



# KREDIT TILSYNET

The Banking, Insurance and Securities Commission of Norway



# *Kredittilsynet*

## **Kredittilsynet's functions and objectives**

Kredittilsynet supervises banks, finance companies, mortgage institutions, insurance companies, securities trading, estate agents, debt collection and accounting and auditing activities.

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

*Act on the Banking, Insurance and Securities Commission (Section 3)*

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

*Kredittilsynet's functions are four-fold:*

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

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

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

*From Kredittilsynet's strategy*

# Contents

Kredittilsynet's functions and objectives .....	page 2
Contents .....	page 3
Preface .....	page 5
Current trends and analyses.....	page 8
Kredittilsynet's operations in figures.....	page 16
Banking, finance and insurance .....	page 20
Accounting .....	page 27
Auditing.....	page 27
Securities trading.....	page 30
Debt collection.....	page 35
Estate agency.....	page 35
Overview of international activities .....	page 38
Ten years of integrated supervision.....	page 41
Kredittilsynet's organisational set-up.....	page 44
Organisation chart.....	page 47





Paradoxically, Ålesund's special Art Nouveau or Jugend architecture is the result of a catastrophic fire in 1904 which reduced the town to ashes. It was rebuilt in the style that was so popular throughout Europe at the time. The splendid Art Nouveau ceiling is in the dining room at Kirkegt. 10.

# Preface

The vigorous recovery in the Norwegian economy together with falling interest rates contributed to a steep rise in real property values and security prices in 1996, with positive effects for financial institutions. Developments ahead are uncertain and risks may be faced. Rising interest rates could lead to a decline in property and securities markets. International conditions could induce such a situation in spite of a buoyant Norwegian economy.

Many households and firms could be tempted to borrow heavily based on their ability to service debt when interest rates are low. If interest rates rise, borrowers would be adversely affected and institutions would risk heavier loan losses. Borrowers and financial institutions should therefore exercise caution and carefully evaluate how much debt they will be able to service if interest rates rise significantly above the level in effect at the start of 1997. Kredittilsynet will monitor the soundness of lending practices and will censure credit institutions that provide full debt-financing for purchases of real estate and securities where collateral has not been stringently assessed.

Overall credit expansion in 1996 was relatively moderate despite the heavy increase in bank lending. A high level of financial saving by households and firms was instrumental in averting a new "yuppie" period of unwarranted heavy lending and inflated property valuations which could potentially fuel a crisis.

Low interest rates together with other savings products, among them those offered by securities funds, led to pressure on interest margins and a reduction in the share of ordinary deposits at many banks. Since lending growth is increasingly based on funding that lacks the stability inherent in customer deposits, some banks may have become more vulnerable to negative developments in financial markets. Continued pressure on interest margins together with the gradual return of losses to normal levels creates new challenges to banks' ability to maintain a satisfactory financial position. Banks still need to cut costs.

The sound performances posted by financial

institutions in 1996 will enable them to consolidate capital levels. Whereas at the end of the third quarter of 1996 all savings banks met the capital requirement of 8 per cent with tier 1 capital, i.e. without resorting, for instance, to subordinated debt, tier 1 capital in several commercial banks amounted to a mere 6 per cent. Although this exceeds the minimum requirement it represents a low level by international standards. Commercial banks in particular should therefore devote a substantial portion of their profits for 1996 to strengthening their capital position.

Lower rates of return in general and the risk of an interest rate increase resulting in lower bond and share values could have an adverse impact on life insurance companies. These companies should therefore employ supplementary provisions to strengthen their buffer capital and their ability to cope with market fluctuations. By so doing they will also enhance their ability to invest in assets carrying higher risk and higher returns.

Developments in securities markets pose challenges on several fronts. In 1996, as previously, instances of possible insider trading were brought to light and referred to ØKOKRIM<sup>1</sup> for investigation. Effective measures against insider trading are important for maintaining confidence in the share market. Attempts at price manipulation must also be combated. New laws and rules are being implemented in the securities sphere in conformity with the relevant EU Directive. These rules provide greater freedom to offer investment services and impose tight requirements on managers and the way such services are organised. The majority of investment firms now in operation received authorisation to operate under the new rules at the end of 1996.

Supervisory activities continued apace in 1996. Particular importance was attached to monitoring the quality of financial institutions' internal controls and management. Monitoring compliance with important legal requirements and ethical rules was another important theme. Rules on capital adequacy and reporting in relation to

<sup>1</sup> National Authority for Investigation and Prosecution of Economic and Environmental Crime.

market risk were introduced. Macroeconomic analyses reinforced the overall supervision effort. Adjustment to EU/EEA rules for financial markets has required the deployment of substantial resources by Kredittilsynet in recent years. Interest in the Norwegian market is growing in foreign quarters, leading to a wider array of services and heightened competition. At present the competitive effects are greater in markets for major firms and special services than in markets for smaller firms and households.


Kredittilsynet commemorated its tenth anniversary in 1996. Experiences with a joint supervision for banking, insurance and securities have been favourable. It is now simpler to supervise financing

operations across sectoral divides, and greater flexibility and expertise can be applied to tasks that have changed over time. The plan for upgrading Kredittilsynet's capacity - formulated after the Storting's (Norwegian parliament) review of Kredittilsynet's organisation in 1992 - was completed in 1996. Under its new framework conditions Kredittilsynet has the capacity and organisational set-up needed to tackle the tasks now faced. However, developments in financial markets will bring new challenges for institutions and Kredittilsynet alike - especially in securities markets where new technology is making increasing demands on competence and capacity.

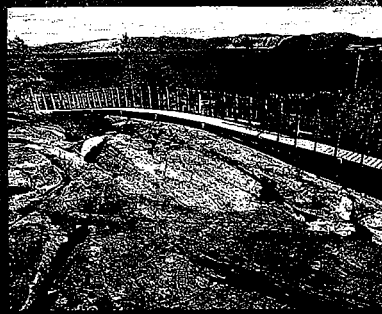
*Oslo, 17 January 1997*



Erling Selvig  
Board Chairman



Bjørn Skogstad Aamo  
Director General, Kredittilsynet



The photos show rock carvings from Alta, Finnmark. The numerous rock carvings from various periods are a worldwide sensation and are featured on UNESCO's World Heritage List. The site contains a large proportion of animal depictions.

Photo: Arve Kjerheim, MIKU

# Current trends and analyses

**Falling interest rates, steeply rising share values and good results in 1996**

**Households, firms and financial institutions vulnerable if interest rates rise and share prices fall**

**Life insurance companies most directly exposed to rising interest rates and falling asset values**

## Introduction

The financial year 1996 featured falling interest rates, a marked advance in share values and good results for all groups of financial institutions. A substantial rise in property values was also recorded.

After a period of sharply increasing asset values, households, firms and financial institutions could all be vulnerable to a value fall resulting, for instance, from a rise in interest rates. Vulnerability will be especially pronounced if property and share acquisitions are largely debt-financed. It is difficult to gauge the probability of interest rate increases and value falls. The short term prospects for the Norwegian economy are good. However, given the high degree of integration of cross-border financial markets, interest rate increases and asset value reductions could feed through from international conditions. Since markets are more likely to fluctuate than remain absolutely stable over time, the question is not if, but when, markets will again be affected by a significant interest rate increases and asset value falls. Hence it will be imperative to keep a close watch on market developments and to be prepared for fluctuations.

Of financial institutions, life insurance companies are the most directly exposed to fluctuations in securities markets since a large portion of their resources is invested in securities. An account

of the consequences for life insurance companies of a fall in share and bond values caused by an interest rate increase of about 2 percentage points is given under a separate heading.

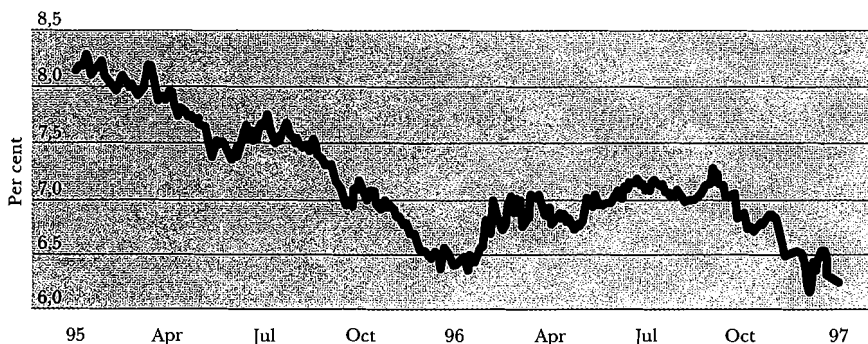
For banks the key factors affecting financial performance are the interest margin, costs and losses. These factors are analysed below. The years 1995 and 1996 were excellent for both savings and commercial banks with profits amounting to about 1 ½ per cent of total assets. The good results are partly attributable to extremely low losses. For many banks the upswing in the property market and generally favourable economic conditions meant that reversals of previous loss provisions exceeded new loss provisions. However, this source of income is drying up and banks face a gradual return to normal loss conditions. Concurrently interest margins are under pressure. The favourable economic climate at the start of 1997 indicates that this will be another good year for the banks. The outlook for 1998-99 is less certain. To illustrate the uncertainty, scenarios have been prepared for bank earnings under various assumptions. In view of the renewed discussion of the banking crisis at the start of the decade, the loss trend is analysed in a separate section.

Financial conglomerates are playing a more and more dominant role in the Norwegian financial industry. Diversification can in many situations make them more robust to negative trends in particular sectors. In other situations negative trends can affect several sectors simultaneously. Kredittilsynet is taking steps to strengthen overall surveillance of conglomerates' financial position.

## Shifting markets

Falling interest rates are accompanied by rising market value of fixed-interest bonds. For financial institutions with substantial holdings of such securities, interest rate falls result in price gains whereas higher rates result in price losses. Life insurance companies in particular, but also to some extent companies in non-life insurance,

**Chart 1: Long interest rates (s465) 01.01.95 - 31.12.96**



Source: EcoWin



as well as savings banks, have substantial bond holdings. After falling throughout 1995, long rates (measured by government bonds maturing from 1993 to 2004, series S456) edged up until early September 1996 when they again fell fairly sharply to a level of about 6.2 per cent at the end of 1996.

