular builds on guidelines published by the European Banking Authority, EBA, in December 2014 and on clarifications set out in the Ministry of Finance's letter of 17 March 2016 to Finanstilsynet.

Finanstilsynet has since 2007 conducted SREP processes and given feedback to the banks on their capital need assessments. As from 2016 the feedback is in the form of a formal decision on individual capital charges for Pillar 2 risks, i.e. risks not covered, or only partially covered, under Pillar 1. Institutions first receive a preliminary supervisory assessment of their need for Pillar 2 capital beyond the minimum requirement and the buffer requirements under Pillar 1. The feedback also includes Finanstilsynet's assessment of institutions' liquidity risk and funding risk. Institutions' managements are invited to comment on the assessments before a final decision is made on a Pillar 2 requirement. The final SREP communication sets out Finanstilsynet's decision on a Pillar 2 requirement, which is legally binding. These decisions are published consecutively on Finanstilsynet's website.

The frequency of Finanstilsynet's review of institutions' risk and capital needs assessments is tailored to the particular institution's size, complexity, field of operation, and the degree of risk the institution poses to the

financial system. Institutions are divided into four groups. For institutions in group 1, which includes the three systemically important financial institutions in Norway, the SREP process is annual. Institutions in group 2, which currently numbers 21 institutions, will receive a SREP feedback with an individual capital charge every second year, while institutions in groups 3 and 4, with total assets above and below NOK 3 billion respectively, will be subject to a SREP review every third year. For banks with subsidiaries in other EU/EEA countries or forming part of a financial group headquartered in another EU/EEA country, the SREP process is rooted in a joint decision reached by the supervisory authorities of the countries in which the banks operate.

Finanstilsynet's SREP reviews and setting of individual capital charges are based in the institutions' own internal capital adequacy assessment process (ICAAP), Finanstilsynet's own risk analyses and on-site inspections. An institution's capital need is determined based on an overall discretionary assessment supported by calculation methods described in enclosures to the circular mentioned.

In 2016 Finanstilsynet completed SREP processes for a total of 38 institutions, including the three systemically important institutions (group 1), 19 large regional institutions (group 2) and 16 smaller banks. Final decisions on individual Pillar 2 requirements have been made for 29 of these institutions.

The Pillar 2 requirements set by Finanstilsynet are grounded mainly in higher risk related to concentration risk, growth and portfolio quality in the credit area, market risk (including property risk), operational risk, pension risk (risk related to employee pension liabilities) and owner risk (risk of loss on ownership interests in co-owned entities). The Pillar 2 decisions resulted in several banks having to increase their common equity Tier 1 (CET1) capital. A majority of the banks met the requirements at the end 2016 through profit retention. Some weakly capitalised banks carried out capital increases in 2016, and a further few banks are expected to supply fresh CET1 capital in 2017.

### On-site inspection

Institutions are selected for on-site inspection on a risk basis.

A total of 34 online inspections were conducted in 2016 at banks, mortgage companies and finance companies. Seven of these were thematic inspections focusing on operational risk. In 2015 32 inspections were conducted. In addition Finanstilsynet, together with other supervisory authorities, participated in several inspections of the Nordea Group. Due to high activity related to the SREP processes and evaluation of recovery plans, the number of on-site inspections was reduced compared with previous years.

In addition to the above-mentioned on-site inspections, 13 on-site inspections focusing on IT infrastructure, disaster solutions, outsourcing and access management were carried out. Moreover, six on-site inspections were conducted to follow up on IRB-approved banks<sup>1</sup>. A further three IRB inspections are to be carried out early in 2017. In addition to on-site inspections at banks, mortgage companies and finance companies, Finanstilsynet carried out three on-site inspections at payment institutions and e-money institutions.

On-site inspections give much emphasis to overall management and control. Recent years have seen increasing weight given to adequate separation between control and executive functions. As from 2014 all banks were required to have in place a dedicated risk control function, and a compliance function was required as from 2016. Several supervisory reports point to a lack of separation of control and executive functions. Finanstilsynet published in February 2016 a new module for operational risk. The module gives banks an overview of factors to which Finanstilsynet assigns importance in connection with on-site inspections.

On-site inspections are important with a view to identifying problem institutions or problem areas at institutions. On-site inspections also provide an opportunity to engage in a close dialogue with management and board of directors as early as possible to enable necessary action to be taken in an effective manner.

### Overall risk assessment at large banks

The largest institutions are subject to regular inspections and are given priority in the inspection programme. Much of the inspection activity focuses on the three systemically important institutions (group 1). Group 2 institutions are also subject to annual wide-ranging overall risk assessment. In 2016 Finanstilsynet conducted an additional nine on-site inspections of group 2 banks. Three of these were general inspections covering all risk areas, four mainly covered the credit area, while the remaining two were confined to specific risk areas. Finanstilsynet gave much attention in the past year, as previously, to the credit area in order to identify

at an early stage shortcomings related inter alia to loss and write-down assessments, exposure monitoring and negative portfolio migration. Finanstilsynet also paid close attention to banks' exposures to particularly vulnerable industries, above all the offshore industry.

In addition to remarks related to credit risk, shortcomings were pointed out at several banks related to their corporate governance, including control functions. Attention was also drawn to a need for better management and control of operational risk, including compliance with the anti-money laundering legislation.

### Small and medium-sized banks and finance companies

Finanstilsynet conducted a total of eleven risk-based inspections at small and medium-sized entities in 2016. Ten of the on-site inspections at small and medium-sized banks are general inspections covering all risk areas.

## Thematic inspections

### Follow up of forbearance reporting

As from the third quarter of 2014 banks have included forbearance exposures in their financial reporting (FINREP). In 2015 Finanstilsynet obtained extra information from eight individual banks in order to review their definitions of forbearance and to illuminate the technical systems used by them to manage such exposures. The review revealed a need to clarify the criteria for determining when forbearance should be deemed to have been granted. In September 2016 Finanstilsynet published an updated guidance on FINREP reporting with recommendations regarding the basis for classifying forbearance exposures. The guidance also contains an information update from the EBA. Finanstilsynet will monitor institutions' application of the new criteria through on-site inspections.

### Follow up of offshore exposure

Finanstilsynet surveyed in autumn 2015 and spring 2016 five selected banks' exposure to the offshore sector. The offshore includes in this context portfolios in the rig and supply segments. For the five banks combined the offshore portfolio accounted for about 6 per cent of the overall corporate portfolio. Between the first and third quarters of 2016, overall write-downs increased from 2.3 per cent of the supply and offshore exposure to 6.1 per cent. At the end of 2016 there was still no improvement in market prospects. Finanstilsynet accordingly anticipates further increases in write-downs of the banks' offshore portfolios in the coming quarters.

<sup>1</sup> Internal ratings based approach (IRB): Banks can apply for permission to use internal models to calculate the capital charge for credit risk.

### Stress testing of liquidity and funding risk

In autumn 2015 Finanstilsynet conducted a thematic inspection of the use made of stress testing as part of the risk management regime in the liquidity risk area at five large banks. The synoptic report of the experience gained from the thematic inspection was published in August 2016. Finanstilsynet's feedbacks to the banks largely turned on the content and structure of the analyses, stringency of the testing and the application of the stress test results. The thematic inspection showed that banks employ differing stress tests and organise the work differently, but that they have an awareness of the importance of conducting stress tests in the liquidity risk area and an interest in further developing and improving their stress tests.

### Thematic inspection on operational risk – incident management

In autumn 2016 a thematic inspection of operational risk management was conducted at seven banks. The inspection mapped the banks' handling of undesired events and of how information on such incidents is used in the banks' planning, management and control of operational risk. The inspection revealed a need for all seven banks to further develop and improve their incident management. Preliminary and final reports to the banks and a public synoptic report from the thematic inspections will be completed in the first half of 2017.

### IRB inspection

Twelve Norwegian institutions have Finanstilsynet's permission to use the IRB approach to calculate capital charges. Finanstilsynet granted no new permissions in 2016, but handled several applications to modify IRB systems. As part of its follow up of the IRB institutions, Finanstilsynet annually inspects on-site the institutions' use of the IRB system and their validation of the models. In the period November 2016 to February 2017 Finanstilsynet conducted inspections at nine institutions. Central themes were validation, criteria for forborne exposures and disclosure of financial information (Pillar 3 in the capital adequacy legislation).

### Recovery plans

As a preventive measure against solvency crises, all banks are required to draw up a recovery plan indicating what steps the bank can take to restore its financial position in a situation where its financial position is vulnerable. Finanstilsynet considers whether each bank's recovery plan is of adequate quality and realistic.

In 2016 Finanstilsynet reviewed the DNB Group's recovery plan and the recovery plans of a further six large banks. Finanstilsynet also provided input to other countries' supervisory authorities' assessment of the recovery plans for Nordea, Danske Bank, SEB, Santander and Handelsbanken.

### Compliance with the residential mortgage lending regulations

According to the residential mortgage lending regulations, a report must each quarter be filed with the board of directors of the banks showing the proportion of mortgages granted that are not in conformance with the regulations' requirements on servicing capacity, loan-to-value ratio or instalment repayments<sup>1</sup>. Since the regulations' entry into force on 1 July 2015 Finanstilsynet has obtained such reports for 19 of the largest residential mortgage banks, including three branches of foreign banks. In addition, reports to the board of directors of a selection of smaller banks have been obtained on a test basis and in connection with on-site inspections.

In the second quarter of 2016 one of the 19 banks exceeded the regulations' non-conformance ceiling of 10 per cent. All 19 banks were otherwise below that ceiling throughout the year. The overall non-conformance share for the 19 banks all told fell from 10.3 per cent in the third quarter of 2015 to 5.7 per cent in the fourth quarter of 2016. The reports show wide variation in the use made by the banks of the flexibility allowed by the regulations.

New requirements added to the residential mortgage lending regulations entered into force on 1 January 2017; see under Regulatory development.

### Residential mortgage lending survey 2016

Finanstilsynet has conducted residential mortgage lending surveys since 1994. The survey is designed to capture trends and developments in banks' residential mortgage lending, not to ascertain their compliance with the home mortgage lending regulations. Monitoring compliance with the regulations is done through on-site inspections and by reviewing reports submitted to boards of directors.

In autumn 2016 the 30 largest banks (Norwegian and foreign) reported data on just under 8,000 repayment mortgages and lines of credit secured on residential property granted after 15 August 2016. The banks reporting to Finanstilsynet altogether accounted for just under 88 per cent of residential mortgages in Norway.

The autumn 2016 residential mortgage lending survey indicated that the banks had eased their requirement on borrowers' debt servicing capacity. Compared with the previous year, a larger proportion of repayment mortgages was granted to borrowers who lacked sufficient income to cover debt servicing and normal living expenses after an interest rate hike of 5 percentage points; see table 6. The increase was particularly large in the case of young borrowers. For lines of credit the proportion was unchanged from the previous year; see table 7. The proportion of repayment mortgages granted with a loan-to-value ratio above 85 per cent was somewhat lower than in previous years. The banks also tightened their lending practice with regard to interest-only mortgages. The proportion of non-conformance

<sup>1</sup> As from 1 January 2017 the reporting obligation includes mortgages with a debt to assets ratio above five.



with the three requirements should be viewed in light of the flexibility available to the banks under the regulations.

Total debt relative to gross income (debt-income ratio) rose markedly compared with previous years, and most in the case of young borrowers. The survey also showed an increase in the volume of high loan-to-value mortgages going to young borrowers compared with

2015. The survey findings suggest that households taking out new mortgages have become more vulnerable, in particular the under-35s. Part of the reason may be that unprecedented low interest rates enable borrowers to service larger debt, but at the risk of underestimating the vulnerability associated with an interest rate hike and lapse of income.

**Table 6: Breakdown of repayment mortgages, in per cent**

	2014	2015	2016
LTV ratio above 85 per cent	19	16	15
LTV ratio above 85 per cent incl. additional collateral	10	7	5
Insufficient debt servicing capacity (5 pp interest rate increase)	4	2	4
Interest-only above 70 per cent	12	9	7

**Table 7: Breakdown of lines of credit, in per cent**

	2014	2015	2016
LTV ratio above 70 per cent	12	13	11
LTV ratio above 70 per cent incl. additional collateral	8	6	4
Insufficient debt servicing capacity (5 pp interest rate increase)	2	1	1

### Financial reports meetings

Again in 2016 Finanstilsynet held semi-annual meetings with the management of the largest banking groups at which the banks presented their results along with updates on key risk factors. They also briefed Finanstilsynet on trends in the markets in which the banks operate and on organisational matters and strategic considerations. The meetings are seen as a useful channel for communication and as a link between Finanstilsynet's and the banking groups' management teams.

### Meetings with branches of foreign credit institutions

Meetings were held over the course of the year with the senior management of a number of branches of foreign banks holding significant shares of the Norwegian market.

### Supervisory collaboration

The supervision of large individual banks operating in several countries is coordinated through supervisory colleges in which the relevant countries' supervisory authorities may be represented. Finanstilsynet is the coordinating authority for the DNB supervisory college, in which eight other supervisory authorities participate. The work of the college follows guidelines issued by EBA.

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

## Licensing

### Licence applications in 2016

Over the course of 2016 Finanstilsynet received a number of applications for permission to establish banks to provide consumer finance. Finanstilsynet does not permit banks to set up business at margins too close to the established minimum requirements. In recent years the CET1 requirement for new banking licence applicants has therefore been raised by 2 percentage points. Banks under establishment today are considered to face further heightened risk, particularly in view of the increased offering in the market. An ever expanding supply side may increase the risk of more borrowers taking out loans they are unable to service, thereby adding to the credit risk. Finanstilsynet has for that reason added 2 percentage points to the minimum CET1 requirement for start-up banks intending to engage mainly in consumer finance. This brings the overall capital adequacy requirement to 19 per cent, of which CET1 capital accounts for 15.5 per cent, based on current buffer requirements.

Instabank ASA was granted a licence to operate as a bank in June 2016 and permission to commence trading in September 2016. The bank targets the market for consumer finance.

The finance company BB Finans AS received permission to convert to bank status (BB Bank) in December 2016. The bank will in the main offer consumer finance. The licence will not be valid until Finanstilsynet receives confirmation that the licence terms and conditions are met.

MyBank AS was granted a licence to set up as a commercial bank in December 2016. The bank will in the main offer consumer finance. Finanstilsynet received in January 2017 confirmation that the licence terms and conditions were duly met, and has granted the bank permission to start trading.