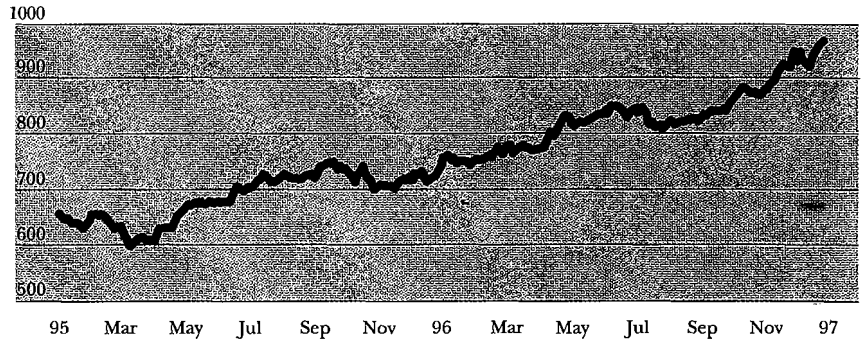
In the share market the positive trend of 1995 strengthened through the year up to end-November 1996. The all-share index showed an increase of about 30 per cent from the turn of the year. The advance from the start of 1995 to the end of 1996 measured 47 per cent. After such a marked increase in share values on domestic and internationally markets, it goes without saying that a turnaround may ensue.

### Housing market

Property markets also showed a substantial value increase. House prices rose strongly in 1996 and at year-end were on a par with the peak reached at the end of the eighties. The overall rise from the trough in 1992 to 1996 was close to 40 per cent. Even so real prices are still markedly lower than in 1987/1988. Great uncertainty is attached to the future trend in house prices. With lower house mortgage rates, expectations of continued growth in employment, higher real wages and a slow rate of house starts in 1996, the stage is set for a further strong rise in house prices in 1997. Experience shows that higher house prices encourage heavier borrowing, which in turn strengthens the rise in prices. If prices rise significantly above a "sustainable" level, there will be a greater risk of substantial price falls in the event of an economic turnaround. With a rising debt-finance ratio this could give rise to problems in the financial industry. It is not easy to define what constitutes an excessively high price rise. A comparison with the level at the end of the eighties is difficult since price levels at that time were artificially high.

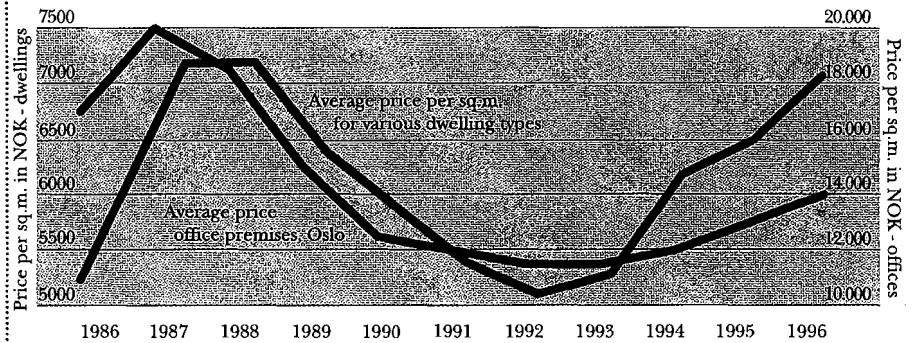
Market values of centrally located office premises in the biggest towns have risen by about 20 per cent since 1992/1993, rentals by a slightly larger margin. Both rentals and market prices for commercial properties remain far lower than at their peak at the end of the eighties. This is also true for commercial properties when not corrected for overall inflation. However, just as

Chart 2: Oslo Stock Exchange, all-share index 01.01.95 - 31.12.96



Source: EcoWin

3: Property market 1985 -1986



Source: NEF/ECON/OPAK

in the case of house prices, caution must be shown when making comparisons with the inflated prices at the end of the eighties. Given the steep price rises of recent years, a high rate of starts and relatively large idle floorage, particularly in Oslo, the possibility of a setback in the wake of an interest rate increase and economic stagnation cannot be disregarded.

### Life insurance

Life insurance companies' results for the first three quarters of 1996 came to NOK 5.3 billion, i.e. 2.2 per cent of average total assets. The value-adjusted result, which includes changes in unrealised gains in the period, was NOK 5.2 billion.

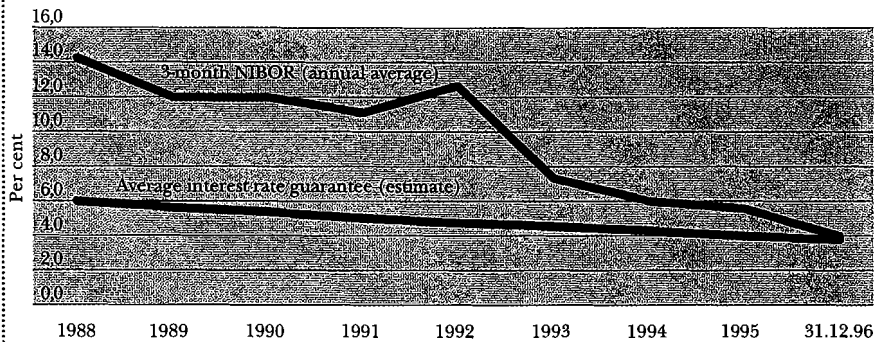
Based on the development in the first three quarters and developments in the securities markets after the end of the third quarter, 1996 seems set to be a good year for life insurance companies. Based on certain assumptions, the value-adjusted result for 1996 will be of the order of NOK 12 - 13 billion.

The all-share index on Oslo Stock Exchange increased by 47% during 1995 and 1996

Property prices are still expected to rise

Life insurance companies' results ahead will largely depend on interest rates and share prices

**Chart 4: Short-term interest rates and annual interest rate guarantee**



Source: Norges Bank and Kredittilsynet

Life insurance companies' results ahead will largely depend on interest rates and share prices. For life insurance companies the average guaranteed interest rate was for a long period low compared with nominal rates, represented by rates on bank deposits, loans and bonds/certificates. This provided life insurance companies with current earnings representing a buffer against price fluctuations on the income side. Even in years with price losses on shares and bonds, it has not been necessary to deplete supplementary provisions or equity capital in order to fulfil the interest rate guarantee. Chart 3 shows the trend in life insurance companies' guaranteed interest rate and the short-term rate represented by three-month NIBOR in the period 1988 to 1996.

Although life insurance companies normally achieve a return on their investments that is somewhat higher than the short-term rate, their income buffer was reduced dramatically in the period (see chart), in step with falling interest rates. Over the period other buffers such as supplementary provisions and unrealised gains therefore acquired increased significance for life insurance companies' ability to maintain flexible asset management. At the end of 1996 there was no significant difference between the short-term interest rate and these companies' guaranteed rate. At times rates may fall to an even lower level. Hence in a situation of persistent low interest rates supplementary provisions and other buffers will be particularly important. Life insurance companies can then invest a large portion of their portfolio in shares and other securities with a higher expected return, but also

a greater risk of fluctuation. This type of adjustment will be necessary in a situation where increasing competition in the pension savings market from banks and investment firms intensifies the pressure on life insurance companies to achieve competitive returns. Lower interest rates also put a greater onus on the administration result and cost reductions.

Life insurance companies are also likely to encounter problems in the short term in the event of an increase in interest rates. For example, an interest rate increase of 2 percentage points concurrent with a 30 per cent fall in share prices would on its own inflict a price loss of about NOK 15 billion. In that event they would have to draw on supplementary provisions and other buffers in order to give policyholders the return guaranteed to them. At the end of the third quarter of 1996 supplementary provisions and unrealised gains combined came to just under NOK 13 billion. Unrealised gains can be expected to have increased somewhat in the meantime. In the longer term higher interest rates could once again yield higher returns. Hence both in order to meet a situation of persistently lower interest rates and a situation of higher interest rates and falling security values, life insurance companies would be well advised to devote a portion of the excellent results in 1996 to increase supplementary provisions.

#### The trend in banks' margins and costs

The interest margin is the difference between the banks' average deposit and lending rates. This margin fell steadily throughout the period from 1988 to 1996. The chart below shows that while the banks' interest margin at end-1988 was 6.1 percentage points, at the end of the first half of 1996 it was down to 3.5 percentage points. This illustrates the steadily growing competition among banks. Even so, the trend in the first two quarters of 1996 may suggest that the fall in the interest margin is starting to level off.

Since the interest margin, which is the banks' principal source of income, has shown a falling tendency in recent years and there is no current indication that it will resume an upward trend, banks will be compelled to adjust costs to income in order to maintain earnings. The chart below shows savings and commercial banks' net interest

**Life companies should devote part of their 1996 profits to increase supplementary provisions**

**Pressure on interest margins compels banks to adjust costs to earnings**

income and total costs in per cent of average total assets.

Net interest income, i.e. overall interest income less interest expenses, shows a somewhat different path than the interest margin, due to changes in composition of balance sheet items. Net interest income peaked in 1993 in both bank groups and has since fallen up to the autumn of 1996 when it started to level off. While the fall has been far bigger for the savings banks, the latter's net interest income remains 1 percentage point higher than that of the commercial banks.

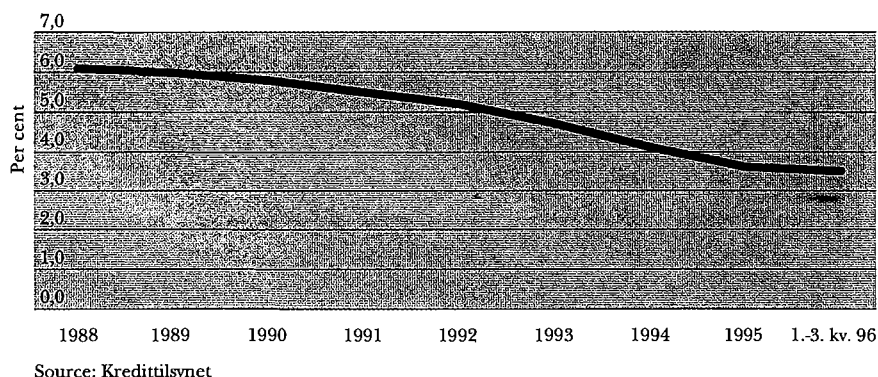
Since the banking crisis the banking industry has cut costs by means of staff reductions and branch closures. Both bank groups have reduced costs in per cent of average total assets since the end of the eighties. From 1993 onwards savings banks can point to a bigger fall than commercial banks. While the fall may at present seem somewhat smaller than could be expected, profit and loss accounts have yet to show the full effect of all rationalisation measures. Costs among savings banks have throughout the period been higher than among commercial banks, largely reflecting the fact that savings banks' funding has to a greater degree consisted of ordinary deposits from small savers, which are more costly than more substantial borrowings.

### Possible trend in banks' results ahead

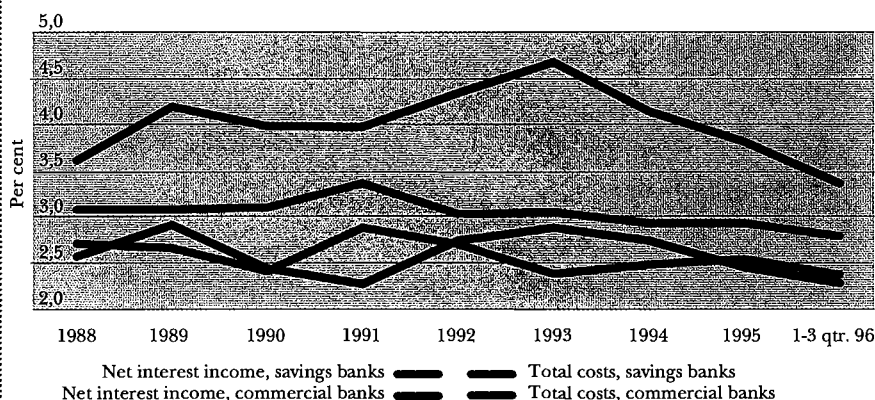
A useful exercise is to see what may happen to banks' earnings if the current trends persist. Continued strong competition on both the lending and deposit fronts against a backdrop of falling net interest income and gradually rising losses, will weaken banks' results. In the past two years banks' operating profits have been satisfactory, also when current volume growth is taken into account. However, only marginal weakening of results would be needed to make it impossible to generate sufficient equity from operations to maintain the current level of tier 1 capital, or for return on equity to fall too low to attract fresh capital through new issues.

To illustrate the challenges confronting the banks we have made a few simple projections of profit and loss items based on the assumption that net interest income will either level off or show a further slight fall. Where losses are concerned, some normalisation of the loss ratio

**Chart 5: Interest margin, all banks, 1988-1996**



**Chart 6: Net interest income and total costs in per cent of average total assets, 1988 - 1996**



is assumed in the years immediately ahead based on the fact that loss provisions have now been reduced to such a low level that there is less likelihood of new write-backs.

### Net interest income

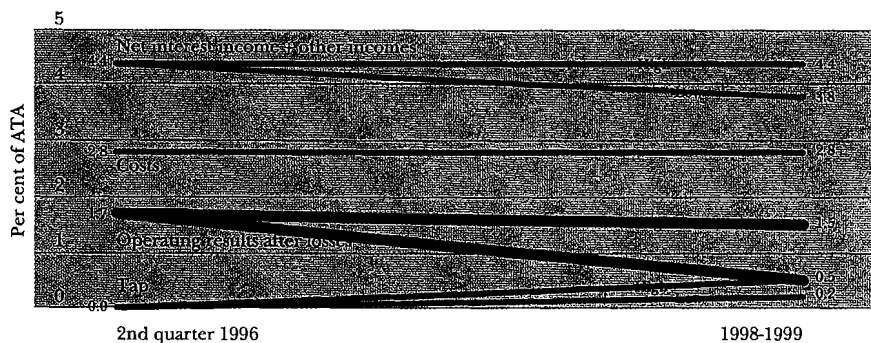
Competition ahead is expected to be fierce on both the lending and deposit sides. At best the banks will succeed in maintaining current levels measured in per cent of average total assets. The second alternative, which appears somewhat more probable, is that net interest income will continue to fall. A somewhat bigger decline is assumed for savings banks (0.6 percentage point) than for commercial banks (0.4 percentage point) since savings banks generate far higher net interest income than commercial banks.

### Registered losses

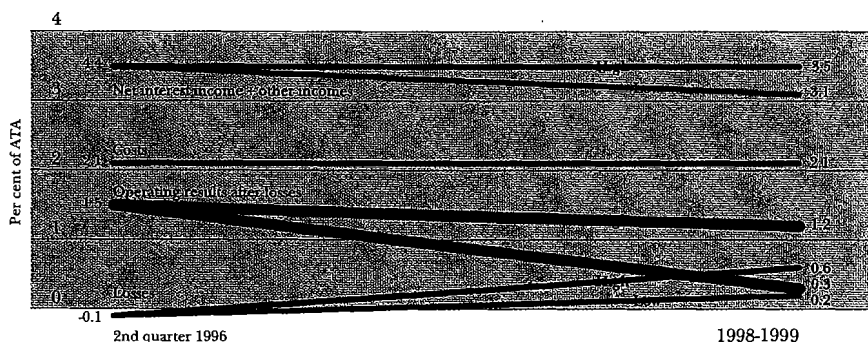
In the past couple of years banks' registered losses have been extremely low, essentially

**Banks could see fall in earnings if the current trend continues**

**Chart 7: Scenarios for savings banks' results in 1988 - 1989**



**Chart 8: Scenarios for commercial banks' results in 1988 - 1989**



because they have been able to reduce loss provisions on the back of improved customer finances and higher collateral security values. In a two to three-year perspective savings banks' losses are assumed to increase to 0.2 - 0.6 per cent of gross lending. This does not represent a particularly pessimistic outlook, but must rather be seen as a "normalisation" of banks' registered losses after a period in which the economic climate has clearly improved. A downturn featuring problems on the labour market combined with rising interest rates and falling property values could lead to losses beyond the levels assumed here, although this currently seems unlikely.

**Other incomes/costs**

For simplicity's sake it is assumed that the level of incomes (other than net interest income) and cost levels will show no change in the period. Incomes derived from gains on securities and currency trading may fluctuate widely and could

conceivably make a negative contribution in a particular year.

**Result after losses**

The profit trend under these assumptions is shown in Charts 7 and 8.

Commercial banks emerge with post-loss profit in the range 0.3 - 1.2 per cent of average total assets, while the corresponding range for savings banks is 0.5 - 1.5 per cent.

The projection, based on unchanged cost levels, shows that current trends may lead to a problematic earnings situation in the course of two to three years. Only in the alternative where net interest income is maintained and losses remain low (0.2 per cent of loans) do earnings appear satisfactory. If heavier losses are assumed, concurrent with falling net interest income, operating results fall to a level which creates problems for the banking sector. The projections illustrate the importance of continued efforts by banks to strive for cost reductions and concurrently increase other earnings. If they fail to do this, earnings problems will arise in the years immediately ahead, even in the absence of new setbacks. This point has been taken by the major banks, most of whom have put cost-cutting measures on the agenda - and seem justified in doing so in light of current tendencies in the banking industry.

**Banking crisis, losses and write-backs**

In 1996, as in 1995, it was asserted that the banking crisis was a pseudo crisis triggered by Kredittilsynet's excessively strict rules for recording losses. References were made to the minimal and at times negative losses recorded in the preceding two or three years.

The rules in effect in the crisis years - and subsequently - required banks to record losses on bad loans in terms of the customer's financial position and the value of the collateral security given. Both these factors may change in a positive direction during an economic upturn of the kind experienced in the past few years. Hence a certain volume of write-backs in the event of a turnaround is built into the system, although this has little relevance when a bank incurs losses and its solidity and financial position are appraised. Even so this issue was

worth a closer look. Since 1994 Kredittilsynet has therefore collected overviews of write-backs of various kinds from all commercial banks and from the 32 biggest savings banks.

There are several ways off assessing these correction items.

The first procedure entails viewing the sum of correction items against gross provisions in the years under scrutiny plus the two preceding years (where figures for gross provisions are available).

For the years 1992 to the first half of 1996 inclusive, write-backs totalled NOK 7,489 million for commercial banks, while incomings on previously registered losses came to NOK 2,348 million, bringing the overall correction for commercial banks for these four and a half years to NOK 9,837 million. Gross registered losses, excl. write-backs and incomings on previously registered losses, for the period 1990 to the first half of 1996 inclusive came to NOK 47,043 million for the commercial banks. Hence write-backs plus incomings on previously registered losses totalled 21 per cent of losses before corrections. While this is not an insignificant correction, it confirms that at least four-fifths of the loss provisions must be regarded as real and necessary despite an unexpectedly positive market trend in the period in question.

When assessing these figures it must be kept in mind that although loss provisions have on average been justified, substantial gross write-backs are a normal part of the picture. Only if the final loss on each bad loan is correctly estimated will the gross write-back be zero.

The second procedure entails looking at net provisions over the period.

In the period 1990-1993 commercial banks alone recorded losses of NOK 37.1 billion on loans and guarantees, while the corresponding figure for savings banks was NOK 14.7 billion. In the final years - 1994, 1995 and the first three quarters of 1996 - book losses were minimal and even negative (i.e. taken to income) among commercial banks in 1995 and 1996. Recorded losses and loss provisions are both based to some degree on judgement and estimates as regards the customer's financial position and value of any collateral security. With full and accurate information, provisions for losses should in

principle go towards covering losses recorded in subsequent periods.

Provision for losses could in retrospect prove either excessively large or too small in relation to losses that are ultimately confirmed.