DeBank AS was granted a licence to set up as a commercial bank in December 2016. The bank will in the main offer operations finance to small and medium-sized business. The licence will not be valid until Finanstilsynet receives confirmation that the licence terms and conditions are met.

Maritime & Merchant Bank AS was granted a licence to set up as a commercial bank in January 2014. The licence has thus far not been put into use. In October 2016 the Ministry of Finance, having received an application from the bank and acting on Finanstilsynet's recommendation, authorised the bank to start trading with lower start-up capital than that initially required. Permission to start trading was given in December 2016.

#### **Applications for exemption from the prohibition against holding more than one board position etc. in a group**

The Financial Institutions Act 2015 entered into force on 1 January 2016. The act precludes the board chair of a parent company of a financial institution from being a member of the board of that financial institution without Finanstilsynet's approval. Nor may the CEO of the parent company in a group be the CEO of a group subsidiary without Finanstilsynet's approval. The act's transitional provisions required institutions to meet the act's requirements within one year of its entry into force. DNB (Bank) ASA, SpareBank 1 Gruppen AS, Storebrand (Bank ASA), KLP (Bankholding AS), KLP (Banken) and Landkreditt (SA) received in 2016 time-limited approval from Finanstilsynet to derogate from the act's main provision.

#### **Nordea's conversion to branch status**

The Nordea Group applied in 2016 for permission to convert its subsidiary banks in Norway to branches of the Swedish parent bank Nordea Bank AB. Applications were concurrently filed with the authorities of Finland and Denmark to convert the Nordea Group's subsidiaries in those countries to branches. Finanstilsynet prepared the case for the Ministry of Finance. In its recommendation to the ministry, Finanstilsynet drew attention to significant economic objections to the conversion of a systemically important bank into a branch, but considered it doubtful that EU rules allow for rejection of the conversion application. On this basis Finanstilsynet recommended the Ministry of Finance to grant the application on certain conditions. Permission was duly granted by the ministry on 20 December 2016. The conversion went ahead on 2 January 2017. The subsidiary banks in Finland and Denmark were converted to branches on the same date.

## Regulatory development

### **Liquidity requirements under CRD IV / CRR**

The EU body of rules contains two quantitative liquidity requirements: a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR). Minimum LCR requirements were given effect in the EU as from 1 October 2015, with a gradual phase-in up to 2018. The EU Commission proposes, as part of the amendments to CRR/CRD IV, to introduce a minimum NSFR requirement of 100 per cent as from 2019.

The LCR rules were incorporated in the CRR/CRD IV regulations<sup>1</sup> with effect from 31 December 2015. Systemically important institutions must meet the LCR requirement at a minimum of 100 per cent. For other institutions the LCR requirement of 100 per cent must be fully phased in as from 31 December 2017.

The LCR requirement must be met for all currencies combined. Finanstilsynet proposed in September 2016 the introduction of general LCR requirements in significant currencies corresponding to the level for all currencies combined, with the exception of Norwegian kroner for institutions with the euro and/or US dollar as a significant currency. For such institutions Finanstilsynet proposes the introduction of an LCR requirement of 50 per cent in Norwegian kroner. The Ministry of Finance circulated the proposal for comment with the deadline for reply set at 31 January 2017.

### **The Basel Committee and the EU Commission's proposal for changes**

Basel III, agreed upon by the members of the Basel Committee in 2010–11, was in response to the international financial crisis. The new standards contained inter alia tighter requirements on own funds, and introduced capital buffers and liquidity requirements. The Basel Committee has since produced several stand-alone standards, among them a standard for large exposures, total loss absorbing capacity (TLAC), disclosure (Pillar 3) and a new standard for market risk. Remaining standards needed to complete Basel III comprise a new standardised approach for credit risk, a standard for use of the IRB approach, an output floor and operational risk. These have yet to be adopted.

The EU Commission published on 23 November 2016 proposals for changes to the CRR and CRD IV. The change proposals are partly a result of enabling provisions set out in the CRR and CRD, partly the inclusion of elements from Basel III (e.g. requirements on long-term funding and leverage ratio) and inclusion of other standards adopted by the Basel Committee. In addition changes are proposed to parts of the EU Bank Recovery and Resolution Directive (*BRRD*). The change proposals are under consideration by the EU. The changes are expected to take effect in 2019 at the earliest.

<sup>1</sup> Supplementary rules are laid down in Regulations on the calculation of liquid assets, cash outflows and cash inflows in the LCR.



### Leverage ratio

Both the Basel Committee and the EU plan to introduce a minimum leverage ratio requirement as from 1 January 2018. The requirement will supplement the capital adequacy charge calculated on risk weighted assets. The EBA sent in August 2016 a report to the EU Commission recommending the introduction of a minimum leverage ratio requirement of three per cent for all credit institutions as from 1 January 2018. The EU Commission forwarded on 23 November 2016 a proposal to introduce a leverage ratio requirement of three per cent as from 1 January 2018, in keeping with the EBA's recommendation. The Basel Committee is considering higher leverage ratio requirements for globally systemically important banks.

The Ministry of Finance asked Finanstilsynet by letter of 9 December 2015 to draft a consultation document and regulations on a leverage ratio. The draft a consultation document, forwarded in April 2016, recommended a minimum requirement of six per cent for banks, finance companies and investment firms and three per cent for mortgage companies. The Ministry of Finance circulated the proposal for comment on 12 April with the deadline for response set at 5 August 2016. The Ministry of Finance established on 20 December 2016 leverage ratio requirements to be met as from 30 June 2017. The minimum leverage ratio requirement is set at three per cent. All banks are required to maintain a leverage ratio buffer of at least two per cent. Systemically important banks are in addition required to maintain a tier 1 capital buffer of at least one per cent.

### Residential mortgage lending regulations

Finanstilsynet gave in September 2016, on commission from the Ministry of Finance, its assessment of the need to continue, in the event amend, the residential mortgage lending regulations. Finanstilsynet recommended, based on the risk of financial instability, amendments to the regulations with a view to achieving a clear, but not dramatic, tightening of lending practices.

Finanstilsynet recommended the following tightening measures:

- Removing the banks' opportunity to derogate from the regulations' requirements on servicing ability, loan-to-value ratio and principal repayments.
- Supplementing present requirements on servicing ability with a provision to cap overall debt at five times gross annual income.
- Reducing the maximum loan-to-value ratio for lines of credit from 70 per cent to 60 per cent.
- Extending the requirement of principal repayments to all mortgages with an LTV ratio above 60 per cent compared with 70 per cent under present regulations.

After circulation of the proposal for comment, the Ministry of Finance adopted new residential mortgage lending regulations on 14 December 2016. The regulations apply as from 1 January 2017 to 30 June 2018.

Several of Finanstilsynet's proposals were acted on. However, banks' opportunity to derogate from the requirements of the regulations was retained at 10 per cent of overall lending per quarter. In the case of residential mortgages on properties in the City of Oslo

the opportunity to derogate from the requirements of the regulations was capped at 8 per cent, or at NOK 10 million per quarter if this is a higher amount than 8 per cent of overall loans in the City of Oslo. A requirement that repayment mortgages on a second dwelling in the City of Oslo should not exceed 60 per cent of property value was also introduced.

### Nibor

A new Act on the fixing of reference interest rates entered into force on 1 January 2016. The act requires the fixing of generally used reference interest rates such as the Nibor to be organised in a satisfactory manner. The administrator (the party responsible for fixing the reference interest rate) and the organisation of the rate fixing process must be approved by the Ministry of Finance. Finanstilsynet will maintain supervision of the administrator and the latter's activity. On commission from the Ministry Finance, Finanstilsynet drafted regulations to supplement the reference interest rate act, based on the EU Regulation which is expected to be incorporated in the EEA Agreement (the Benchmarking Regulation). The Norwegian regulations entered into force on 16 on November 2016.

### Recovery and resolution

The EU Banking Recovery and Resolution Directive entered into force on 1 January 2015. The directive requires all banks to draw up recovery plans setting out specific, implementable measures for dealing with financial crisis situations. The plans are to be evaluated by national supervisory authorities. National resolution authorities will draw up resolution plans for financial institutions headquartered in their home country.

Institutions must meet a minimum requirement on own funds and eligible liabilities (MREL) that can be written down or converted to equity (be subject to bail-in) where a bank is in crisis. Deposits covered by deposit-guarantee arrangements will normally be protected against loss. Certain other types of liabilities are excluded from the scope of the bail-in requirement.

The Bank Law Commission presented on 26 October 2016 a draft version of statutory provisions to transpose the Recovery and Resolution Directive into Norwegian law. The Commission's submission also contains a proposal for the transposition of amendments to the EU's Deposit Guarantee Directive into Norwegian law.

The Bank Law Commission considers that the Crisis Management Directive's provisions on capital inadequacy and government-directed administration of institutions in the banking sector are essentially in line with the principles underlying existing regulation in the Financial Institutions Act 2015. The main new elements are requirements for recovery plans and resolution plans, rules on write-down of own funds or conversion of own funds to equity capital, and rules on eligible liabilities (bail-in). The establishment of a national resolution fund is a further new requirement. The Ministry of Finance is put forward as the resolution authority.

The Ministry of Finance circulated the Banking Law Commission's proposal for comment in October 2016 with the deadline for response set at 9 January 2017.

## Report from the supervised sectors

# Supervision of ICT and payment systems

## Developments in 2016

2016 saw fewer reports of serious incidents in central infrastructure compared with previous years. However, the year saw a larger number of reports of less serious incidents in parts of the payments infrastructure and payment services. Telecoms operators' importance for payment system accessibility is rising. New mobile payment systems are replacing cash and cards, but lack payment terminals' back-up solutions and may be vulnerable to disruption.

An increase was seen in internet banking fraud in 2016. Advanced phishing<sup>1</sup> continues to be the main technique used. Various forms of targeted fishing are also used by attackers perpetrating CEO fraud<sup>2</sup>, to which many of the banks' corporate customers were exposed in 2016. Payment card losses continued to rise in 2016, in particular on cards used to make internet purchases.

### Incident reporting

Finanstilsynet received 131 incident reports in 2016, about the same number as in the previous year. The Ministry of Finance was alerted on one occasion. There were a number of incidents in the banks' systems for monitoring transactions related to money laundering and terrorist financing. Debt collection agencies became subject to the incident reporting requirement in December 2015, and Finanstilsynet received three reports from such agencies in 2016.

### Supervision of IT and payment services

Finanstilsynet conducted 24 on-site inspections of IT and payment services in 2016. These inspections cover testing of disaster recovery solutions, outsourcing, anti-money-laundering (AML) surveillance, telephone logging and access control.

Three of the inspections focused on compliance with the banks' requirements on computer systems for reporting to the Norwegian Banks' Guarantee Fund. The outcome was still less than satisfactory for a number of banks.

### Outsourcing

Finanstilsynet received 27 notifications of outsourcing of ICT operations in 2016. A number of these concerned outsourcing to global actors such as Microsoft, Google and Facebook. Finanstilsynet pointed out that institutions must have in place agreement that ensure that both they and Finanstilsynet have the right of inspection required under the ICT Regulations.

### Payment systems

Finanstilsynet received 20 notifications from supervised entities of changed or new payment services in 2016. The majority concerned mobile-based solutions. Such solutions are increasingly used for person-to-person payments, invoice payments and point of sale (POS) payments. Some mobile application providers have launched their own POS solutions for processing electronic transactions. Finanstilsynet notes that the grocery trade actors have joined forces to develop a standardised POS solution for both payment cards and smartphones.

Finanstilsynet brought to light several shortcomings in the banks' compliance with guidelines on internet payment security in 2016, for example the absence of a function enabling the cardholder to block the card for internet use.

### Risk and vulnerability analysis (RAV)

Finanstilsynet's *RAV analysis* points up findings and observations made in the course of supervisory activities. It bases its description of the institutions' own assessments on the results from a questionnaire survey and interviews with institutions. The *RAV analysis* was presented at a press conference in April. In May Finanstilsynet organised, together with Norges Bank, a seminar at which the *RAV analysis* and Norges Bank's yearly report "*Financial Infrastructure 2016*" were presented.

### Licensing and legislation

Regulations on interchange fee regulation (IFR) between payment card schemes entered into force on 1 September 2016. Finanstilsynet started drafting regulations to transpose the EU's Revised Payment Services Directive (PSD2) into Norwegian law in 2016.

Finanstilsynet published in April 2016 a new guidance on estate agents' compliance with the ICT regulations.

<sup>1</sup> Disguising as a trustworthy entity and asking for information from someone who surrenders the information in full confidence.

<sup>2</sup> CEO fraud: impersonating a company executive in order to trick an employee in accounts into transferring money to anomalous accounts.

**Emergency preparedness**

Finanstilsynet is secretariat to, and heads, the Financial Infrastructure Crisis Preparedness Committee (BFI). The BFI held three meetings and two emergency preparedness exercises in 2016. Finanstilsynet participated in an exercise under the auspices of the Norwegian Directorate for Civil Protection. The theme was a cross-sectoral cyber attack targeting institutions in the financial sector.

Finanstilsynet drafted in collaboration with Norges Bank provisions regulating banks' responsibility for assuring preparedness for cash distribution.

**Report from the supervised sectors**

# Insurance and pensions

Insurers and pension providers are key actors in the financial markets due to their substantial investment of capital under management. Market developments thus have a major influence on institutions' performance. Regulation and supervision of the insurance and pension sector are important in safeguarding customers' rights under insurance and pension contracts, and in instilling public confidence in the insurance market. The supervisory regime aims to foster financially solid, risk-aware institutions with sound governance and control.

## Developments in 2016

Since life insurers and pension funds invest much of their managed assets in securities markets, developments in these markets are of great significance to their profits and financial strength. Although the share of unit linked defined contribution pensions is growing, the bulk of pension providers' liabilities still comprise contracts providing a guaranteed annual rate of return, and a lasting low interest rate level thus poses a major challenge.

Global government bond yields fell to unprecedented low levels after a further decline in the first half of 2016. At the start of July the fall was replaced by an increase in yields. The increase continued in the fourth quarter, largely driven by a steep rise in US yields following the presidential election. The increase in US yields has fed through to Norwegian and other countries' fixed income markets. Global equity markets rose by about 5 per cent in the third quarter and continued to rise in the fourth quarter. Norwegian and international equity markets rose for 2016 as a whole, and the same applies to Norwegian and US government bond yields. This contributed to stronger results for pension providers in 2016 than in 2015.

## Supervision and oversight

### Monitoring and analyses

Monitoring and analyses of developments in the economy and markets provide the background for Finanstilsynet's assessment of the general state of the financial sector and its supervision of individual institutions.