Excessive loss provisions/recorded losses will show in item 1 and 2:

**1. *Incomings on previously recorded losses***

These are dividend on settlement of estates etc., paid at a later date.

**2. *Reduction of excessive provisions for loss on known loans***

This may be due to improvement of the customer's financial position and/or improvement in the value of collateral security, for example a rise in property prices. This item also contains write-backs of general loss provisions.

Inadequate loss provisions will show in item 3 and 4.

**3. *Recorded losses not covered by loss provisions***

As a rule provision for loss should be made as soon as loans are identified as doubtful. Provisions should in principle match subsequently recorded losses. Where the provision is too small, or no provision has been made by the time the loss is verified, the shortfall is also a correction item.

**4. *Increase of inadequate loss provisions on known loans***

This will apply to loans where either the customer's financial position and/or collateral value has taken a negative turn.

Looking at the sum of these four items tells us whether recorded losses and loss provisions in previous periods were too small or too large. In the case of commercial banks after 1992 (where information is available), the corrections in 1992 and 1993 show that previous loss provisions had been inadequate, whereas the picture is reversed in the years 1994, 1995 and for the first three quarters of 1996. This is due to the positive economic trend in the latter years with marked



**Table 1: Net corrections, recorded losses in commercial banks 1992 to 3rd quarter 1996, in millions of kroner**

	1992	1993	1994	1995	1st-3rd qtr. 1996
1. Incomings on previously recorded losses	376	422	662	588	387
+2. Reduction of excessive provision for loss on known loans	582	910	2608	2647	995
-3. Recorded losses not covered by loss provisions	1667	1122	1031	373	140
-4. Increase of inadequate loss provisions on known loans	2695	2480	1194	667	416
=5. Net corrections	3404	2270	1045	2195	826

**Table 2: Changes in loss provisions after 1992. Commercial banks, in millions of kroner**

1. Loss provisions at 01-01-92	23209
-2. Recorded losses covered by loss provisions	22960
+3. Loss provisions on new loans	11516
+4. Increase of inadequate loss provisions on known loans	7452
-5. Decrease of excessive loss provisions on known loans	7742
+6. Technical corrections (forex etc.)	340
=7. Loss provisions at 30-09-96	11815

improvements both in business and household finances and a steep rise in property prices; cf. chart 3. Overall net corrections are fairly modest in the period 1994-1996. In monetary terms they come to NOK 4,006 million for commercial banks, or just over 10 per cent of losses of NOK 37.1 million incurred in 1990-1993.

A third procedure is to look at overall provisions at various points in time. Starting on 1 January 1992, i.e. after the crisis year 1991, we have the following picture shown in Table 2.

Loss provisions at the start of 1992 correspond approximately to the amount employed to meet subsequent confirmed losses. The amounts subsequently employed to correct for insufficient/-excessive loss provisions on loans already assessed as bad are of roughly equal size.

With the benefit of hindsight the provisions made can be said to have been fairly correct even though divergencies in both directions were substantial. Provisions as at 30 September 1996 were in monetary terms approximately equal to provisions on new loans in the years 1992-1996. These figures do not give a reliable indication of whether recorded losses were at any time overstated, especially when corrections are made for economic developments over recent years. Net write-backs have declined in recent quarters.

It is uncertain whether loss provisions now made will be sufficient to meet actual losses in the years ahead.



The rusty side of SS Hestmanden awaits restoration. The work is to be done at the ship conservation centre and boatyard at Bredalsholmen in Kristiansand - a national centre devoted to the preservation of the crafts involved in steel ship construction.

Photo: Arve Kjerseim, NIKU

# Kredittilsynet's operations in figures

**Table 3: Number of supervised entities as at 31 December 1996**

1995	1996	
<b>Banking and financial institutions</b>		
133	133	Savings banks
17	17 <sup>1)</sup>	Commercial banks (of which 2 foreign-owned in 1996)
1	1	Norges Postbank
10	12	Foreign branches of Norwegian banks
3	3	Norwegian branches of foreign banks
40	38	Finance companies
5	8	Norwegian branches of foreign finance companies
11	8	Mortgage companies
	1	Norwegian branches of foreign mortgage companies
11	10	Loan intermediaries
<b>Insurance</b>		
10	9	Life insurance companies
53	45	Non-life insurance companies
20	19	Local marine insurance associations
22	44	Insurance brokers
38	39	Local fire insurance associations
18	18	General agents of foreign companies (six are being wound-up)
135	136	Private pension funds
129	114	Private pension schemes
32	31	Municipal pension funds
21		Private relief funds
<b>Securities trading</b>		
32	34	Stockbroking firms (of which 28 also trade in options and 13 are engaged in active portfolio management)
23	22	Management companies for securities funds
13	11	Project broking undertakings
1	1	Options trading undertaking
<b>Estate agency</b>		
318	348	Estate agencies
917	918	Lawyers' practices incl. estate agency
<b>Debt collection</b>		
142	127	Debt collection agencies
<b>Auditors</b>		
3,769	3,942	auditors
413	448	Auditing firms
<b>Data processing centres</b>		
1	1	Norwegian Options Clearing House
1	1	Norwegian Registry of Securities
1	1	Banks' Central Clearing House
1	1	Fellesdata

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

**Table 4: Number of on-site inspections by type of institution:**

	1994	1995	1996
Banks/financial	49	57	52
Insurance	11	18	15
Insurance brokers			3
Pension funds	15	17	9
Stockbroking firms	29	32	15
Other securities institutions	10	15	
Estate agencies	42	59	86
Debt collection agencies	36	41	30
Auditors	92	129	134

**Table 5: Cases handled after delegation from the Ministry of Finance**

	SAVINGS BANKS		COMMERCIAL-BANKS		INSURANCE COMPANIES		FINANCE COMPANIES		PENSION FUNDS	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
Articles	26	22	10	15	29	26	27	36		
Own funds	6	8	8	8	4	3	10	8	93	26
Control committee							1	1		
Committee of shareholders /rept./supervisory board		0		0	1	0	4	0		
Organisema		1		1		1	7			

**Table 6: Cases in the accountancy and auditing field 1995-1996**

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

### On-site inspections in 1996

The number of on-site inspections in 1996 should be viewed in the light of the focus given in 1994/1995 to checking internal controls at small savings banks and pension funds. In 1996 larger, more resource-demanding institutions were again given priority. In the securities field, processing of licence applications under the revised Securities Trading Act resulted in fewer on-site inspections.

### Establishment of branches and cross-border activities

In 1996 one Norwegian bank established a branch in another EEA member state, and one bank and one credit institution notified cross-border operations. One bank and two credit institutions reported the establishment of branches. The foreign bank in question had not established its branch by year-end, and plans to start operations during the spring of 1997. Until

**Processing licence applications under the revised Securities Trading Act resulted in fewer on-site inspections in the securities field**

then the bank will continue operating through its representative office which will be wound up once the branch has been established. Kredittilsynet also received 15 notifications from credit institutions wishing to offer cross-border services into Norway from other EEA states.

In 1996 one Norwegian non-life insurance company opened a branch in another EEA state. Seven Norwegian non-life insurance companies reported cross-border activities. Five insurance companies (two life and three non-life companies) opened branches in Norway. Moreover, 55 insurance companies announced their wish to offer cross-border services into Norway. Ten of these are life-insurance companies.

#### **Increases of capital:**

##### ***Banks***

Three commercial banks were authorised to increase their share capital by a total of NOK 247.5 million in 1996. Including premium, their tier 1 capital was increased by a total of NOK 417.5 million. Three savings banks were authorised to increase their primary capital by up to NOK 177.5 million.

Ten banks, of which five were savings banks, were authorised to raise subordinated debt of up to NOK 2,874 million. In 1995 the equivalent figure was NOK 1,859 million, distributed on four savings banks and four commercial banks.

##### ***Insurance companies***

One non-life insurance company were authorised to increase its share capital by NOK 3 million.

One life insurance company and one non-life insurance company raised subordinated debt worth up to NOK 1,070 million in 1996. The equivalent figure for 1995 was NOK 804 million distributed on one non-life and one life insurance company.

##### ***Finance companies***

In 1996 Kredittilsynet approved applications from eight finance companies to increase share capital and raise subordinated debt. The increases totalled NOK 325.9 million, comprising NOK 35.4 million in share capital increases and NOK 290.5 million in subordinated debt.

##### ***Parent companies in financial conglomerates***

Three parent companies in financial conglomerates increased their own funds by about NOK 308 million, comprising about NOK 308 million in share capital and NOK 83 million in subordinated debt.

Twenty-four applications for authorisation to act as sales agents for units in securities funds, and 71 applications for registration as fund managers, were approved.





The full-page photo shows the weather-beaten wall of a log building at the water-mill at Kjellvik in Sørfold in the county of Nordland. The site epitomises a well-preserved cultural environment in which all the buildings occupy their original sites.

Photo: Arve Kjørsheim, NIKU

# *Banking, finance and insurance*

Supervision of banking, finance and insurance in Norway is three-pronged. Alongside on-site inspections and documentary supervision, Kredittilsynet is required to perform administrative and research assignments, as well as framing and interpreting rules and regulations.

## **Supervision of financial strength and profitability**

As part of its supervision of financial institutions' solidity, Kredittilsynet has focused on monitoring the trend in banks' interest margin and their measures to adjust to a possible lasting lower income level. Most of the bigger financial institutions have made or plan to make cost cuts.

The year 1996 featured sagging interest rates combined with a favourable trend in share prices. This led to good returns on invested capital for life insurance companies and pension funds. It also led to good results overall for non-life insurance companies in 1996. The biggest companies combined recorded somewhat higher claims and cost ratios than in previous years, although there is some variation in the trend among the companies. The decline in interest rates in maritime insurance and long-lasting frost in south-eastern Norway in the winter of 1996, which caused substantial water damage, were among the factors contributing to the higher claims ratio. Results for vehicle insurance were generally good in 1996 and some companies took out substantial gains in writing back earlier claims provisions. Some uncertainty is attached to how increased car sales in 1996, and the growing share of motorists using non-studded snow-tires in the past winter, will be reflected in claim ratios and results in 1997.

Banks' credit practice was again in focus in 1996 in the light of the fierce competition in the credit market and against the background of the experiences from the 1980s. At on-site inspections importance was attached to checking that banks had acted on the recommendations given by Kredittilsynet in its circular entitled "Advice to

banks on credit practice". A particular focus was put on documentation routines and assessment of ability to pay, loan-to-value ratio, risk pricing and monitoring of loans.

The banks continued work on assessing, documenting and formalising internal control in conformity with the internal control regulations. The regulations on internal control in insurance companies came into force on 30 June 1996. It is too early to assess companies' compliance with these regulations.

Kredittilsynet has devised a special report form to be completed by the responsible actuary in life insurance companies. The report forms part of the annual accounting statement and was first used for the accounting year 1995. In it the actuary comments on and assesses specified conditions within his/her area of responsibility, including the trend in the company's premium earnings and compensation payments, analyses of the elements comprising the calculation bases, write-back of profits etc.

In 1993 a scheme entailing additional mathematical reserves was introduced as a means of strengthening the financial position of life insurance companies. In 1996 the right to make supplementary provisions was extended to pension funds. Pension funds were concurrently exempted from making deductions in tier 1 capital for investments in the own funds of other financial institutions, provided the particular pension fund's articles of association bar it from raising own funds from entities other than the undertaking or local authority for which it was established.

Kredittilsynet again gave high priority to quality control of own funds raised by the institutions in order to ensure that such funds can function as a genuine buffer against the risks the institutions incur. The body of rules lays down various risk weights for the items that form the basis for measuring capital adequacy. In its work on these issues Kredittilsynet believes that maintaining a consistent line in conformity with the intentions behind the rules is an advantage

**Kredittilsynet's focus on the trend in banks' interest margin and their adjustment to possible lower earnings**

in the short and long term, despite pressures in the opposite direction. Where mergers are concerned, Kredittilsynet stressed the importance of a satisfactory capital base after merger by requiring merged units to maintain a tier 1 ratio in excess of the statutory minimum requirement.

Kredittilsynet continually monitors compliance with the various requirements as to financial strength and safety. This includes capital adequacy requirements for all financial institutions, solvency margin requirements for insurance companies and liquidity requirements for and constraints on banks' share- and property holdings.

Non-life companies' technical provisions remain generally well above the minimum requirements. For the big companies coverage is 13 to 33 per cent in excess of minimum requirements.

Calculation and reporting of solvency margin requirements and solvency margin capital respectively, required for the first time as at 31 December 1995, showed that the requirements were met by all life and non-life companies.

Kredittilsynet has taken up with life insurance companies the need to strengthen provision for claims events that have occurred but have not been reported in group life insurance. Such provisions have long traditions in non-life insurance, whereas life insurance companies have not in Kredittilsynet's view made sufficient provisions.

In 1995 the Ministry of Finance asked Kredittilsynet to prepare a review of costs in life insurance. The background was media focus on life companies' excessive expenditures compared with the costs set out in their measurement bases. Kredittilsynet took a close look at the cost burden in each branch of insurance. The investigation uncovered a number of complex problems, and will be completed early in 1997.

### **Supervision of conglomerates**

The Norwegian financial and insurance market is dominated by a small number of conglomerates and collaborative groups each of which is seeking to consolidate its position. Judged by size of total assets, about two-thirds of domestic financial services are accounted for by the eight largest conglomerates, viz. Den norske Bank, Kredittkassen, Sparebanken NOR, Storebrand, Gjensidige, Sparebankgruppen, Norges Postbank

and Landsbanken/Samvirke. The main events in this context in 1996 were Den norske Bank's takeover of the life-insurance company Vital and Storebrand's establishment of its own banking arm. The State has a substantial stake in three of the biggest conglomerates, and two others (a savings bank and a mutual company) are organised in such a way as to prevent acquisition.

Small and mid-size banks are endeavouring to counter the competition from the conglomerates by forming alliances in order to be able to offer a full range of financial services. An important event in this connection was the establishment of the holding company Sparebankgruppen which in the first instance comprises the four big regional savings banks - Sparebanken Midt-Norge, Sparebanken Nord-Norge, Sparebanken Rogaland, Sparebanken Vest. In addition there is a group of small savings banks. The participants in Sparebankgruppen are profiling their operations under a joint name and will offer insurance and security-based products through two subsidiaries, David and Odin. Other savings banks are opting for collaboration with Sparebanken NOR in order to meet the growing competition.

Interest in establishing a presence in the Norwegian market appears to be growing in foreign quarters, especially Norway's neighbouring countries. So far only Handelsbanken has invested heavily in the Norwegian market, but both SE-banken and the biggest Danish banks now appear to be increasing their presence in Norway. The Danish company Codan is establishing a new life insurance company in collaboration with Fokus Bank, and Skandia is setting up a branch from the United Kingdom to sell unit-linked products. In the autumn of 1996 the Swiss insurance company Zürich Insurance Company made a bid to take over all shares in Protector Forsikring AS. The company already has a branch in Norway.

Supervision has been realigned towards greater emphasis on financial conglomerates in view of their central role in the financial market and their significance for the stability of Norway's financial industry. Any assessment of risk must be based on an overall consideration of the financial conglomerate in question. While the focus of supervision will remain on the

**Small and mid-size banks form alliances to counter competition from conglomerates**

**Scrutiny of costs in life insurance**

**Supervision of conglomerates expanded and strengthened**

individual institution, greater attention will be given to the conglomerate as a whole, including risk related to ties and constraints that could have repercussions for participating companies. Consideration is also being given to how reporting can best be adapted to Kredittilsynet's information requirements and be turned to account for supervision and analysis purposes.

Several important issues attach to intra-conglomerate relationships. Cost distribution among the various legal entities and the principles for pricing intra-conglomerate transactions are pertinent examples. Intra-conglomerate observance of statutory confidentiality with regard to customer information was also addressed and assessed in 1996.

Where specific cases are concerned, standards requiring ordinary commercial principles to be applied to transactions between group companies were further developed. Kredittilsynet also reviewed rules and practice for authorising group models and changes in the latter. This led to simplifications being proposed to the Ministry of Finance to facilitate institutions' work on such matters.

Kredittilsynet scrutinised the major conglomerates to check compliance with terms and conditions set out in their licences. Checks were also made to verify that group structures and reorganisations conformed with requirements as to an appropriate and simple organisational set-up. In January 1996 Kredittilsynet considered an application from (UNI) Storebrand regarding organisation of its asset management. In its recommendation to the Ministry of Finance, Kredittilsynet stressed that the company charged with managing the group companies' investment portfolio should be owned by the life insurance company. However, the Ministry of Finance's final authorisation decision disregarded this condition.

The composition of the boards of three financial conglomerates was reviewed in connection with applications for dispensation under section 5-1 of the Insurance Activities Act. Where the two insurance conglomerates, (UNI) Storebrand and KLP Forsikring are concerned, Kredittilsynet considered applications to make group contributions under section 2a-8 of the Financial Institutions Act which lays down certain constraints on the right to transfer funds between companies in the same group. Applying

the rules on group contributions is so complicated that Kredittilsynet has recommended changes to the Ministry of Finance.

### **Supervision of market risk**

New capital adequacy rules for market risk were adopted on 17 July 1996, largely in accordance with Kredittilsynet's proposal. The rules require all institutions to define a trading portfolio. Institutions whose portfolio is above a certain size are required, based on detailed technical rules, to calculate capital requirements to cover risk of loss due to value changes in the portfolio. Kredittilsynet prepared for the implementation of the new body of rules with the first-time report on 31 December 1996, and made substantial changes in capital adequacy returns in that connection. Compliance with the market risk regulations was also checked. These regulations also require Kredittilsynet to approve certain calculation methods employed by institutions and to carry out quality assurance tests, and preparatory steps were taken in that connection.

In 1996 on-site scrutiny of financial institutions' market risk was to a greater degree integrated with inspections at investment firms than previously. This is partly a consequence of the new Securities Trading Act and the fact that several institutions integrated their securities trading activities and foreign-exchange and money-market activities in 1996.

On-site supervision of market risk importance focused inter alia on the relevance and information value of reporting of market risk to the management and board. Importance was attached to a clear division of responsibility between executive units on the one hand and registering and reporting units on the other.

### **IT supervision**

Development of information technology is forging ahead and new services are being introduced. Prompted by media notices, Kredittilsynet twice stepped in to investigate IT security at institutions under its supervision. It did so after transaction information went astray in the Banks' Central Clearing House's routines for invoice payments via the Internet and in Fellesdata's routine for invoice payments by telephone.

Financial institutions's use of information

technology and the associated safety issues are also a natural theme for general on-site inspections. "Thematic inspections" in the IT field are also carried out at large financial institutions. Prompted by the increasing use of information technology in the payments system, Kredittilsynet has looked at likely trends in IT-based payment services and forms of distribution. It has examined the potential for cost reductions in the banking sector and the challenges facing the banks in terms of efficiency improvements and cost adjustments. Systems safety and new rules which could have a bearing on the payments system were analysed. The knowledge gained from such studies is turned to account in the work of supervision.

In 1996 a substantial portion of Kredittilsynet's resources in the IT sphere was devoted to supervision of major institutions. Inspections were carried out at Den norske Bank, Kreditkassen, (UNI) Storebrand and the Banks' Central Clearing House/Bank-Axept.

### **Ethical behaviour, financial crime**

Ethical guidelines and measures to combat money laundering are standard themes for general on-site inspections. Their aim is not primarily to uncover financial crime, but to see that institutions have routines designed to prevent such crime. To this end Kredittilsynet called in selected banks for details of their routines for reporting suspicious transactions to ØKOKRIM (the National Authority for Investigation and Prosecution of Economic and Environmental Crime) pursuant to provisions of the Financial Institutions Act on money laundering.