Finanstilsynet prepares quarterly reports on profitability, financial strength and balance sheet composition of life insurers and non-life insurers, while reports for pension funds are half-yearly. Quarterly press releases summarise these analyses, which are also published in *Report for Financial Institutions* (Norwegian only) on Finanstilsynet's website. Overall assessments of the situation in the financial sector and of various risks faced by Norwegian financial institutions were published in the spring 2016 report *Risk Outlook I* and the autumn 2016 report *Risk Outlook II*.

### Reporting

The reports filed by institutions are an important basis for analyses and on-site inspections. Solvency II was implemented for insurers on 1 January 2016. It brings a new reporting set-up. In addition to Finanstilsynet's use of data from the Solvency II reporting for supervision and analysis purposes, the data are sent to the European Insurance and Occupational Pensions Authority (EIOPA). Compilation, revision and organisation of data involved a wide-ranging effort in 2016, which will continue in the years ahead. Solvency II does not apply to pension funds. However, since 2012 pension funds have reported their stress tests based on the Solvency II valuation principles, and the semi-annual reporting of these stress tests is retained.

### Norwegian insurers' and pension funds' financial strength and profitability

Interest revenues account for a significant portion of insurers' overall financial revenues and have traditionally been a relatively stable revenue source. However, the current low interest rate level makes it difficult for insurers to achieve return above the guaranteed minimum return. Although the share of unit linked defined contribution pensions is growing, the bulk of life insurers' liabilities still comprise contracts providing a guaranteed annual rate of return.

Insurers still hold a substantial proportion of bonds maturing several years ahead, and carrying interest rates higher than the current market rate. Assuming no change in the market interest rate, these bonds will be reinvested at a lower rate of interest upon maturity, which will reduce interest revenues ahead. In 2016 life insurers' unrealised gains were somewhat lower than in the same period of the previous year. Life insurers posted in aggregate a realised loss on financial assets in 2015 and a realised gain in 2016.

Solvency II has brought substantial changes for insurers both in terms of capitalisation and systems. The challenges are particularly large for life insurers since, in contrast to the previous solvency framework, both assets and liabilities are measured at fair value. With today's low interest rate level, this entails a substantial increase in the value of the liabilities compared with the former regime. By building up buffers, reducing costs and adjusting risk, life insurers overall have strengthened their financial position so as to fulfil the new solvency capital requirement even without use of transitional measures for technical provisions.

Pension funds have a larger share of equities in their balance sheets than life insurers. Over time this has resulted in wide fluctuations in return. The equity market upturn in 2012 to 2014 brought substantially higher return for pension funds than in 2011 when the market trend was negative and the rate of return was low. As a result of the equity market upturn in 2016, value-adjusted return has risen and is higher than in the same period last year.

Non-life insurers recorded stronger results in 2016 than in 2015, mainly as a result of improved financial return. Their profitability, measured by the combined ratio, was at about the same level in 2016 as the previous year. Non-life insurers are generally well capitalised, and the introduction of Solvency II has posed negligible challenges to capital positions.

## Facts

*At the end of 2016 13 life insurers, 59 non-life insurers (including 15 fire insurers) and six marine insurance associations were licensed to operate in Norway. A further 13 branches of Norwegian insurers were operating abroad<sup>1</sup> and 29 branches of foreign insurers in Norway. 107 insurance intermediaries<sup>2</sup> were registered in Finanstilsynet's concessions register at the end of 2016. 48 private pension funds and 39 municipal pension funds held a licence at year-end.*

### On-site inspection

On-site inspections were conducted at four life insurers in 2016. The main theme at three of the inspections was the calculation and validation of technical provisions and capital charges under Solvency II. These inspections cover inter alia models and central assumptions underlying the institutions' solvency calculations that are important in ensuring the quality of the calculations.

On-site inspections were conducted at two pension funds in 2016. Both inspections were prompted by a weak financial position. The pension funds' management and control systems were also covered.

On-site inspections were conducted at six non-life insurers. The inspections addressed management and control – in particular preparation for the new Solvency II regime. In addition two group inspections were carried out that also apply to non-life and life insurers. The theme here was overall management and control, and compliance with the separation principle.

On-site inspections were conducted at three insurance intermediaries. Finanstilsynet addressed capitalisation, selection of insurance providers and compliance with the obligation to disclose information about commission, guarantee arrangements and the customer's right to complain.

Final reports from the inspections mentioned will be available in 2017.

<sup>1</sup> In the EEA area.

<sup>2</sup> The figures for insurance intermediaries do not include agent activities of insurers that keep their own agent registers.

### Financial reports meetings

Finanstilsynet holds semi-annual meetings with the managements 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 through subsidiaries or large branches is coordinated through supervisory colleges in which the various countries' supervisory authorities are represented. Finanstilsynet heads the supervisory college for Gjensidige Forsikring ASA and Storebrand ASA, and organised meetings in April and October respectively in 2016.

Finanstilsynet participates in supervisory colleges for the following foreign insurance groups operating in Norway: Danica pensjonsforsikring, Tryg A/S and Alpha Forsikring A/S (Denmark) and If and Nordea Life and Pensions (Sweden) along with Help Forsikring (Arag) (Germany).

### Foreign insurers placed into administration

Finanstilsynet has followed the situation of Norwegian customers of foreign insurers placed into administration in 2016.

Enterprise Insurance Company PLC, an insurer domiciled in Gibraltar and supervised by the Financial Services Commission of Gibraltar, was assigned a liquidator on 26 October 2016 upon being declared insolvent. The company had engaged in cross border insurance business from Gibraltar into Norway and is accordingly not a member of the Norwegian deposit guarantee scheme for non-life insurance.

Gable Insurance AG, an insurer domiciled in Liechtenstein and supervised by the Financial Market Authority Liechtenstein, was placed into administration on 10 October 2016. Responsibility for winding up the company is in the hands of PricewaterhouseCoopers AG. Gable had engaged in cross border insurance business from Liechtenstein into Norway and, like Enterprise, is not a member of the Norwegian deposit guarantee scheme for non-life insurance.

## Licensing

### Licence applications

In June 2016 Finanstilsynet granted the Gjensidige Group permission to wind down Gjensidige Pensjon og Sparing Holding AS and Gjensidige Bank Holding AS on certain conditions.

Watercircles Forsikring ASA started trading as a non-life insurer in October 2016 after receiving the requisite licence in August 2015.

In September 2015 Garantiforsikring AS was granted a licence to engage in credit insurance activity. The institution applied for permission to defer using its licence until September 2017. Acting on Finanstilsynet's advice, the Ministry of Finance rejected the application and instructed the institution to start using its licence by the end of 2016. The institution did not comply.

Finanstilsynet authorised the merger of three municipal pension funds: Andebu kommunale pensjonskasse, Stokke kommunale pensjonskasse and Sandefjord kommunale pensjonskasse with effect from 1 January 2017. This was prompted by the merger of the municipalities of Andebu, Stokke and Sandefjord. The merged pension fund will be known as Sandefjord kommunale pensjonskasse.

The marine insurance associations Lofoten Fartøyassuransforening Gjensidige and Bø Gjensidige Båtforsikringsforening Havbrott were merged with the marine insurer Nordlys Forsikring Gjensidige with effect from 1 January 2016. Six entities held a marine insurance association licence at the end of 2016.

### 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. Only one complaint was received in 2015, and is under consideration by the board.

## Regulatory development

### Solvency II – The European solvency framework for insurers

The new European solvency framework for insurers, Solvency II, entered into force on 1 January 2016. It brings new requirements on fair valuation of technical provisions and new risk-sensitive capital requirements, new requirements on insurers' system of risk management and internal control, and new requirements on reporting to the supervisory authorities and information disclosure. The new framework is implemented in Norway in the Financial Institutions Act 2015, the Solvency II Regulations and regulations supplementing the Solvency II Regulations. In addition, technical standards and recommendations have been established in the EU with more detailed rules and clarifications that also apply in Norway.

The new requirements on technical reserves and capital have brought substantial changes in prudential requirements. Requirements on life insurance products with a guaranteed return, in particular paid-up policies, are tightened. This is partly because technical provisions have increased since they are now valued using the market interest rate, and partly because the solvency capital requirement will now cover market risk related to the insurer's investments and liabilities. However, a transitional arrangement for life insurers means that the

increase in technical provisions upon the switch to the new framework can be phased in gradually over a period of 16 years.

Norwegian insurers have reported stress tests using a simplified version of the Solvency II rules since 2008 and have in general met the new requirements by a sufficient margin. One life insurer did not meet the requirements and was granted dispensation from the requirements in 2016.

Finanstilsynet conducted three on-site inspections in 2016 focusing mainly on institutions' calculations of technical provisions and capital charges.

In May 2016 insurers delivered their first reports under the Solvency II regime. The reporting requirements are wide-ranging and required substantial resources on the part of the institutions and Finanstilsynet alike in 2016. In addition to the standardised reporting, institutions also delivered a self-assessment of risk and solvency (ORSA). In May 2017 institutions will for the first time disclose qualitative and quantitative information under the requirements of the Solvency II framework.



## Tax consequences of Solvency II

Implementation of the Solvency II framework brings significant changes in how insurers are to value technical provisions for solvency purposes. This is especially true for non-life insurance, where the rules governing contingency provisions have been revoked. For many non-life insurers, overall technical provisions under the Solvency II framework will be substantially lower than the provisions previously utilised for solvency purposes and tax purposes. Any change that brings valuation for tax purposes more into line with valuations under Solvency II could entail a tax cost for these institutions. This will in turn reduce the institutions' own funds. No changes in the tax legislation's rules on the deductibility of provisions for insurance liabilities have been adopted for the accounting year 2016. The issue remains under consideration at the Ministry of Finance.

### Natural disaster capital

The Ministry of Justice and Public Security adopted on 19 February 2016 amendments to the Regulations on the Norwegian Natural Perils Pool. The amendments clarify member institutions' liabilities towards the Natural Perils Pool in a situation where an institution is wound up due to insolvency, providing a basis for non-life insurers' 'natural disaster capital' to be included in own funds in capital group 2 to meet the capital requirements under Solvency II.

### Amendments to regulations supplementing the Solvency II Regulations

Provisions supplementing the Norwegian Solvency II Regulations were adopted in an annex to those regulations. Finanstilsynet circulated on 7 November 2016 for comment draft amendments to the annex. The amendments are prompted by amendments to the EU Regulation on which the Norwegian rules are based. The main amendment sets special rules for infrastructural investments in the calculation of solvency capital charges. In addition, changes are made to set the stage for European long-term investment funds (ELTIF) and assets traded on multilateral trading facilities, and for an extension of the scope of transitional rules applying to equities. The amendments to the regulations were adopted on 21 December 2016.

### Internal model

Solvency II permits insurers to use their own models to compute the solvency capital requirement. This requires the permission of the supervisory authorities. Finanstilsynet received in 2016 applications from three institutions wishing to make use of such models. The applications have yet to be decided.

### New capital requirements for pension funds

The Ministry of Finance has commissioned Finanstilsynet to draft regulations on a new capital requirement for pension funds. A draft was forwarded to the ministry on 15 September 2016, and circulated for comment with the deadline set at 9 January 2017. The proposed capital requirement has its basis in Finanstilsynet's stress test 1, and is a simplified version of the solvency capital requirement under Solvency II.

### Work on a new occupational pensions directive for pension providers

The European Council adopted in December 2016 the revised Institutions for Occupational Retirement Provision Directive, *IORP II*, which had been passed by the European Parliament in November the same year. The directive brings new and expanded requirements on management and control, disclosure and reporting (Pillar 1 and Pillar 2) of activities, and measures to simplify cross-border activities. Member countries have a two-year period in which to conform their national legislations. EIOPA presented in March 2016 its opinion to EU institutions on a common framework for risk assessment and transparency for IORPs. EIOPA recommended inter alia the introduction of harmonised risk management and risk reporting for occupational pension providers.



Report from the supervised sectors

# The securities area

The overarching aim of regulation and supervision of the securities market is to ensure reliable information provision and secure, orderly and efficient trading in financial instruments thereby enabling the securities market to function as a source of capital for business and industry and as a basis for saving and investment.

Supervision of the securities area includes marketplaces and settlement systems, investment firms, mutual funds and management companies, alternative investment fund managers (AIFMs), listed issuers' financial reporting and prospectus control. Supervision covers securities institutions' financial position and operations, and their compliance with business rules and general rules of conduct.

## Developments

### Stock market

At the start of the year the Oslo Børs Benchmark Index was at 600 points. The year's highest value, the highest ever, was 686 points recorded on 12 December. The lowest was 515 points on 11 February 2016. At the end of 2016 the benchmark index stood at 679 points, an increase of 13.2 per cent for the year.

Turnover at Oslo Børs fell in 2016 compared with the past few years. In 2016 equities worth NOK 1,002bn changed hands, down 10 per cent from 2015 when turnover

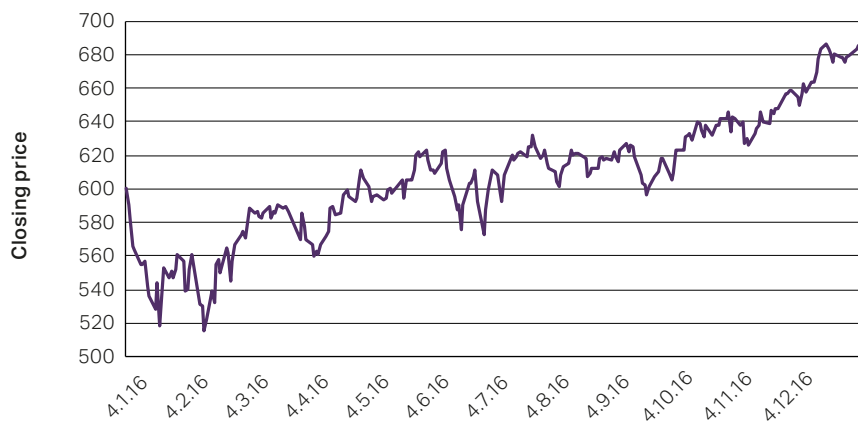
totalled NOK 1,113bn. An average of 92,410 trades was transacted daily, some 10,000 fewer than in 2015 when the highest ever number was recorded.

Oslo Børs' market share of equities that are also traded on other marketplaces (equities included in the OBX index) was about 65.6 per cent, down from about 65.9 per cent in 2015<sup>1</sup>.