### **Macroeconomic analysis**

The macroeconomic surveillance programme drawn up in 1994 was implemented in 1995 and 1996. The selection of indicators employed are continually reviewed in light of ongoing developments in the financial industry and in the economy in general. Macroeconomic surveillance, which assesses threats to the stability of the financial industry, is one of several instruments used by Kredittilsynet in its supervisory activities. Under the programme two reports were drawn up during the year for discussion at meetings with the Ministry of Finance, Norges Bank and

the other Nordic supervisory authorities. Collaboration with other institutions in Norway and other countries was strengthened in 1996.

### **Co-ordination with the Competition Authority**

The Ministries of Finance and of Government Administration asked Kredittilsynet and the Competition Authority on 4 July 1996 to study the need for a co-ordinated approach on issues related to competition conditions in the financial market. After a joint working group had examined the matter, the two agencies in conjunction sent the ministries in question guidelines for future collaboration. Collaboration will be based on the following four basic principles: a continued independent role for institutions, efficient and satisfactory case-handing procedures, predictability for market players and preparations for an overarching body.

The new guidelines entail that more cases are being referred to the Competition Authority. However, it is no longer consulted on a formal basis since it might then be required to adopt a prior standpoint in cases which can be dealt with under the competition legislation.

Kredittilsynet is required to send a copy of all applications related to mergers and acquisitions, co-operation agreements as well as of dispensations in connection with product packages, to the Competition Authority for its information. If the Competition Authority finds reason to proceed further, it contacts Kredittilsynet at once to exchange information and ascertain progress made in the case. Where co-operation agreements are concerned, the Competition Authority has a period of two weeks in which to make a provisional response on whether or not an agreement warrants dispensation from the Competition Act. An aim is to harmonise enforcement of the provisions on disclosure and effective interest rates.

### **Administration of regulations and framing regulations**

After the third year of operation of the EEA Agreement, work on introducing most of the EEA-wide legislation has been completed, and securer routines have been established for collaboration within the framework of the above Agreement. In the field of banking and finance,

**Guidelines drawn up for collaboration between Kredittilsynet and the Competition Authority**

**Ethical guidelines and measures to combat money laundering are standard themes for general on-site inspections**

**Kredittilsynet's macroeconomic surveillance programme introduced in 1995 and 1996**



**Rules governing unit-linked insurance introduced in December 1996**

**Insurance companies' maximum liability per claim arising from a natural catastrophe raised from NOK 1.8bn to 2.8bn**

bilateral agreements have in addition been established between the supervisory authorities of countries having establishments on each other's territory.

Kredittilsynet issued a comprehensive statement on the bank law commission's interim report on deposit-guarantee schemes and public administration etc., of financial institutions. Like Kredittilsynet, the Ministry of Finance's Bill and the Storting's treatment of the latter gave more weight to deposits and less to loans etc., than did the Commission's report. Kredittilsynet assisted the Ministry of Finance in responding to questions raised in the Storting's Standing Committee on Financial Affairs during the Bill's passage through the Storting. Kredittilsynet framed a draft regulation governing payment of fees to the two bodies administering the banks' deposit-insurance funds and reported to the Ministry of Finance on transitional arrangements and implementation matters.

In the autumn of 1995 Kredittilsynet proposed to the Ministry of Finance law amendments shadowing an EU Directive aimed at impeding irregularities and fraud in the financial sector. The Directive was a direct response to the collapse of the Bank of Credit and Commerce International (BCCI). Kredittilsynet's proposal was followed by a Bill (Ot.prp. nr. 75 (1995-96)) introduced in the Odelsting and dealt with by a plenary Storting in the autumn of 1996. The widening of auditors' duty to report to Kredittilsynet is of particular significance for supervision.

Kredittilsynet proposed to the Ministry of Finance new regulations on the duty to disclose effective interest rates which lays down joint, uniform rules for consumer credit agreements and a disclosure duty under the Financial Institutions Act and equivalent rules pursuant to the Credit Purchase Act.

A further proposal to the Ministry of Finance called for some types of intra-conglomerate finance companies to be exempted from the licensing obligation.

Kredittilsynet considers most life insurance companies' provisions for future administrative costs to be plainly inadequate, and that varying practice from company to company distorts competitive conditions. Differing practice has been particularly in evidence within group

pension insurance. Kredittilsynet laid down minimum rules for such provisions and a plan to progressively increase them up to 1998.

A committee was appointed to frame a new act on private service pension schemes, on which Kredittilsynet is represented by two members and one secretary. Kredittilsynet's board chairman, Mr. Erling Selvig, heads the committee, which is due to present its recommendations in the spring of 1997.

Rules for unit-linked insurances were adopted in December 1996. The rules are not in the form of a separate regulation, but in the form of amendments to other regulations. Kredittilsynet assisted the Ministry of Finance in this process.

In the autumn of 1995 the technical reporting committee on provisions etc., in non-life insurance was charged with drawing up methods for calculating upper limits for technical provisions. The background to this assignment was the Ministry of Finance's letter of 30 August 1995 asking Kredittilsynet to recommend an upper limit for insurance companies' tax-deductible technical provisions. The committee presented its report on 1 April 1996. The report was considered by Kredittilsynet's administration and a recommendation in the matter was sent to the Ministry of Finance in June 1996.

In September 1996 the Ministry of Justice asked Kredittilsynet for its comments on a proposal from Norsk Naturskadepool (Norwegian Pool for Natural Perils) that insurance companies' maximum liability per claim arising from a natural catastrophe should be raised from NOK 1.8 billion to NOK 2.8 billion with effect from 1 January 1997.

During the year a survey was made of statutory requirements which have been complied with in the main areas of supervision but have yet to be complied with in other areas and therefore need to be monitored in 1997. Greatest weight was given to checking compliance with rules on conglomerates in the Financial Institutions Act.

A survey was made of special risks attached to existing conglomerates. Introduction of further supervisory measures is under consideration.

In 1996 a number of approaches related to interpretation of rules in the insurance field were dealt with. They included questions related to the regulations governing pension funds, insurance

broking and private occupational pension schemes. Where the latter are concerned, most approaches concerned distribution of premium fund resources or departures from the principle of proportionality in connection with organisational changes in undertakings that run pension schemes (mergers, demergers or curtailments).

Standard articles of association for private pension funds were laid down in 1995. Standard articles have been drawn up for both individual enterprises and for conglomerates. In conformity with the regulation governing application the Insurance Activity Act to pension funds, the funds have submitted new articles of association which in varying degrees conform to the standard laid by Kredittilsynet.

In conjunction with the adoption of a new regulation on insurance broking, an internal working group prepared for the supervision of insurance brokers in 1996. It drew up a new reporting system for insurance broking undertakings which will be required annually to report accounts figures and off-balance sheet items, changes in conditions with a bearing on the basis for registration, overall premium amounts mediated to insurance companies in Norway and other countries, which insurance companies the undertaking can mediate to etc., specified commission earnings and compensation claims, if any, brought against the undertaking. Undertakings are also required to submit an auditor's statement regarding clients' funds. The above reporting will form the main basis for document-based supervision of insurance broking undertakings.

In 1996 Kredittilsynet devoted substantial resources to monitoring and analysing the major non-life insurance companies' technical provisions and own funds. In 1994 Kredittilsynet submitted to the Ministry of Finance a number of proposals for regulations framed against the background of rules set out in European Union insurance directives. In 1996 Kredittilsynet was involved in supplementary work on some of these proposals.

Kredittilsynet drew up a draft regulation, pursuant to the regulation on branches, on how EEA companies should fulfil requirements and conditions on guarantee schemes in the Insurance Activities Act with associated regulations. The draft

regulation was circulated for comment in November 1996.

### **Other issues related to insurance**

The collaborative project with the Association of Norwegian Insurance Companies on a statistical and accounting database for life insurance was brought to completion in 1996, while in the case of non-life insurance companies complete reporting will be introduced for the accounting year 1997.

EEA collaboration on the statistics side has confronted Statistics Norway with new data requirements from the insurance industry. A project group was set up to increase the efficiency of reporting to the authorities by, among other things, avoiding double reporting by companies. The group will construct a reporting system that enables companies to report to one single base. The project is based on the reporting system constructed in conjunction with the Association of Norwegian Insurance Companies and on Statistics Norway's existing database. Norges Bank and the Association of Norwegian Insurance Companies are participating in the project alongside Kredittilsynet and Statistics Norway.

In the autumn of 1996 Kredittilsynet was notified that five of the marine insurance associations coming under the Marine Insurance Associations Act of 3 July 1953 had terminated their contract with the marine insurance group Gjensidig Skadeforsikringsselskap regarding reinsurance of catastrophic risks. Termination was effective as from 1 January 1997. After Kredittilsynet asked the companies to explain the repercussions of terminating the contract, it was informed that a new contract was formalised with Gjensidig Skadeforsikring with effect from 1 January 1997.

In its capacity as secretariat to the Non-life Insurance Companies' Guarantee Scheme and the Credit Insurance Companies' Guarantee Scheme, Kredittilsynet has made altogether five payments totalling NOK 50.3 million to the parties directly insured in Star Forsikring AS (under public administration). Including disbursements made in 1996, this brings overall payments to parties directly insured in Star Forsikring to about NOK 92 million.

**EEA collaboration requires  
new statistical data from the  
insurance industry**

**Monitoring and analysis of  
technical provisions and own  
funds**



Urnes stave church in Sogn and Fjordane, built in the second half of the 12th century, features on UNESCO's World Heritage List. The full-page photo shows the decorative carving around the north door.

Photo: The Directorate for Cultural Heritage

# Accounting and auditing

## Accounting

Kredittilsynet continued the process of adjusting accounting regulations to EU rules with a new review of the regulations on banks' and insurance companies' annual accounts.

Rules for dealing with financial derivatives were also framed, and provisions requiring additional information on financial derivatives were incorporated in the annual accounts regulations. A study of accounting treatment of financial derivatives internationally and nationally is in progress with the aim of presenting recommendations for accounting treatment, including classification and valuation, of financial derivatives. The study is continuing into 1997.