In 2016 equity capital worth NOK 27.8bn was raised on Oslo Børs and Oslo Axess<sup>2</sup>, and about 11.1 per cent of the equity capital was raised in connection with listings. In all, eight new entities were admitted to Oslo Børs / Oslo Axess in 2016, down from twelve in 2015.

Chart 2: Oslo Børs Benchmark Index

Source: Thomson Reuters



<sup>1</sup> Source: Fidessa Fragmentation Index

<sup>2</sup> Source: Oslo Børs

**Bond market**

The number of new issues in the Norwegian bond market<sup>1</sup> rose in 2016 compared with 2015. In 2016 bonds worth a total of NOK 314.5bn were issued (exc. government bonds), with banking and finance accounting for NOK 216.9bn, corporates for NOK 162.9bn and municipal and county authorities for NOK 34.7bn.

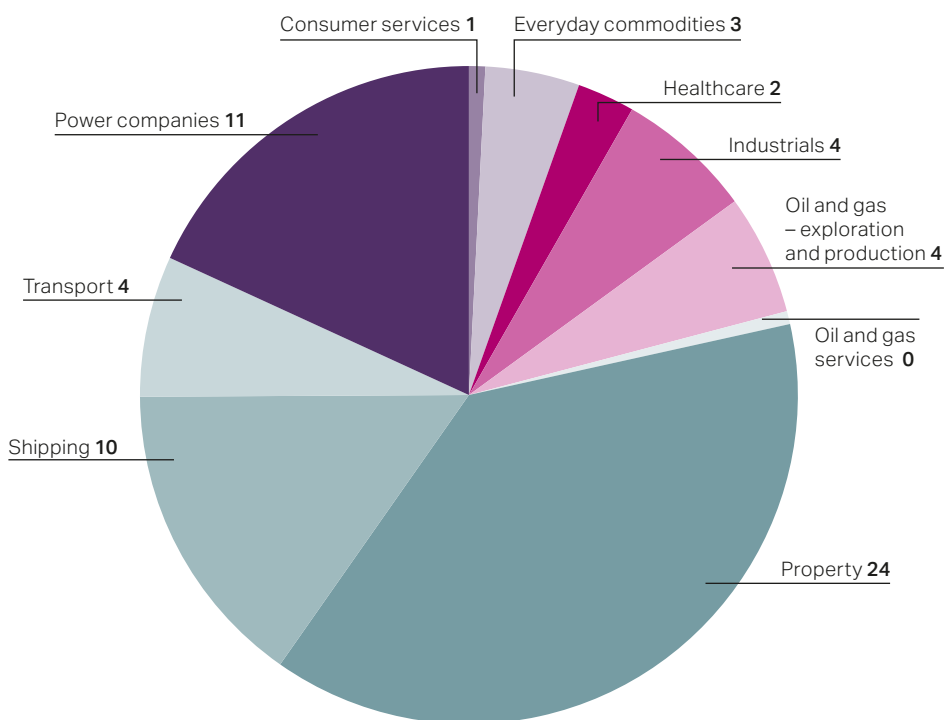
Total outstanding volume in the Norwegian bond market, including government bonds, came to NOK 1,637bn at year-end. Of this, NOK 774.6bn was issued by banks and other financial institutions, NOK 470.1bn by the central government sector (including government bonds and Treasury certificates) and NOK 388bn by corporates. See chart 3 for corporate<sup>2</sup> bonds by sector.

The bulk of the Norwegian bond market is quoted on Oslo Børs or Nordic ABM. The outstanding volume of quoted bonds at year-end was NOK 1,618.5bn. This broke down to NOK 222bn in corporate bonds and NOK 592bn in other bonds on Oslo Børs (exc. government bonds), and NOK 56bn in corporate bonds and NOK 362bn in other bonds on Nordic ABM. In 2016 bonds worth NOK 3,833bn were traded on Oslo Børs, and NOK 406bn on Nordic ABM. Trades on the stock exchange are in principle bilateral, and are notified for publication in the exchange's systems<sup>3</sup>.

Bonds quoted on Oslo Børs and Nordic ABM are owned mainly by life insurers and private pension funds, banks, foreign companies, mutual funds and mortgage companies.

**Chart 3: Corporate bonds – issued volume in 2016 (billions of NOK)**

Source: Stamdata.no



<sup>1</sup> The market is defined as bearer bonds with a Norwegian identification code (ISIN)

<sup>2</sup> Source: Stamdata

<sup>3</sup> Source: Oslo Børs

### **Mutual fund market**

Norwegian personal customers' net subscription in Norwegian mutual funds in 2016 totalled NOK 4.8bn. Of this, NOK 2.4bn, net, was invested in equity funds, minus NOK 0.6bn in balanced funds and NOK 3.5bn in fixed income funds. Net subscription in Norwegian equity funds was NOK 7bn in 2016. Total net subscription in mutual funds managed by Norwegian fund management companies came to NOK 39.2bn compared with NOK 11.7bn in 2015. Aggregate total assets managed by Norwegian management companies came to NOK 981.6bn at the end of 2016<sup>1</sup>.

### **Regulatory development in the securities area**

The government appointed in 2015 a law commission to draft provisions to implement new EEA legislation in the securities area and provisions to replace or amend the Markets in Financial Instruments Directive (MiFID), the Transparency Directive and the Market Abuse Directive. The commission has also considered further national regulation to assure consumer protection for customers of investment firms. The commission has in addition reviewed the rules governing the mandatory bid obligation and aspects of appeal board procedure. The commission presented its first interim report in February 2016. The report recommends amendments to the Securities Trading Act to implement changes to the Transparency Directive. The Ministry of Finance has circulated the report for comment. In January 2017 the law commission delivered its second interim report to the Ministry of Finance. This report recommends amendments to the Securities Trading Act aimed at contributing to more transparent and well-functioning markets and to increased investor protection.

A working group headed by Finanstilsynet delivered in November 2016 on commission from the Ministry of Finance a proposal for rules to implement expected EEA rules corresponding to the Regulation on improving securities settlement and on central securities depositories (CSD Regulation). The working group also recommended rules giving bond issuers access to the identity of the holders of their bonds. The Ministry of Finance had requested that the current Norwegian statutory protection of rights and the rules governing the right of access to information set forth in the Securities Register Act should as far as possible be retained, a request with which the working group's recommendation complies. The ministry has circulated the proposal for comment.

Finanstilsynet prepared in 2016 a consultation document proposing amendments to the regulations on annual financial statements of investment firms. According to the amendments, all entities in the securities area that are subject to capital requirements must comply with the regulations' provisions governing the preparation of financial statements, and must file their annual financial statements with Finanstilsynet within 90 days of the end of the financial year.

<sup>1</sup> Source: Norwegian Fund and Asset Management Association

Report from the supervised sectors

# Investment firms

## Supervision and monitoring

Finanstilsynet's supervision of investment firms' compliance with the conduct of business rules aims to ensure a high level of investor protection in the securities market and to promote market integrity. The supervision of investment firms also aims to promote an informed attitude to risk.

Finanstilsynet conducted on-site inspections at seven Norwegian investment firms and at one Norwegian branch of a foreign investment firm in 2016. Two further inspections specifically targeted investment firms' ICT solutions.

Investment firms' investor protection and compliance with conduct of business rules were a key theme at on-site inspections in 2016 as in previous years. Finanstilsynet checked the firms' investment advice, inter alia whether recommended investment services and financial instruments were appropriate to the clients. Finanstilsynet also checked whether the information firms had given their clients on risk and costs was balanced, correct and understandable.

Finanstilsynet also addressed investment firms' control function, in particular how the structure and organisation of this function were designed with a view to limiting conflicts of interest.

Experience from recent inspections (apart from CFD inspections, described below) shows shortcomings in firms' customer due diligence and anti-money laundering efforts, in compliance (internal control) and in the directors' and management teams' oversight of the business.

### Thematic inspection of the CFD market

A CFD, or Contract for Difference, is an agreement between two parties to exchange the difference in the value of an underlying financial instrument such as an index, commodity or currency between the date the contract was opened and the date it was closed. The high level of gearing offered by a CFD renders the positions taken vulnerable. In 2015 and 2016 Finanstilsynet conducted on-site inspections at eight such investment firms operating principally in the CFD business.

## Facts

*At the end of 2016 126 investment firms were operating in Norway, of which 25 also held a banking licence and 19 were branches of foreign investment firms.*

Finanstilsynet revoked the licence of two of the above firms. One has appealed against the revocation, and the appeal was referred to the Ministry of Finance. A third firm received a warning of licence revocation in 2016. Revocation of this firm's licence was decided in January 2017. A fourth firm handed in its licences after receiving a warning of revocation. Finanstilsynet's decisions (and warnings) in these instances were prompted by serious, systematic breaches of the Securities Trading Act's requirements since the firms concerned had incited customers' short-term, loss making trading in CFDs. An aggravating circumstance was Finanstilsynet's exposure of a large measure of inadequate customer testing, misleading marketing, incomplete information about costs and risk, and deficient internal control.

The European Securities and Markets Authority (ESMA) has published several warnings regarding CFDs, and in 2016 published a warning directed at trading in CFDs, binary options and other products. ESMA's warning states that the products involved are speculative and complex and that the investor is in many cases not fully aware of the risks attending them. Finanstilsynet posted this warning on its website.

### Market warnings

Finanstilsynet published six warnings against firms providing investment services in Norway without the requisite licence. Finanstilsynet also published 434 warnings given by foreign supervisory authorities against firms providing investment services in the EU/EEA without the requisite licence. Finanstilsynet's website also carries information on investment fraud, advising investors on how to protect themselves against fraudsters. Finanstilsynet's market warnings are also available at [Finansportalen.no](http://Finansportalen.no).

### Monitoring of firms' financial development

Finanstilsynet monitors investment firms' profitability and financial positions on the basis of their periodical reporting. The reporting also provides a picture of any trends in income distribution and of the risk attending the business.

Based on investment firms' half-yearly returns, Finanstilsynet publishes half-yearly press releases in which trends in these entities' business are presented and commented on. In 2016 the operating revenues of investment firms not integrated in banks were 2 per cent down on the previous year. Operating profits were on the other hand 8 per cent higher. In 2016, as in most previous years, investment firms' largest revenue source was their corporate finance business. Their next largest revenue source was investment advice, followed by secondary market trading of stocks and bonds.

Finanstilsynet registered and brought to light a total of nine firms that breached the capital requirements in 2015. The firms concerned were followed up on, and several received warnings of possible licence withdrawal due to capital inadequacy. The breaches were in the main rectified by cash deposits or by adjustments to group structure. At the end of 2016 five investment firms were required to report their capital adequacy position each month due to low capital adequacy, negative profit growth and/or poor quality reporting.

Finanstilsynet registered and brought to light a total of 13 breaches of the rules governing large exposures at investment firm in 2016. The firms in question were closely monitored, and several orders to rectify the breaches were issued. The orders were in all cases complied with.

## Licensing

### Authorisation process

Four new investment firms (Gjensidige Bank ASA, Credeva Corporate Finance AS, Carn Capital AS and Verdipapirservice AS) were licensed to provide investment services in 2016. In addition Pareto AB established a branch in Norway. Six existing firms (Midcoast Capital AS, Jool Markets AS, Alpha Spar AS, Clarkson Platou Project Sales, Kraft Finans AS and Multi Markets AS) were granted an expanded licence enabling them to provide further investment and ancillary services.

### Fitness and propriety testing

In 2016, 184 fit-and-proper tests were carried out of board members and managers at investment firms. Qualifications, job experience and previous conduct are covered. Testing is carried out in connection with licence applications and management and board changes. In most cases where a manager was not considered suitable the decision cited a lack of relevant experience, and the entities came into line with Finanstilsynet's assessments.

## Report from the supervised sectors

# Mutual funds and collective investment schemes

## Supervision and oversight

### Management companies for securities funds

A mutual fund is a regulated savings product offering a high degree of investor protection through the legislation. Supervision in this area is largely geared to ensuring that consumer interests are protected and that mutual funds can be suitable savings products for non-professional investors.

Net subscription in Norwegian asset management companies' mutual funds rose from NOK 11.7 billion in 2015 to NOK 39.2 billion in 2016, of which bond funds accounted for NOK 27.0 billion and equity funds for NOK 13.4 billion. Overall net subscription, combined with a net rise in value over the year, brought aggregate total assets at Norwegian securities funds to NOK 981.6 billion at year-end.

Management companies' financial development and compliance with the capital adequacy legislation are monitored through half-yearly reports and capital adequacy reports. Breach of the own funds requirements was registered at one management company. Overall, these entities retain good profitability.

Management companies are required to report possible breaches of the investment limits set out in the Securities Fund Act and in fund rules. For their part, depositaries are required to inform Finanstilsynet on a quarterly basis of breaches brought to light. The number of reported breaches in 2016 was on a par with previous years. Depositaries' reports are an important supplement to the management companies' own reports. In 2016 Finanstilsynet drew up new procedures for control and follow up of reports.

No ordinary on-site inspections were conducted at management companies in 2016. The practice of contact meetings was continued, and seven contact meetings were held in addition to a number of meetings at which themes of a more specific nature were discussed. Regular contact with market actors contributes to an effective and targeted supervisory activity.

In 2016 one ICT inspection was conducted, at Skagen AS, focusing on the conversion of the register of unit holders from the central securities depository (Verdipapirsentralen ASA (VPS)) to Skagen AS. No significant risk was brought to light that was not dealt with by the entity.

## Facts

*At the end of 2016 there were 31 management companies for securities funds, and one branch of a management company in Finland. Of these, 21 were also licensed to provide the investment service "active management of investors' portfolios of financial instruments". At the end of 2016 the companies managed 412 securities funds under licence from Finanstilsynet. UCITS investment funds make up the largest group of Norwegian securities funds.*

### Thematic inspection of balanced funds

Balanced funds' total assets have grown by more than 180 per cent since the start of 2013, reaching NOK 58.9 billion in 2016. Against the background of the considerable increase in new subscription in balanced funds from Norwegian private customers, and the priority given to consumer protection, a thematic inspection of the management and pricing of balanced funds was carried out involving analysis of 47 Norwegian balanced funds.

Five areas were identified as offering potentials for improvement, as described in Finanstilsynet's report of 30 September 2016. These involve high costs of equity management, little use made of allocation limits, a need for improved transparency in reporting to clients, and misleading use of benchmark indices.

In connection with the thematic inspection a special inspection was conducted of balanced funds managed by Danske Capital AS. This inspection was completed in summer 2016.