In 1994 Kredittilsynet set up a committee to assess existing loss regulations, in part in the light of accounting theory and practice in other countries. This work has taken much longer than originally planned, partly because of capacity problems in Kredittilsynet's administration which provides the secretariat to the committee. So far there are no indications that changes are needed in the rules on loss provisions, and the existing regulations still apply.

Kredittilsynet monitors developments in national and international accountancy through its participation in the Norwegian Accounting Standards Board's consultative body, the Stock Exchange Accounting Committee, and through continual updating on international standards, including the IASC (International Accounting Standards Committee), the ASB (Accounting Standards Board) and the FASB (Financial Accounting Standards Board).

Systems based on new technology that diverge from the basic systematics of the Accounting Act require special attention when processing applications for dispensation from the accounting regulations. Kredittilsynet believes that current accounting rules should be modified in step with technological developments in the field.

## Auditing

As in previous years, Kredittilsynet performed various types of auditor supervision. The largest number of inspections were carried out at auditors selected by Kredittilsynet itself. Complaints filed against auditors fell from 38 in 1995 to 16 in 1996.

Statistics on reactions are shown in table 7. The relatively large number of auditors opting to hand in their licence or withdraw from the register must be viewed in the light of the deliberate focus, in 1996 as in 1995, on inspections of auditors of an advanced age or operating on a limited scale. The fact that some of the latter choose to notify their intention to cease auditing activity after receiving notice of inspection should come as no surprise. Thirty auditors voluntarily handed in their licences in 1996 after notice of inspection. It should be noted that 24 of the latter were not members of an auditors' association.

Contacts with other countries' auditor supervision bodies expanded. As in 1995, resources were allocated to the work of framing legislation on auditing and auditors.

**Further adjustment of accounting provisions to EU rules**

**Complaints filed against auditors down from 38 in 1995 to 16 in 1996**

**Growing contact with other national auditor supervision bodies**

**Table 7: Reactions in 1994-1996**

	LICENCE WITHDRAWN	STERN REPRIMAND	REPRIMAND/ CRITICISM	NO REACTION	TOTAL	LICENCE REVOKED
1994	9	26	35	27	97	28
1995	6	25	19	39	109	30
1996	8	25	48	53	129	30

### **Information technology**

In 1996 Kredittilsynet inspected IT systems at major financial institutions and at joint institutions that process data for the financial industry. Issues raised with institutions' boards and administrations were responded to satisfactorily. Besides performing and following up on IT supervision and exercising administrative functions in connection with the IT regulations, Kredittilsynet was actively involved in issues connected with new services, e.g. routines for transmitting payments across the Internet. Kredittilsynet also participates actively in the work of standardising the control and auditing of IT systems.

### **Other areas**

Kredittilsynet is responsible for supervising the Accounts Authorisation Board and for dealing with appeals against decisions of the Board. In 1996 Kredittilsynet levelled serious criticism against the authorisation scheme for accountants and the administrative functions assigned to the Authorisation Board. Criticism was directed especially at the register of accountants, which is not deemed to be of the quality required of a public register. In order for the statutory scheme to function as intended, it is crucial that its administrative functions are discharged satisfactorily. Kredittilsynet's report was forwarded to the Authorisation Board in November 1996 with a copy to the Ministry of Finance. Eighty appeals against decisions of the Board were processed in 1996.

A scheme involving penalties for late filing of accounts with the Register of Company Accounts was introduced with effect from the accounting

year 1990. In 1996 Kredittilsynet handled 758 complaints against decisions of the Brønnøysund Register compared with 480 in 1995. Kredittilsynet reversed the Brønnøysund Register's decision in 37 cases. Since no limitation period restricts the right to seek refund of a late-filing penalty, refund applications were processed for all accounting years since 1990. In a consultative comment on a draft version of a new accounting act, Kredittilsynet recommended allowing a wider scope for exercise of judgement when processing applications for remission of late-filing penalties.

Kredittilsynet's regulations on internal control in the field of banking and insurance will be reviewed in 1997, a process in which the experiences of supervised entities will be given particular weight. Consideration will be given to extending the scope of the regulation to other entities supervised by Kredittilsynet.

In 1996 Norwegian financial institutions reported 164 cases to ØKOKRIM (the National Authority for Investigation and Prosecution of Economic and Environmental Crime) where money laundering was suspected. A number of these were subsequently investigated by ØKOKRIM. The Storting voted in its spring session to extend the obligation to report suspicious transactions to Norges Bank (the central bank), Norges Postbank, management companies for securities funds, investment firms, insurance brokers, project brokers, stockbrokers, foreign exchange brokers and a number of other undertakings. The law amendment took effect on 1 January 1997.





Did you know that Norway is a "major power" when it comes to lighthouses? This has of course to do with its long coastline. The small photo shows the lighthouse at Lyngør. The full-page photo shows prisms from the light at Okseøy.

Photo: Arve Kjerseim, NIKU

# Securities trading

## Main priorities

Supervision of the securities market comprises supervision of institutions and supervision of transactions. Institutional supervision focuses on the activity of management companies for securities funds and investment firms as well as banks authorised to perform investment services. Transaction supervision entails checking that the various players in the securities market comply with requirements as to sound broking and business practices.

Ordinary on-site inspections entail scrutiny of the greater part of the activities of the inspected undertakings. "Thematic" inspections are limited to scrutiny of one or more selected themes. During the year both ordinary inspections and thematic inspections were carried out at investment firms as well as at management companies for securities funds.

Alongside on-site inspections, institutions' activities are also supervised on the basis of regularly submitted reports. Investment firms report key economic variables on a weekly and monthly basis, while management companies report quarterly. The reports are followed up closely by Kredittilsynet, and in a number of cases formed the basis for further investigation of certain institutions.

Within the area of supervision of transactions, a number of cases handled by Kredittilsynet in 1996 were in response to heavy activity in the market. The main focus was on deals related to takeover bids and other events substantially affecting prices. In some cases the work entailed contact with foreign supervisory authorities.

## Administrative tasks and work on administering and framing regulations

Alongside its supervisory responsibilities, Kredittilsynet performs a number of administrative functions connected with institutions. These range from amendments to articles of association to various types of authorisation. In addition, a number of legal issues are handled

that arise out of supervision or administrative tasks. In 1996, as in 1995, a substantial number of authorisations were granted to agents wishing to sell units in securities funds. Supervision of sales agents will have to be intensified.

## Amendments to the Securities Trading Act

In its spring session 1996 the Storting (Norwegian parliament) dealt with a Bill to amend the Securities Trading Act. The Act was amended on 7 June 1996. The amendments are based on the initial interim recommendation of the Securities Trading Act Committee. The primary aim of the Bill was to bring the Securities Trading Act into line with the requirements of the Investment Services Directive (ISD) which Norway is obliged to implement under the terms of the EEA Agreement. The reform entails that investment services vis-à-vis third parties, including stockbrokers, cannot be provided without official authorisation. The definition of "investment services" has a wider compass than the earlier provisions both as regards products and services.

The Ministry of Finance delegated licensing powers to Kredittilsynet with effect from 31 December 1996, nonetheless such that undertakings could apply for authorisation with effect from 1 July 1996. However, the Act did not come into force until year-end. Kredittilsynet announced that undertakings seeking authorisation to provide investment services prior to 1 September 1996 could expect to have their applications processed by 31 December 1996. Altogether 42 undertakings submitted complete applications by this date. Of these, 23 were stockbrokers, five were banks and 14 were new undertakings. Processing the applications drew heavily on Kredittilsynet's resources in the autumn of 1996. Since it dealt with the applications collectively, Kredittilsynet was able to resolve a number of issues before authorisations were granted, thereby ensuring uniform treatment of the applications. Among the legal issues offering particular challenges was the requirement that

the responsible manager and managers directly in charge must satisfy certain requirements as to competence and good repute. Accordingly Kredittilsynet had to decide what constituted good repute. Other relevant issues were the separation of licence-free services from services requiring a licence, creation of dividing lines between particular services which, if provided by the same person, could lead to that person's interests coming into conflict with those of an investor, or to breaches of confidentiality requirements. There was much contact between Kredittilsynet and the applicants during the autumn, and a number of applicants opted to make changes in their management, organisational set-up and other changes in order to qualify for a licence.

Of applications received by 1 September 1996, 41 were granted and one was yet to be fully processed. Several licences were granted subject to conditions which had to be met within a certain period. Others were granted subject to conditions which must be met before operations can start.

### **New regulations**

Upon revision of the Securities Trading Act, the Ministry of Finance, based on drafts drawn up by Kredittilsynet, laid down regulations on:

- investment firms' investor-protection arrangements
- collateral for margin requirements for investment firms when negotiating loans of financial instruments or when lending such instruments from their own portfolio
- initial capital for investment firms.

Kredittilsynet also laid down regulations on:

- investment firm's obligation to keep records of received and executed orders
- undertaking's obligation to notify Kredittilsynet of its shareholder structure
- trading for own account as part of an undertaking's ordinary asset management.

All regulations were drafted by Kredittilsynet during the spring of 1996. Of particular significance is the capital adequacy regulation of 17 July 1996 on minimum capital requirements for market risks etc., incurred by credit institutions and investment firms. The regulation requires credit institutions and other investment

firms to satisfy specific requirements as to minimum own funds to cover various categories of risk, viz. position risk, settlement and counterparty risk and, where appropriate, foreign exchange risk.

### **Further work on framing and administering legislation**

A Bill based on the Securities Trading Act Committee's interim recommendation no. 2 (NOU 1996:2) is due to be considered by the Storting during its spring session. This part of the law reform will entail changes in the rules on sound broking and business practices, including a new provision on price manipulation and changed rules on insider dealing/trading. Early in the summer of 1996 Kredittilsynet presented a statement on the recommendation which largely supported the Bill.

### **On-site inspections - securities broking firms**

A total of 15 inspections were carried out at securities broking firms in 1996. Issues raised during supervision included routines for dealing with possible settlement problems. Other central themes were raising staff awareness of, and dealing with, conflicts of interest as well as risk associated with issuing and trading in non-standardised derivatives.