### Managers of alternative investment funds

Finanstilsynet focused mainly on processing applications under the new body of rules, giving guidance to affected actors and establishing reporting solutions under the Directive on Alternative Investment Fund Managers (AIFMD). The first round of reports from AIF managers was carried out in January 2016. An on-site inspection was initiated at one manager in autumn 2016.

Reviewing the half-yearly returns and capital adequacy reports enabled four alternative investment managers' non-compliance with own funds requirements to be brought to light. One of the managers is also a management company for securities funds. These cases of non-compliance, which were partly down to faulty calculation of the capital requirements, were soon rectified.

In 2016 a thematic inspection was carried out of selected AIF managers to check their compliance with the ban on marketing of alternative investment funds to non-professional investors. The survey showed that a number of AIF managers managed funds owned by non-professionals. Several owners had bought units after the Act's entry into force. The thematic inspection was brought to a close with Finanstilsynet's circular no. 11/2016 on the legal framework for the activity of the registered AIF managers.

## Licensing

### Management companies for securities funds

In 2016 one new company received a licence to engage in securities fund management. In 2016 Finanstilsynet authorised the establishment of 41 new securities funds (25 UCITS funds), while 22 securities funds were liquidated. Over the course of the year a number of approvals were given to change securities funds' rules.

The result of the UK referendum on EU membership (Brexit) immediately gave rise to market gyrations. This, combined with closed stock exchanges in Sweden and Finland, made it difficult to calculate the value of some securities funds heavily exposed to these markets. Finanstilsynet received some applications for permission to suspend the valuing and disbursement of claims for redemption, but only one such permission proved necessary (Pareto Nordic Return).

A number of UCITS funds established in other EEA states have been passported for marketing in Norway. Some Norwegian managers of AIFs have notified marketing of securities funds in other EEA states. Finanstilsynet's overview of foreign UCITS funds marketed in Norway is available in Finanstilsynet's concessions register.

### Managers of alternative investment funds

The number of licence holding AIFs has continued to grow since the licence requirement entered into force on 1 July 2014. In 2016 seven new licences were awarded, bringing the number of AIFs under ordinary supervision to 35 (six applications were either withdrawn during processing or were rejected). At the same point 69 managers were registered in Finanstilsynet's register of registered managers of alternative investment funds (19 new registered AIF managers in 2016). Funds managed by these managers cannot be marketed to non-professional investors.

In dealing with one appeal, the Ministry of Finance concluded in a decision of 4 January 2016 that Irish qualifying investor alternative investment funds (QIAIFs) can be marketed to certain categories of non-professional investors in Norway. Against this background Finanstilsynet authorised the marketing of two Irish AIFs. Authorisation was given on condition that marketing would be confined to the same groups of non-professional investors as were eligible to subscribe in the funds under Irish law. 2016 saw an increase in the number of applications to market AIFs to non-professional investors, and 16 such licences were granted over the course of the year.

In 2016 Finanstilsynet granted 122 licences to market AIFs to professional investors in Norway where either the manager, the fund or both are established outside the EEA.

A number of AIFs established in other EEA states have been passported for marketing to professional investors in Norway. This applies in particular to funds established in Ireland, the United Kingdom or Luxembourg. Some Norwegian managers of AIFs have notified cross border services out of Norway.

## Report from the supervised sectors

# Market infrastructure

## Supervision and monitoring

The securities market infrastructure comprises trading venues operated by Oslo Børs ASA (Oslo Børs, Oslo Axess, Oslo Connect and Merkur Market). Oslo Børs also owns Fish Pool ASA. Other trading venues included are Norexeco ASA, Nasdaq Oslo ASA and the investment firm ICAP Energy AS, which operates a multilateral trading facility. In addition there is the infrastructural entity Verdipapirsentralen ASA (VPS) which runs a securities depository and is operator of the central securities settlement system in Norway (VPO NOK).

The foreign central counterparties SIX x-clear AG, Nasdaq Clearing AB, European Commodity Clearing AG (ECC), LCH Ltd and European Central Counterparty N.V. (EuroCCP) are all licensed to carry on business as central counterparties in Norway. They are also important elements of the Norwegian infrastructure. The two first-mentioned central counterparties have a Norwegian branch, while the remainder operate cross-border activities into Norway. EuroCCP currently does not offer services as a central counterparty for Norwegian trading venues, but offers such services to foreign market places where certain Norwegian securities are traded.

The ongoing supervision of infrastructural entities comprises inter alia fitness and propriety assessments of the management team, approval of entities' internal rules and assessment of risk factors and capital. Regular meetings are held with the entities. In collaboration with Norges Bank, Finanstilsynet evaluates the VPS's depository function in light of the CPSS-IOSCO principles for financial market infrastructures. This evaluation receives further mention in Norges Bank's yearly report on financial infrastructure.

There were no reports of serious ICT incidents at infrastructural entities in 2016.

### Admission of shares of Oslo Børs VPS Holding ASA to trading on Merkur Market

On behalf of Oslo Børs VPS Holding ASA, Oslo Børs presented to Finanstilsynet plans to admit the shares of the holding company to trading on the trading venue Merkur Market, which is operated by Oslo Børs. The background to the approach was the Ministry of Finance's refusal in 2012 to allow the shares to be quoted on Oslo Børs or Oslo Axess, citing the need to assure the market places' independence and public confidence. The ministry also pointed out that such quotation would trigger conflicts of interest. Finanstilsynet considered that interest conflicts would also be present upon admission to trading on Merkur Market. Finanstilsynet therefore concluded that admission of the shares to trading on Merkur Market would not be in keeping with the Securities Trading Act.

### Researchers' access to the securities register

Finanstilsynet is empowered to allow Verdipapirsentralen ASA to disclose confidential information to researchers. The condition is that such disclosure is considered reasonable and does not entail disproportionate inconvenience for other interests. Finanstilsynet granted two applications from researchers to access data in 2016 and is considering two further applications.



## Report from the supervised sectors

# 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 unlawful insider trading, market manipulation and due care in handling inside information are at centre-stage. Finanstilsynet also oversees compliance with the rules on the preparation 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. Finanstilsynet works closely with the National Authority for Investigation and Prosecution of Economic and Environmental Crime (ØKOKRIM) and Oslo Børs in this sphere.

A number of the cases investigated by Finanstilsynet in 2016 were initiated by reports filed by investment firms. Many were also referred to it by Oslo Børs or initiated by Finanstilsynet itself in response to market events.

In 2016 Finanstilsynet investigated:

- 96 new cases of unlawful insider trading and/or breaches of confidentiality
- 44 new cases of market manipulation / unreasonable business methods
- 25 new cases of securities trading requiring disclosure
- 38 new cases of securities trading requiring notification

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

The following were also investigated:

- 768 alarms from Finanstilsynet's own surveillance system, SKADI
- 403 alarms from a system designed to identify breaches of the mandatory disclosure obligation

Finanstilsynet made approaches to several managers at the VPS securities depository in 2016 regarding transactions in equities and other financial instruments carried out by shell companies exposed via Panama Papers. The approaches covered transactions over the past ten years.

Finanstilsynet has in several instances assisted foreign supervisory authorities in their investigations of market abuse.

### Administrative fines

Over the course of 2016 Finanstilsynet imposed seven administrative fines for breaches of the disclosure requirement and five administrative fines for breaches of the notification requirement. Finanstilsynet publishes the fines on its website.

### Notifications to the prosecuting authority

Finanstilsynet reported four cases of suspected unlawful insider trading and/or breach of the duty of confidentiality to the prosecuting authority in 2016.

### Follow-up of reported cases

The collaboration between Finanstilsynet, ØKOKRIM and local police districts on reported cases makes for more effective and efficient combating of crime in the securities market. Finanstilsynet assisted the prosecuting authority at interviews and carried out various analyses in reported cases in 2016. Finanstilsynet's staff are on occasion called on to give evidence in court cases. This happened in 2016 as previously.

### Transaction reporting

In 2016 about 130 million transactions were reported to Finanstilsynet's transaction reporting system (TRS), of which 62 per cent were from foreign and 38 per cent from Norwegian investment firms. Finanstilsynet participates in a development project with Sweden, Denmark, Finland, the Netherlands and Ireland on changes to the reporting regime that will be required under the MiFID/MiFIR directive and regulation.

### Short selling register

With the incorporation of the Short Selling Regulation into the EEA Agreement, Finanstilsynet needs to have in place systems to receive and publish short positions on a daily basis. A disclosure obligation will apply to investors with short positions that result in a threshold being crossed. Finanstilsynet developed a solution for reporting and publishing such data in 2016.

### Automation

In 2016 Finanstilsynet installed its own surveillance system – SKADI (Surveillance Knowledge And Detection Interface). This alarm system is programmed to uncover patterns in large volumes of data. It identifies events and transactions that call for closer examination under the conduct of business rules of the Securities Trading Act.

A system to identify possible breaches of the mandatory disclosure obligation was also developed.

### **Court rulings**

The following court rulings were delivered in 2016 in cases which Finanstilsynet investigated and reported to the prosecuting authority:

- In April 2016 Oslo City Court delivered judgment in a case of insider trading. A director at a company listed on Oslo Børs bought shares in the company at a point where a mandatory bid was in effect but where a possible increase of the bid price was not market knowledge. The court cited the fact that the defendant received inside information at a board meeting. The sentence of one year's imprisonment, of which six months were suspended, was not appealed. The judgment is accordingly final.
- Stavanger District Court delivered judgment in a case of insider trading and incitement to insider trading at an oil service company listed on Oslo Axess. A person who had obtained inside information about results of exploratory drilling bought shares in the company concerned for himself and his wholly-owned limited company. This person was sentenced to five month's imprisonment and confiscation of about NOK 2.4 million. The individual who had passed the information to him, and thereby incited the purchase, was sentenced to 90 days' imprisonment. Following rejection of the convicted persons' appeal by both the Gulating Court of Appeal and the Supreme Court, the judgment is final.

Report from the supervised sectors

# 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 million 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 Norwegian regulated market, including where a company whose shares are already admitted to trading plans to increase its capital by more than 10 per cent.

### Prospectus vetting in 2016

Slightly fewer share prospectuses were approved in 2016 than in the previous year. The number of prospectuses issued in connection with initial public offerings on Oslo Børs or Oslo Axess totalled eight compared with 13 in 2015. The number of bond prospectuses in 2016 was higher than in 2015. However, the number in 2015 was halved compared with 2014 due a substantial reduction in the number of new bond issues, in particular high yield bonds in the oil and oil service sector. Moreover, a somewhat larger number of high yield bonds were issued than in 2015.

Finanstilsynet vetted prospectuses for several sizeable transactions in 2016. These included prospectuses for the public offering and listing of Norske Skog, Arcus og Golden Ocean Group. A number of savings banks also raised capital in 2016.

An overview of prospectuses vetted by Finanstilsynet in 2015 is given in table 8.

**Table 8: Vetted documents**

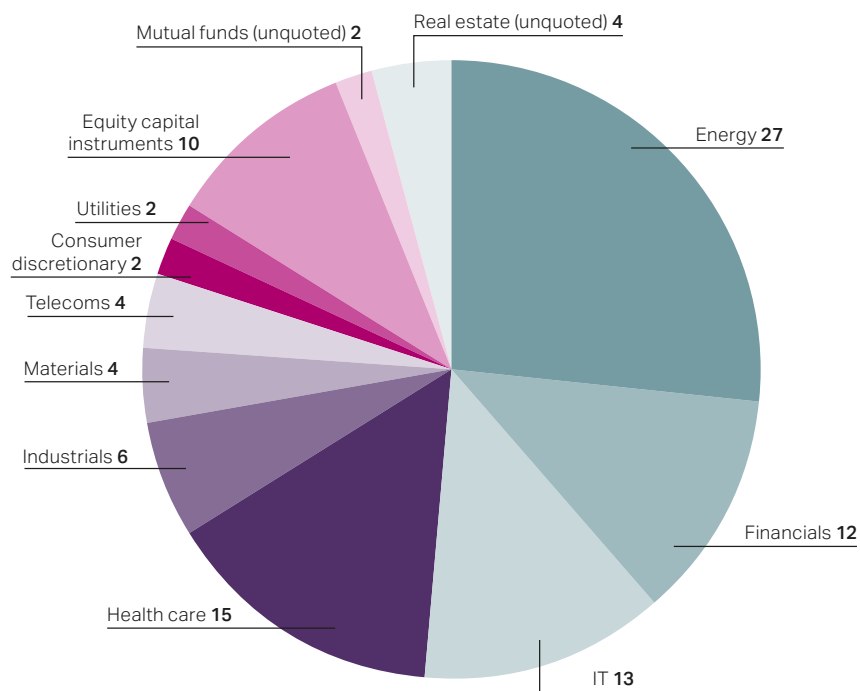
	2012	2013	2014	2015	2016
Shares (quoted shares in parenthesis)	54 (45)	60 (52)	53 (47)	58 (53)	<b>52</b> <b>(46)</b>
Bonds	146	178	194	99	<b>118</b>
Warrants	-	-	-	-	-
Total	200	238	247	157	<b>170</b>

Finanstilsynet discontinued eight vetting processes after capital raising and/or admission to listing were cancelled. In addition, three vetting processes for capital raising and admission of shares to listing were discontinued on Finanstilsynet's initiative. In most cases vetting is discontinued because the prospectus is incomplete or essential information is unobtainable. These processes will in many cases be resumed at a later stage once relevant information is in place. Further, a large number of documents related to passported prospectuses were notified to competent authorities in the EU/EEA area and vice versa.

Finanstilsynet started vetting of nine prospectuses related to new share admissions. Of these, eight prospectuses were for IPOs on Oslo Børs or Oslo Axess. A total of 46 prospectuses for listed limited companies were vetted. A further six prospectuses for share issues by unlisted companies were vetted.

**Chart 4: Share prospectuses approved by Finanstilsynet in 2016 – by sector**

Source: Finanstilsynet



## Report from the supervised sectors

# Financial reporting enforcement – listed companies

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

At the end of 2016 259 companies were subject to Finanstilsynet's supervision of financial reporting. Of these, 35 were foreign. 190 were issuers of shares and equity certificates. Several issuers of shares and equity certificates also issued bonds that are quoted on Oslo Børs. Over the course of the year eight new companies were admitted to Oslo Børs, two to Oslo Axess. Three of the admissions to Oslo Børs had transferred from Oslo Axess. A total of eight issuers were delisted, four from Oslo Børs and four from Oslo Axess.

## Enforcement of financial reporting

### Selection

Finanstilsynet applies several criteria to select entities for review. Some entities are selected on the basis of signals given or by rotation, others on the basis of risk assessments. Risk-based analyses rely on data reported by companies via the Altinn internet portal.

### Results of the enforcement

In 2016 Finanstilsynet reviewed all or parts of the financial reporting of 47 entities. Particular attention was focused on issuers of shares and equity certificates, but also on some bond issuers. Finanstilsynet also reviewed the audit reports of all listed companies. 13 cases were given closer scrutiny, and eight had yet to be finalised at year-end.

Finanstilsynet received reports from two auditors indicating that the financial reporting of the issuers failed to provide a true and fair view under the provisions of the Securities Trading Act. These reports were acted upon either on an individual basis or as part of the normal enforcement process.

The cases described below are all from the review of the 2014 annual accounts, which was completed in 2016.

### Odfjell Drilling Limited

This review covered primarily the entity's impairment tests of the Deepsea Atlantic and Deepsea Stavanger rigs. Odfjell noted over the course of 2014 several indications of falling values and impairment tested all rigs under IAS 36 *Impairment of Assets* at the end of 2014. Finanstilsynet's review opened with an examination of the entity's impairment tests as at 31 December 2014. In light of the continuous negative market development in 2015, the review was extended to include ensuing quarters. The entity had not written down its assets at any of the reporting dates.

Finanstilsynet gave warning of an order to rectify the accounts on the basis that the impairment tests in the third quarter 2015 were not based on reasonable and documentable assumptions for cash flows, and that the discount rate applied was too low. Odfjell was instructed to recalculate value in use for Deepsea Atlantic and Deepsea Stavanger as at 30 September 2015. The entity wrote down the rigs by USD 158.5 million in the second quarter of 2016.

### Agder Energi AS

Finanstilsynet reviewed this entity's accounting treatment of power contracts with embedded foreign currency derivatives. Agder Energi has long-term contracts to supply power to energy-intensive industry. The contracts are bilateral and virtually all contracts after 2010 are denominated in euro. Hence the parties to the contracts have incurred exposure both to power prices and to the euro.

The exception from the main principle that embedded derivatives should be separated from the host contract applies in three specific situations. One of the exceptions applied in the case concerned. Agder Energi did not separate embedded foreign currency derivatives, but accounted for them as a part of the power contract.

In Finanstilsynet's assessment the entity was not entitled to apply the above exception to contracts between two Norwegian entities with the euro as settlement currency. The foreign currency derivative had to be separated from the host contract and accounted for at fair value. Agder Energi did not agree with Finanstilsynet's assessment and considered their approach to be keeping with IFRS. Finanstilsynet accordingly ordered Agder Energi to revise their accounting for embedded derivatives.

Agder Energi brought its accounting policy into line with Finanstilsynet's order in the second quarter of 2016.

#### **Helgeland Sparebank**

The main aim of this review was to identify activity or exposures beyond the scope of ordinary savings bank business that could potentially pose a risk, and to ensure that any such elements were recognised, measured and disclosed in the accounts under IFRS. Finanstilsynet identified two such elements: the bank's stake in Helgeland Invest AS and its exposure to and stake in a halibut farm.

Helgeland Sparebank took due note of Finanstilsynet's assessments of the entity's presentation of the two investments in its accounts. In the interim accounts for the fourth quarter of 2015 the entity rectified the errors and disclosed the effects of the rectification for previous periods.

#### **General Exploration Partners Inc.**

This review focused on various aspects of General Exploration's stake in the Atrush block in Kurdistan, above all the company's assessment of whether the asset's recoverable value had fallen below its book value, along with some other matters.

The company's assessments did not indicate there was a basis for write-down of the asset concerned. Finanstilsynet was nonetheless critical of the fact that the discount rate applied in 2014 was applied once again in 2015. Finanstilsynet asked the entity to provide in future reports further information on the assumptions underlying its impairment assessments and on its assessment of the going concern assumption.

#### **Report on impairments**

Information about impairment write-downs, including a description of impairment tests and assumptions employed, as well as an account of the uncertainty of significant assumptions, are basic information for the user of annual accounts who wishes to assess the reliability of a company's estimates. This is particularly important in situations where market uncertainty is substantial and changes in the assumptions employed may have a significant impact on estimated values. Finanstilsynet published against this background a report dated 5 December 2016 which explains the process underlying its review of impairment assessments, and the factors to which importance is attached in reaching decisions. The report places the most important issues considered alongside the assessments made by Finanstilsynet in recent years.

#### **Administrative fine for late publication of periodic financial reports**

Finanstilsynet's enforcement of periodic reporting includes checking that reports are published within deadline. Failure to observe the deadline normally attracts an administrative fine.

Administrative fines were imposed on five issuers in 2016 for late publication of their annual reports.

#### **Expert Panel on Accountancy**

The Expert Panel on Accountancy was appointed by the Ministry of Finance on 13 October 2005 to give Finanstilsynet specialist advice when reviewing the accounts of issuers of transferable securities quoted on a regulated market. The Expert Panel met twice in 2016. The panels' statements are in the public domain, with the exception of confidential information. Finanstilsynet publishes the public content of the panel's statements in anonymised form on its website.

#### **The Expert Panel in the period 1 January – 31 December 2016**

**Stig Enevoldsen**  
*chair*

**Signe Moen**  
*deputy chair*

**Frøystein Gjesdal**  
*member*

**Gry Kjersti Berget**  
*member*

**Kjell Magne Baksaas**  
*member*

**Nina Rafen**  
*member*

**Geir Moen**  
*member*

**Karina Vasstveit Hestås**  
*alternate*

**Roar Inge Hoff**  
*alternate*

**Reidar Jensen**  
*alternate*

Report from the supervised sectors

# Auditing

Finanstilsynet’s oversight of auditors comprises approval or licensing of individuals and firms, registration and supervision of statutory audit work. Finanstilsynet checks that auditors maintain their independence, and that they perform their work in a satisfactory manner and in compliance with law and good audit practices.

Market participants’ confidence in financial reporting by business and industry is key to a well-functioning market. This is particularly true for reporting by public interest entities such as banks and other financial institutions, insurers and listed companies. High audit quality contributes to increased confidence. In order to properly perform his/her role as representative of the general public, the auditor must be independent and perform the audit in conformity with the requirements of the Auditors Act.

## Trends

The audit industry reflects the dominant position of the largest audit firms. According to the latest off-site supervision data (2013), the five largest audit firms’ market share is 67.6 per cent in terms of statutory audit fees. There remain a number of small audit firms, although the number of firms with just one statutory auditor has fallen in recent years. The number of audit firms that audit public interest entities continues to fall, and stood at 13 at year-end.

## Supervision and monitoring

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 are required at least every sixth year, while auditors and audit firms that audit public interest entities are subject to periodical quality assurance review at least every third year.

The periodical quality assurance reviews are coordinated with reviews conducted by the Norwegian Institute of Public Accountants (DnR) of its members. Should the DnR bring to light circumstances that may prompt revocation of an auditor’s licence, the matter is referred to Finanstilsynet for further action. The DnR’s report for 2016 is presented on page 58. Where public interest entities are concerned, all supervision is carried out by Finanstilsynet. Public interest entities that are audited by small audit firms are for the most part local savings banks and small insurers.

In 2016 Finanstilsynet received some 60 reports of possible audit deficiencies from the DnR, the tax authorities, bankruptcy administrators and other parties. All reports are reviewed and assessed for further action on the part of Finanstilsynet. Cases not given priority by Finanstilsynet are likely to conclude with the auditor being asked to conduct a self-evaluation. Failings in the conduct of the audit that emerge in the self-evaluation must be assessed and measures needed to enhance audit quality must be set out. The evaluation must be documented.

32 on-site inspections were conducted in 2016. Some of these matters will be finalised in 2017.

Finanstilsynet’s impression after the supervisory and monitoring work conducted in 2016 is that many audit firms make a major effort to ensure that the general public can have confidence in auditors’ attestations. However, the fact that Finanstilsynet continues to find substantial flaws in audit firms’ procedures designed to assure audit quality and in the actual conduct of the audit is a ground for concern.

**Table 9: Revocation of auditors’ licences**

	2012	2013	2014	2015	2016
State authorised auditors, licences revoked	19	0	0	2	1
Registered auditors, licences revoked	17	0	2	0	1
Audit firms, licences revoked	0	0	0	0	3

*The number of licence revocations is higher in years in which off-site supervision is carried out.*

**Supervision of audit firms**

Fourteen inspections of audit firms were conducted in 2016, of which four concerned firms that audit public interest entities. Audit firms which audit companies listed on a US stock exchange are also subject to oversight by the Public Company Accounting Oversight Board (PCAOB) in the US. One inspection was conducted on a joint basis with the PCAOB and was headed by Finanstilsynet.

At several inspections in 2016, which covered audits of public interest entities, Finanstilsynet revealed that anti-money laundering procedures, procedures to ensure independence and audit firms' own cyclical inspections of audit quality, were unsatisfactory. At the engagement level Finanstilsynet identified cases of weak compliance with policies for accepting or continuing audit engagements. Finanstilsynet also drew attention to insufficient involvement in the conduct of the audit by the statutory auditor and the function responsible for audit quality controls.

Checks on individual assignments also brought to light weaknesses in auditors' documentation of their understanding of the business to be audited, in audit procedures performed and in the use of analysis in the planning, performance and completion of the audit. Weaknesses in the audit of significant areas were pointed out at several inspections.

**Other individual cases**

Finanstilsynet concluded that the audit of the Vardia Insurance Group in connection with its admission to stock exchange listing in 2013 was sufficiently weak to justify revocation of the licence of the auditor concerned. The revocation order was appealed.

One of the inspections prompted by referrals from the tax authorities covered a review of 35 audit engagements handled by four of five partners in the company. It was not possible based on the audit documentation to determine whether a number of central aspects of the engagements had been subject to audit procedures. The matter will be brought to completion in 2017.

**Thematic inspections**

Each year Finanstilsynet conducts an audit-related thematic inspection. Audit firms selected for inspection invariably include firms that audit public interest entities.

In 2016 the thematic inspection addressed auditors' use of random sampling when performing audit procedures. The thematic inspection showed that random sampling is not performed and documented in all cases as required by good audit practices.

The report from the thematic inspections will be published early in 2017.

**Other supervisory activity**

Finanstilsynet's inspections continue to reveal that many supervised entities covered by the Risk Management Regulations omit to obtain auditor confirmation as required by the regulations. In such cases Finanstilsynet draws the auditor's attention to the obligation to send a numbered letter to the client.

**Matters referred to the Board of Appeal for Audit and Accounting Matters**

One audit matter was referred to the Board of Appeal for Audit and Accounting Matters in 2016. This was an appeal against withdrawal of a state authorised auditor's licence.

The Board of Appeal's rulings are in the public domain and available at *Lovdata*, Norway's law database.

**Licensing**

**Table 10: Number of approved auditors and audit firms at 31.12.2016**

	2012	2013	2014	2015	2016	Licensed in 2016
State authorised auditors	3,339	3,544	3,729	3,888	<b>4,044</b>	<b>162</b>
Registered auditors	3,365	3,429	3,462	3,492	<b>3,526</b>	<b>56</b>
Of which: statutory auditors	1,840	1,799	1,625	1,584	<b>1,560</b>	<b>64</b>
Audit firms	600	563	533	516	<b>488</b>	<b>14</b>

Finanstilsynet authorises auditors as either registered or state authorised auditors. In 2016 258 candidates took, and 254 passed, the examination. When processing applications for an auditor register number, which is needed in order to become a statutory auditor, Finanstilsynet checks that the auditor meets the statutory continuing education requirement and has the required indemnity insurance.



## International tasks

The global collaboration between audit supervisory authorities takes place through the International Forum of Independent Audit Regulators (IFIAR). 51 countries, including Norway, are represented on the IFIAR. The IFIAR publishes each year a report on audit quality.

At EU level the Committee of European Auditing Oversight Bodies (CEAOB) was established in 2016 as a result of the new Audit Regulation. The CEOB has set up several sub-groups, including an inspections sub-group. Finanstilsynet attends meetings of the CEOB as an observer.

The CEOB superseded the European Audit Inspection Group (EAIG) in 2016. The EAIG had been formed by European supervisory authorities to develop and harmonise the conduct of audit supervision. The EAIG coordinated its member countries' views on new audit standards proposed by audit industry bodies and also established a European database for inspection findings. The database provided a useful basis for communication with standard setters and for the supervision of the five large audit firms. The EAIG established European supervisory colleges for EY, PwC, Deloitte and KPMG. The EAIG's activities continue under the CEOB.

## Regulatory development

In October 2015 the government appointed a committee to recommend changes in the legislation on auditing, auditors and external accountants. A report on amendments to the auditing legislation is to be presented by 29 June 2017. Finanstilsynet has one member on the law committee.

Finanstilsynet  
Postboks 1187 Sentrum  
0107 Oslo

Oslo, 25 January 2017  
Our ref.: TML/KMH

## Quality Assurance Review of Auditors – Annual Report 2016

According to the *Guidelines for periodic quality assurance reviews of auditors and audit firms*, The Norwegian Institute of Public Accountants (DnR) is appointed by Finanstilsynet to conduct the periodic quality assurance review of auditors who perform statutory audits of the annual financial statements of entities other than public interest entities. The Board of DnR hereby presents a summary of the quality assurance reviews conducted in 2016.

### Organisation of the quality assurance review

The quality assurance review is described in *Details of the quality control programme for statutory auditors 2016* as posted at [www.revisorforeningen.no](http://www.revisorforeningen.no). It is designed to test compliance with the Act on Auditing and Auditors and with good auditing practices, including International Standards on Auditing, in addition to compliance with the provisions of the Act on Auditing and Auditors concerning the auditors' capabilities to fulfil their obligations related to financial status, independence, indemnity insurance and continuing professional education. In addition, last year's review included a separate check of compliance with the Money Laundering Act.

The reviews were conducted by a review team comprising 31 state authorised and registered auditors, all with a broad professional background.

### Selection of auditors for quality assurance review

In 2016 the quality assurance programme covered 841 statutory auditors. 163 of these were selected for ordinary quality assurance review. Upon being notified that they had been selected for review, eight statutory auditors announced that they would discontinue their business or retire as statutory auditors in the course of 2016. In addition, six statutory auditors had their reviews deferred to 2017.

Thus 149 statutory auditors had ordinary quality reviews in 2016. In addition to the ordinary reviews, six statutory auditors were subject to follow-up reviews, resulting in a total of 155 conducted reviews in 2016.

### Results of the quality assurance reviews

	Number	%
Approved	135	87
Not approved – new review	12	8
Referred to Finanstilsynet for further action*	8	5
<b>Total number of reviews conducted</b>	<b>155</b>	<b>100</b>

\* Reason for referrals: Continuing education deficiencies (5), personal finances (1), audit deficiencies (2).

Yours sincerely

Trond Martin Lindberg (sign.)  
Chair  
The Norwegian Institute of Public Accountants



# M

## **MANAGEMENT AND CONTROL OF FINANSTILSYNET'S OPERATIONS**

# MANAGEMENT AND CONTROL OF FINANSTILSYNET'S OPERATIONS

## Management structure and reporting

Finanstilsynet's Board of Directors, which is appointed by the Ministry of Finance for four years at a time, has the overarching responsibility for Finanstilsynet's activities. The Director General, who is appointed by the King in Council for a term of six years (with a possible extension of a further six years), is in charge of day-to-day management. The Director General confers with his management team which alongside the Director General comprises the Directors of the two supervisory departments and the administration department, the General Counsel and the Communications Director.

Finanstilsynet is divided into two supervisory departments and one administration department, each headed by a department director (Deputy Director General). The departments are divided into sections, each headed by a head of section. The 'legal quality assurance' and 'international coordination' functions are assigned to the Director General's staff. A communications unit reporting directly to the Director General is responsible for internal and external communication.

Finanstilsynet's activity is regulated by the Financial Supervision Act. This Act is supplemented by special statutes applying to the respective supervisory sectors. Every fourth year Finanstilsynet draws up a strategy document which together with the Ministry of Finance's letter of allocation is the basis for annual action plans adopted by the Board of Directors (see chapter II page 7). The action plans are the basis for the ongoing management and for reporting to both the Board of Directors and the Ministry of Finance.

The Board of Directors meets each month to deal with important supervisory matters related to regulations and licences, budget and action plans. The Board receives regular reports on Finanstilsynet's activities. Finanstilsynet meets with the Ministry of Finance on a quarterly basis. The agency also reports annually through its annual report and a supplementary short report to the Ministry of Finance on its activities based on the action plans. In all these contexts there is a tight focus on ensuring a high level of mission achievement through effective and efficient resource use.

Finanstilsynet bases its supervisory activity in all areas on risk assessments and each year draws up risk assessments with regard to its own operations. These are closely linked with the Board of Directors through the latter's consideration of the action plan and are communicated to the Ministry of Finance which follows up on the assessments in its management dialogue with Finanstilsynet.

Where risk assessments providing a basis for supervision are concerned, the *Risk Outlook* reports are key basis documents. 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 economies. 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 special reports, which also cover financial institutions earnings, financial strength and liquidity position. The reports assess potential sources of future stability problems in the Norwegian financial system. The *Risk Outlook* reports are published in late spring and late autumn. A further basis for risk assessments is Finanstilsynet's annual analysis of risks related to the use of IT in the financial sector (Risk and Vulnerability Report).

Finanstilsynet is subject to audit by the Office of the Auditor General. See chapter VI, annual accounts, page 65.

## Internal control

Internal control at Finanstilsynet is a line management responsibility, and is thus a part of the agency's internal management. The description of procedures, for example budget allocation authority and other internal guidances, clarifies responsibilities and authority and contributes to effective control.

The management regularly follows up on all units' action plans. It does so to ensure that resource input, mission achievement and results are in keeping with priorities and expectations, and that any divergences are identified, explained and addressed. Such follow up also ensures a coordinated approach and holistic perspective across the agency.

Finanstilsynet continued its effort to promote information security in 2016. Exercises and attitude-shaping initiatives were carried out in the information security and technology area.

Compliance with the Personal Data Act was followed up on for parts of Finanstilsynet's area of operations, and this work continued in 2016.

No significant weaknesses, faults or deficiencies were brought to light by Finanstilsynet's internal control system in 2016.

In addition to the ordinary audits by the Office of the Auditor General, inspections were carried out at Finanstilsynet by the National Security Authority and Tax Region West. The latter focused on value-added tax payable on services supplied from abroad.

The internal control system at Finanstilsynet provides a sound basis for ensuring purposeful, efficient operations, reliable reporting and compliance with relevant rules and internal policies and procedures. The agency is characterised by a high degree of stability in terms of its organisation, staffing and systems. Faults or significant failure of procedures are extremely rare. After an overall assessment in 2013 Finanstilsynet saw no need to establish an internal audit function, but was ready to review the issue if the risk position or other aspects of the agency changed significantly. A new assessment in 2016 brought to light no new risk factors or changes calling for the establishment of an internal audit function.

Finanstilsynet has an internal controller who reports to the Board of Directors each year.

An internal control regime is in place for IT matters of a technical nature. The first round of internal control under this model was conducted in 2016.

### **Security**

Finanstilsynet attaches much importance to security and to maintaining security and preparedness for possible crises at individual institutions, in the financial infrastructure and in markets. The agency also has preparedness for possible events in its own organisation. Exercises with a view to crises in institutions and markets and in Finanstilsynet's own organisation are conducted on a regular basis. Finanstilsynet uses the CIM support system in its work on preparedness.



## **ASSESSMENT OF FUTURE PROSPECTS**

## ASSESSMENT OF FUTURE PROSPECTS

Political uncertainty and a setback in the international economy might spark renewed turbulence in financial markets. In the Norwegian economy, a possible protracted low oil price will impact on the level of domestic activity. There is a risk that households' high indebtedness and the high house prices in Norway could trigger or intensify a setback in the economy.

Weakened profitability and tight liquidity among a number of bond issuers connected to the oil and offshore industry cast uncertainty over their ability to redeem or refinance loans falling due in the next few years. This could have knock-on effects in the form of losses for institutional and private investors alike and higher loss risk for a number of banks.

Finanstilsynet keeps track of key macroeconomic variables and conducts stress tests of banks' ability to withstand a negative trend in the economy. It is important that the banks remain well capitalised and maintain sufficient liquidity buffers to face a potentially weaker trend in the Norwegian and international economies and renewed turbulence in international financial markets.

One of the two systemically important banks in Norway, Nordea, will operate as a branch as from 2017. Large branches of foreign banks will account for much of the Norwegian banking market, and some of these branches will also be systemically important. A cooperation agreement has been formalised with Nordic supervisory authorities and the European Central Bank (ECB) on the supervision of large branches.

Digitalisation brings frequent changes in processes and products in the financial area. Complexity and vulnerability are growing in step with developments in the ICT area and with the entry of new actors into the value chain. This imposes stringent requirements on Finanstilsynet's staff and their capacity to keep track of and understand the risks attending the respective solutions and systems. Operational risk denotes on the one hand the risk of increased complexity leading to internal faults at supervised institutions due to technical or human failure. It also denotes the increased risk of supervised institutions or infrastructure systems being affected by internet-based attacks from external sources.

A high cost level and stringent requirements on customer protection and documentation mean that institutions are finding it less remunerative to offer face-to-face individual customer treatment. A challenge to Finanstilsynet ahead will be to ensure that internet-based solutions meet requirements regarding adequate customer protection, identification, documentation and technical security.

In its 2014 assessment of Norway, the Financial Action Task Force (FATF, an inter-governmental body developing and promoting policies to combat money laundering and terrorist financing) pointed to several weak aspects of Norwegian government authorities' work in this area. Finanstilsynet will accordingly further develop and strengthen its supervision of supervised institutions' compliance with the relevant legislation.

In the pensions area recent years have seen a gradual transition from defined benefit pensions to defined contribution pensions offering investment choice. The new products require professional and balanced advice. In both the insurance area and the securities area there is a need to monitor institutions' compliance with sound business practices in their marketing and advisory activities, and to verify that marketing material contains balanced information on risk and costs.

While the new pension agreements are mainly contributory, life insurers will in the coming years continue to face a substantial residual risk related to existing defined benefit policies, including paid-up policies offering a guaranteed return. The new solvency framework for insurers, Solvency II, which came into force in 2016, provides a better basis for monitoring institutions' solvency. It also brings a comprehensive change in regulatory conditions, and work on guiding institutions and adapting the reporting regime and supervisory methodology will continue in 2017.

Given the continued high pace of introduction of new Europe-wide rules and supervisory convergence in the coming years, Finanstilsynet is expected to continue to devote substantial resources to regulatory development. This will mainly comprise assignments from the Ministry of Finance in preparing for implementation of directives and regulations as part of Norway's EEA obligations. Finanstilsynet will also need to devote substantial resources to regulatory development and supervisory collaboration under the auspices of the European supervisory authorities – the EBA, ESMA and EIOPA. This will continue to pose a substantial challenge to Finanstilsynet's resource management.

Another aspect of the regulatory changes that will require further system development and processing capacity is the increasing volume of reporting called for by the EU supervisory authorities. This involves obtaining fairly wide-ranging data from Norwegian financial institutions for inclusion in the overarching surveillance of the financial sector in Europe, and reporting on Finanstilsynet's compliance with European supervisory standards.

The implementation and follow-up of the EU's Bank Recovery and Resolution Directive, inter alia in the form of requirements for annual preparation and follow-up of institution-specific recovery plans and resolution plans, will take up much of Finanstilsynet's resources in the years ahead. Under the new body of rules, all banks must draw up recovery plans setting out concrete and implementable measures for dealing with financial crisis situations. The plans will be quality assured and approved by Finanstilsynet.

New EU regulations will widen Finanstilsynet's remit by bringing trading in commodity derivatives, and thereby new non-financial institutions, under regulation and supervision. Institutions trading in commodities, including power companies, will be subject to the same regulation as investment firms. They will face a licensing requirement giving rise to associated supervisory tasks. The scope of Finanstilsynet's tasks should be viewed in light of important Norwegian derivatives markets in a number of commodity segments, such as fish and energy, and appurtenant derivative trading platforms.

Handling the strong growth in Finanstilsynet's remit has been challenging. The tasks set have been fulfilled with no additional resources provided in recent years. Finanstilsynet has to some degree streamlined its operations through digitalisation and changed working processes. The most important contribution to efficiency gains is nonetheless a stricter prioritisation of efforts in various areas. Continued growth in the agency's tasks will further sharpen the need for effective use of available resources. A risk-based approach will still need to be applied. Hence expected consequences of events and possible rule breaches must weigh heavily in the allocation of resources. Finanstilsynet must also contribute to further efficiency gains through digitalisation of reporting and work processes.





## **ANNUAL ACCOUNTS**

# ANNUAL ACCOUNTS

## Comments from the Director General

The annual accounts are prepared and presented in accordance with the Regulations on Financial Management in Central Government and are in keeping with basic principles for budgeting and accounting enshrined in rules on financial management and in circulars from the Ministry of Finance. The presented accounts with notes provide a true and fair view of Finanstilsynet's disposable appropriations, revenues and expenses, assets and liabilities in 2016.

The Storting determines Finanstilsynet's expenditure budget and revenue budget as part of the government budget. The 2016 operating expenditure budget (item 01) originally totalled NOK 332.4 million. The budget was increased by NOK 2 million to cover unforeseen outlays, including krone exchange rate changes against the euro, and by NOK 5 million as compensation for the public sector wage settlement. Finanstilsynet has taken over responsibility for payment of Norway's EFTA contribution to the EU Commission with regard to the financial market, and the budget was accordingly increased by NOK 330,000. Including NOK 11.0 million carried forward from 2015, the aggregate disposable operating budget came to NOK 350.8 million.

Parts of Finanstilsynet's budget are allotted over item 45 *Major equipment procurements and maintenance*. This appropriation is earmarked for an IT development project, and unused funds can be transferred to subsequent budget years independently of operating expenditure. In the 2016 budget this appropriation totalled NOK 18.5 million which, together with NOK 4.97 million carried forward, brought disposable funds to NOK 23.47 million. The funds are used to develop IT systems needed to meet European reporting requirements and to carry out necessary analysis of available information. New requirements on supervision and supervisory methodology also entail a wide-ranging need for adjustments to systems that support the supervisory effort.

Finanstilsynet's expenditure budget was reduced by NOK 11 million as from 2015 as a result of a new VAT (value added tax) netting arrangement in the central government administration. VAT payments on goods and services covered by the arrangement are expensed on a central expenditure item under the Ministry of Finance. VAT payments are however shown in Finanstilsynet's appropriation report, see table 13, and are included in the supervisory levy. Aggregate expenditure came to NOK 372.4 million, an increase of 6.2 per cent from 2015. The expenditure underrun for item 01 *Operating expenditure* was NOK 12.39 million, which Finanstilsynet has applied to carry forward to 2017. The expenditure underrun for item 45 was NOK 2.25 million, which will be disposable in 2017. Calculation of underruns is shown in Note B.

Total salary expenditure came to NOK 264.2 million – 3.8 per cent more than in 2015. Annual salary growth in the state sector is put at 2.4 per cent. Higher salary growth in Finanstilsynet than in the state sector as a whole is explained by increased use of overtime and substitutes

due to a heavier workload. Moreover, the number of FTEs at the end of 2016 was 264, one FTE higher than at the end of 2015. Disbursements for investment and other disbursements to operations (see reporting by natural classification) show an increase of 11.5 per cent from 2015. This increase is due to an increase of NOK 8 million in the appropriation to major equipment procurements and maintenance (item 45). Establishing new systems for reporting to the EU, and making necessary adjustments to existing systems, is resource demanding for Finanstilsynet. European organisations increasingly demand contributions on an annual basis. Hence developments in the EU/EEA are expected to require more resources in the years ahead.

Finanstilsynet charges for prospectus control under the Securities Trading Act and for processing applications for a licence to operate as a payment institution. In 2016 the arrangement switched from payment in arrears to payment in advance to ensure payment for the work done. Pursuant to section 9 of the Financial Supervision Act, Finanstilsynet's expenses are covered by the institutions under its supervision over the financial year. The Act requires the expenses to be apportioned among the various institutional groups based on the extent of supervision, and expenses are therefore payable in arrears. The Storting adopts a revenue appropriation equal to the expenditure appropriation for the previous year, but the apportionment of the supervisory levy is based on accounting data. Levies for 2016 will be collected in 2017. The supervisory levy is apportioned on the individual institution under detailed rules set out in regulations.

The Norwegian National Collection Agency annually collects supervision fees and other levies on behalf of Finanstilsynet. This work also includes accounting and reporting of payments to the central government accounts. In order to provide as complete a picture as possible of Finanstilsynet's annual accounts, we have assigned these figures to a separate column in table 3: *Appropriation report for 2016, itemised*.

After prior consultation with the trade organisations concerned, Finanstilsynet's expenditure for 2015 was communicated to the institutions for payment in May. The overall claim came to NOK 341.8 million. Supervised entities liable to pay the amount levied numbered 14,926, of which 76 were foreign branches. The largest category of supervised entities is external accountants, numbering 11,541 at the end of 2015.

The Office of the Auditor General audits the activity of Finanstilsynet. The audit report for 2016 is due to be available by 1 May 2017 and to be published on Finanstilsynet's website as soon as possible thereafter.

Oslo, 16 February 2017



**Morten Baltzersen**

Director General, Finanstilsynet

### **Accounting policies**

Finanstilsynet's accounts are kept on a cash basis. Revenues and expenses are recognised as and when paid. The accounts follow the calendar year and contain all reported expenditures and revenues for the accounting year. Expenditures and revenues are entered in the accounts on a gross basis.

Finanstilsynet pays pension premiums to the Norwegian Public Service Pension Fund. For 2016 a pension premium of 17.5 per cent is computed on fixed salaries compared with 16.6 per cent in 2015. Of this, 2 per cent is withheld from the employee. Pension premiums are paid in arrears in six annual instalments. The calendar year's final instalment falls due the following year. Hence there is a period displacement for the final instalment each year. Employer's contributions are computed and entered in the accounts to show the total salary expenditure.

Finanstilsynet is attached to the central government's consolidated accounts scheme at Norges Bank and has drawing rights equivalent to the Storting's appropriation. Upon the transition from one year to the next the balance on each settlement account is reset to zero.

### **Appropriation reporting**

Appropriation reports with notes show the appropriations at Finanstilsynet's disposal, collated with accounting data reported to the central government accounts.

The Norwegian National Collection Agency is granted a debit authorisation in chapter 4602, items 03 and 86, and in chapter 5580, item 70. Finanstilsynet has been given special authorisation to extend the standard appropriation report by adding further columns. Hence the report from the National Collection Agency is shown in the column "Entered by others in accordance with authorisations". The actual difference between appropriation and accounts is shown in the column "Deviation from allocation".

### **Reporting by natural classification**

Reporting by natural classification with notes shows Finanstilsynet's reports to the central government accounts in 2016 based on the standard chart of accounts in the accounting year with comparatives for 2015.

Note 8 shows the difference between the final account and preliminary account with the Treasury. The final account with the Treasury shows the sum of booked amounts in assets and liabilities in Finanstilsynet's account specification, while the preliminary account with the Treasury shows assets and liabilities reported to the central government accounts.

**Table 11: Appropriation report for the accounting year 2016, itemised**

Expenditure chapter	Chapter name	Item	Item text	Note	Total appropriation	Accounts 2016	Expense overrun (-) or underrun	Entered by others in accordance with authorisations	Deviation from allocation
1602	Finanstilsynet	01	Operating expenses	A, B	350,797,000	338,401,942	12,395,058		
1602	Finanstilsynet	45	Major new procurements and maintenance	A, B	23,471,000	21,220,355	2,250,645		
1633	Govt. VAT netting arrangement	01	Operating expenses		0	13,127,122			
Total expensed					374,268,000	372,749,419			

Revenue chapter	Chapter name	Item	Item text	Note	Total appropriation	Accounts 2016	Revenue overrun (-) or underrun		
4602	Finanstilsynet	03	Prospectus control fee	A	10,180,000	5,486,100	4,693,900	4,222,415	471,485
4602	Finanstilsynet	86	Relinquishment of gain and violation penalties etc.	A	500,000			2,821,854	-2,321,854
5580	Sectoral levies set by Ministry of Finance	70	Contributions from supervised entities	A	341,000,000	687,426	340,312,574	341,746,944	-1,434,370
5700	Revenue from National Insurance	72	Employer's contribution		0	32,745,339			
Total taken to revenue					351,680,000	38,918,865		348,791,213	-3,284,739

**Net amount reported to the appropriation account** **333,830,554**

**Capital accounts**

	Norges Bank CA / receipts	14,914,758	
	Norges Bank CA / payments	-348,520,228	
716106	Change in outstanding account with the Treasury	-225,084	
Total reported		0	

**Holdings reported to the capital account (31.12)**

		31.12.2016	31.12.2015	Change
716106	Outstanding account with the Treasury	-12,058,466	-11,833,382	-225,084

**Note A Explanation of overall allocation**

Chapter and item	Brought forward from last year	Current year's allocations	Overall allocation
160201	11,023,000	339,774,000	350,797,000
160245	4,971,000	18,500,000	23,471,000
460203		10,180,000	10,180,000
460286		500,000	500,000
558070		341,000,000	341,000,000

**Note B Explanation of utilised authorisations and calculation of amount possibly to be brought forward to next year**

Chapter and item	Headword	Expense overrun (-) / underrun	Expensed by others in accordance with debt authorisations	Expense overrun (-) / underrun under debt authorisations	Overall basis for amount brought forward	Max. amount to be brought forward*	Possible amount to be brought forward calculated by Finanstilsynet
160201		12,395,058		12,395,058	12,395,058	16,988,700	12,395,058
160245	"May be brought forward"	2,250,645		2,250,645	2,250,645	28,700,000	2,250,645

\* The maximum amount that may be brought forward is 5% of the year's appropriation on operating items 01-29, with the exception of item 24, or the sum of the last two years' appropriations under the headword "may be brought forward". See circular R-2/2017 for further details on transfer of unutilised appropriations.

## Explanation of use of budget authorisations

### **Debit authorisations received**

The Ministry of Finance has authorised Finanstilsynet to place orders over and above appropriations granted on chapter 1602, item 45, of NOK 10 million. Finanstilsynet did not make use of this authorisation in 2016.

By letter of 7 April 2016 the Ministry of Finance authorised Finanstilsynet to post salaries to project managers for IT development programmes on chapter 1602, item 45.

### **Headword "may be brought forward"**

Finanstilsynet's appropriation on item 45 is allocated under the headword "may be brought forward". The appropriation on this item covers development programmes for the IT systems.

### **Debit authorisations granted (expensed by others)**

Finanstilsynet has granted the Norwegian National Collection Agency a debit authorisation on chapter 4602, items 03 and 86, and chapter 5580, item 70.

### **Authorisation to overstep operating appropriations against corresponding revenue overruns**

Finanstilsynet received no revenue overrun authorisation in 2016.

### **Possible amount to be brought forward**

Expenditure underrun on item 01 is calculated at NOK 12,395,000. This figure is below the limit for transfer of 5 per cent of the year's appropriation on item 01, and the entire amount is deemed possible to bring forward to 2017. The entire unutilised appropriation of NOK 2,251,000 on item 45 may be brought forward.

**Table 12: Statement of reporting by natural classification, 31.12.2016**

	Note	2016	2015
<b>Operating revenues reported to the appropriation account</b>			
Receipts of fees	1	5,486,100	0
Receipts of grants and transfers	1	0	0
Receipts of sale proceeds and rents	1	0	0
Other receipts	1	0	0
Total receipts from operations		5,486,100	0
<b>Operating expenses reported to the appropriation account</b>			
Disbursements to salaries	2	264,213,424	254,511,881
Other disbursements to operations	3	91,558,342	80,597,902
Total disbursements to operations		355,771,766	335,109,782
<b>Net reported operating expenses</b>		<b>350,285,666</b>	<b>335,109,782</b>
<b>Investment and financial revenues reported to the appropriation account</b>			
Receipts of financial revenues	4	0	-3,960
Total investment and financial revenues		0	-3,960
<b>Investment and financial expenses reported to the appropriation account</b>			
Disbursement to investments	5	3,850,530	4,984,296
Disbursement to purchase of equities	5	0	0
Disbursement to financial expenses	4	0	0
Total investment and financial expenses		3,850,530	4,984,296
<b>Net reported investment and financial expenses</b>		<b>3,850,530</b>	<b>4,988,256</b>
<b>Collection activities and other transfers to central govt.</b>			
Receipts of taxes, charges, fees etc.	6	687,426	3,302,460
Total collection activities and other transfers to central govt.		687,426	3,302,460
<b>Grant management and other transfers from central govt.</b>			
Disbursements of grants and benefits	7	0	0
Total grant management and other transfers from central govt.		0	0
<b>Revenues and expenses reported on central govt. chapter</b>			
Group life insurance account 1985 (ref. chap. 5309, revenues)		0	0
Employer's contribution account 1986 (ref. chap. 5700, revenues)		32,745,339	31,352,210
VAT netting arrangement account 1987 (ref. chap. 1633, expenses)		13,127,122	10,900,228
Net expenses reported on central govt. chapter		-19,618,217	-20,451,982
<b>Net reported to the appropriation account</b>		<b>333,830,554</b>	<b>316,343,596</b>
<b>Overview of outstanding accounts with the Treasury</b>			
<b>Asset and liabilities</b>		<b>2016</b>	<b>2015</b>
Receivables		36,753	246,210
Cash		0	0
Bank accounts with central govt. funds outside Norges Bank		0	0
Tax withholdings owed		-11,799,944	-11,131,571
Public charges owed		-295,275	-158,896
Other liabilities		0	-789,126
<b>Total outstanding account with the Treasury</b>	<b>8</b>	<b>-12,058,466</b>	<b>-11,833,382</b>

<b>Note 1 Receipts from operations</b>	<b>31.12.2016</b>	<b>31.12.2015</b>
<i>Receipts from fees and charges</i>		
Prospectus control fees	5,486,100	0
<b>Total receipts from fees and charges</b>	<b>5,486,100</b>	<b>0</b>
<i>Receipts from grants and transfers</i>		
<b>Total receipts from grants and transfers</b>	<b>0</b>	<b>0</b>
<i>Receipts of sale proceeds and rents</i>		
<b>Total receipts of sale proceeds and rents</b>	<b>0</b>	<b>0</b>
<i>Other receipts</i>		
<b>Total other receipts</b>	<b>0</b>	<b>0</b>
<b>Total receipts from operations</b>	<b>5,486,100</b>	<b>0</b>
<b>Note 2 Disbursements to salaries</b>		
	<b>31.12.2016</b>	<b>31.12.2015</b>
Salaries	204,119,392	195,567,634
Employer's contribution	32,745,339	31,352,210
Pension expenses*	28,520,285	27,778,431
Sickness benefit and other refunds (-)	-6,489,358	-5,414,966
Other benefits	5,317,766	5,228,572
<b>Total disbursements to salaries</b>	<b>264,213,424</b>	<b>254,511,881</b>
<i>* Finanstilsynet pays pension premium to the Norwegian Public Service Pension Fund</i>		
<b>FTEs</b>	<b>264</b>	<b>263</b>
<b>Note 3 Other disbursements to operations</b>		
	<b>31.12.2016</b>	<b>31.12.2015</b>
Rent	17,362,592	16,896,976
Maintenance of own buildings and facilities	0	0
Maintenance and conversion of rented premises	45,285	137,588
Other expenses on operation of property and premises	6,021,511	5,907,204
Repairs and maintenance of machinery, equipment etc.	690,578	692,713
Minor equipment procurements	467,344	628,497
Lease of machinery, furniture etc.	7,358,362	8,676,009
Purchases of external services	34,015,646	24,067,851
Travel and per diem	6,189,247	6,041,814
Other operating expenses	19,407,777	17,549,250
<b>Total other disbursements to operations</b>	<b>91,558,342</b>	<b>80,597,902</b>
<b>Note 4 Financial revenues and financial expenses</b>		
	<b>31.12.2016</b>	<b>31.12.2015</b>
<i>Receipts of financial revenues</i>		
Interest revenues	0	-3,960
Foreign exchange gain	0	0
Other financial revenues	0	0
<b>Total receipts of financial revenues</b>	<b>0</b>	<b>-3,960</b>
<i>Disbursement of financial expenses</i>		
Interest expenses	0	0
Foreign exchange loss	0	0
Other financial expenses	0	0
<b>Total disbursement of financial expenses</b>	<b>0</b>	<b>0</b>

<b>Note 5 Disbursed to investments and purchase of equities</b>	<b>31.12.2016</b>	<b>31.12.2015</b>
<i>Disbursed to investments</i>		
Intangible assets etc.	2,551,140	805,196
Sites, buildings and other real property	0	0
Emergency preparedness acquisitions	0	0
Infrastructure assets	0	0
Machinery and vehicles	0	0
Operating movable property, furniture, tools etc.	1,299,391	4,179,101
<b>Total disbursed to investments</b>	<b>3,850,530</b>	<b>4,984,296</b>
<i>Disbursed to purchase of equities</i>		
Capital contributions	0	0
Bonds	0	0
Investments in equities and participations	0	0
<b>Total disbursed to purchase of equities</b>	<b>0</b>	<b>0</b>

<b>Note 6 Collection activity and other transfers to central govt.</b>	<b>31.12.2016</b>	<b>31.12.2015</b>
Contributions from supervised entities	687,426	3,302,460
<b>Total collection activity and other transfers to central govt.</b>	<b>687,426</b>	<b>3,302,460</b>

<b>Note 7 Grant management and other transfers from central govt.</b>	<b>31.12.2016</b>	<b>31.12.2015</b>
<b>Total grant management and other transfers from central govt.</b>	<b>0</b>	<b>0</b>

#### **Note 8 Final and preliminary account with the Treasury**

<b>Part A Difference between booked and reported account with the Treasury</b>		<b>31.12.2016</b>	<b>31.12.2016</b>	
		Specification of booked account with Treasury	Specification of reported account with Treasury	Difference
<b>Financial fixed assets</b>	Investments in equities and participations*	0	0	0
	Bonds	0	0	0
	<i>Total</i>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Current assets</b>	Accounts receivable	330,250	0	330,250
	Other receivables	36,753	36,753	0
	Bank deposits, cash etc.	0	0	0
	<i>Total</i>	<b>367,003</b>	<b>36,753</b>	<b>330,250</b>
<b>Long-term liabilities</b>	Other long-term liabilities	0	0	0
	<i>Total</i>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Short-term debt</b>	Accounts payable	-15,925	0	-15,925
	Tax deductions owed	-11,799,944	-11,799,944	0
	Public charges owed	-295,275	-295,275	0
	Other short-term liabilities	0	0	0
	<i>Total</i>	<b>-12,111,144</b>	<b>-12,095,219</b>	<b>-15,925</b>
<b>Total</b>	<b>-11,744,141</b>	<b>-12,058,466</b>	<b>314,325</b>	

\* Entities which own financial assets in the form of investments in equities and participations also complete Note 8B. Finansstilsynet does not own equities or participations, and Note 8B is therefore not drawn up.





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