In 1996 the biggest banks incorporated their securities broking firms as separate departments or as part of their foreign exchange and capital markets division. This required clarification of the organisation of the operations in question in relation to the bank's other activities. Compliance with Kredittilsynet's requirements in this area will be monitored.

In May 1996 Kredittilsynet ran, in conjunction with the Norwegian Registry of Securities, a trial in which a broking firm's inability to settle the day's accounts with other brokers was simulated. The trial revealed several flaws of both a legal and technical nature. In 1997 Kredittilsynet will give priority to pinpointing and assessing the risk factors involved.

Kredittilsynet is drawing up new supervision methods in response to the changes in enterprises' formal lines of delegation resulting from revision of the Securities Trading Act. Whereas previously Kredittilsynet dealt mainly with the

**New regulations laid down in conjunction with the revision of the Securities Trading Act**

**New supervisory methods in response to changes in lines of delegation resulting from revision of Securities Trading Act**

enterprise licensee, it will in future deal with the executive board and manager, as is the case in most other supervisory work.

### **Documentary supervision**

Documentary supervision provides Kredittilsynet with information on undertakings' risk exposure. Significant changes to the Securities Trading Act and the associated regulations make it necessary to assess which form of reporting will be appropriate to documentary supervision in the future. New requirements on reporting capital adequacy were introduced at the turn of the year. When new reporting routines are drawn up, importance will be attached to eliciting information that can give an early warning of hazards. Reporting of current liquidity by investment firms that are not banks will also be looked into.

### **Transaction supervision**

Routine investigations prompted by company announcements of information crucial to the pricing of shares sometimes put Kredittilsynet on the track of suspected illegal insider trading or illegal investment counselling. In the winter of 1995/96 press notices uncovered suspicious sales of shares from "insiders" ahead of negative market reports from a company to the market. After interviewing persons involved Kredittilsynet concluded that criminal insider dealing had probably taken place. The case was referred to ØKOKRIM in the spring.

Later in the year enquiries were made into unusual transactions that had taken place shortly before negative announcements were made by another listed company. Kredittilsynet decided in December to ask ØKOKRIM to consider taking criminal action. Suspicion centres on illegal insider dealing and illegal advice based on confidential, price-sensitive information.

### **Cases with international ramifications**

Early in the autumn of 1996 it came to public knowledge that investments made by a London-based management company on behalf of securities funds in Scandinavian high-technology shares had breached the funds' own internal rules and UK securities legislation. It emerged that a London broking house with Norwegian ties was involved. The Norwegian securities

market received negative publicity in the international press since some of the investments were in Norwegian listed shares and had been made via brokers with strong connections to Norway. Kredittilsynet initiated investigations as soon as the matter came to light and held talks with UK supervisory authorities and persons with knowledge of or directly involved in the affair. Kredittilsynet's approach has been two-pronged. On the one hand it focused its enquiries on whether transactions in Norwegian securities have taken place in unlawful or censurable circumstances, on the other hand on whether Norwegian stockbroking firms have displayed unlawful or censurable conduct. Other aspects of the case are assumed to come under the responsibility of other countries' supervisory authorities. In some areas the affair has required close co-operation with the Oslo Stock Exchange which for its part has had to decide whether the rules on flagging and mandatory offers have been breached.

Kredittilsynet has initiated investigations of foreign managers who have been authorised to register with the Norwegian Registry of Securities as managers for non-resident shareholders in Norwegian companies. A condition for authorisation is that Kredittilsynet will on request be supplied with the names of shareholders registered with the individual manager. The primary aim of the investigations is to check that managers meet the conditions for authorisation. However, the manager issue itself is also of interest in view of the large volume of Norwegian shares in non-resident hands, since the managers are "front men" for a substantial portion of the foreign owners. The question of who are the real owners behind the foreign managers was raised in earnest in the above case in which the funds' holdings in Norwegian companies were concealed by the managers. The lack of visibility of the actual owners creates problems for enforcement of marketplace rules such as those relating to the flagging obligation and mandatory offers. There is also a risk that investors will engage in illegal insider dealing behind cover provided by one or more managers. In some cases it has been difficult to obtain correct information on actual ownership.

**Two cases referred to ØKOKRIM for investigation after suspicion of insider trading**

**A steadily growing share of financial saving is channelled towards securities funds**

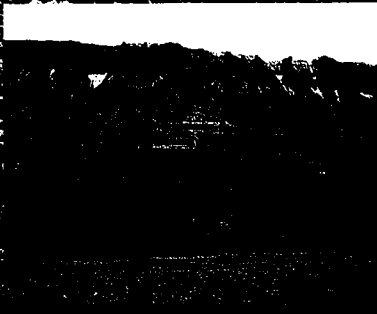
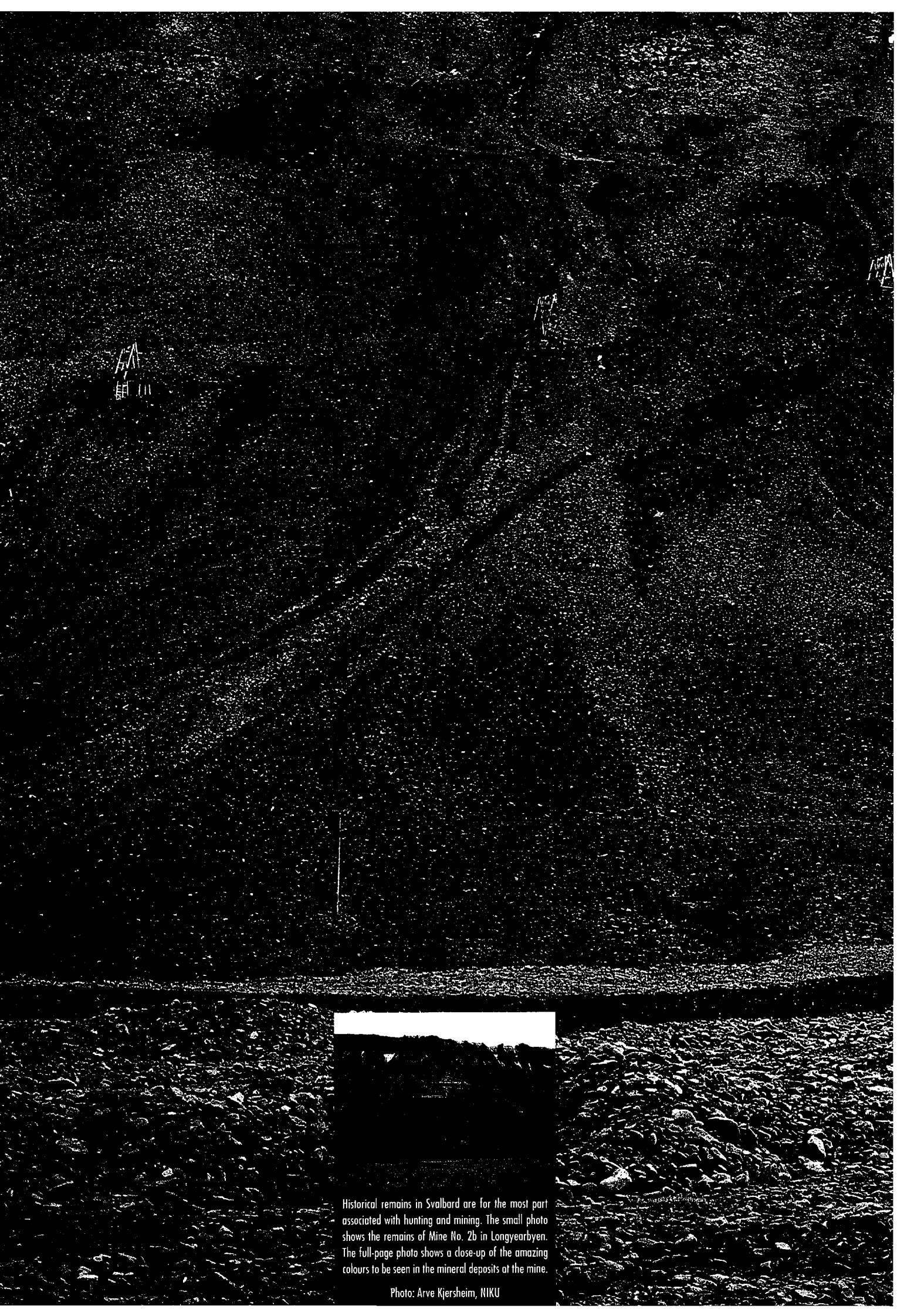
### **Securities funds**

Developments in Norway increasingly shadow developments in the international arena where a steadily growing share of financial saving is channelled towards securities funds. Securities funds have now become a genuine alternative for households and small businesses and institutions. In order to establish a basis for confidence in securities funds as a medium for saving and investment, Kredittilsynet believes it is important to pursue a fairly restrictive line and strict control of management companies' compliance with the rules. Kredittilsynet considers it important to instil in investors an understanding of the risks inherent in investment in securities funds compared with ordinary bank saving. On the other hand this form of saving generates greater liquidity in the securities market and helps ordinary people to share in the higher returns that are a feature of the securities market compared with traditional forms of saving. Kredittilsynet sees a number of challenges here both in terms of the quality of management and of information provided to the public.

### **On-site inspections - management companies for securities funds**

In 1996 a total of eleven inspections were carried out at management companies for securities funds. Thematic inspections were carried out at a number of companies during the autumn on the basis of reports regularly submitted to Kredittilsynet by all companies. Conditions prompting criticism of one company included repeated breaches of diversification rules and inadequate valuation of security holdings in certain funds. Kredittilsynet will in 1997 continue its follow-up of flaws that have been brought to light.

**Important to instil in investors an understanding of the risks inherent in investing in securities funds compared with ordinary bank saving**



Historical remains in Svalbard are for the most part associated with hunting and mining. The small photo shows the remains of Mine No. 2b in Longyearbyen. The full-page photo shows a close-up of the amazing colours to be seen in the mineral deposits at the mine.

Photo: Arve Kjerseim, NIKU



# *Estate agency and debt collection*

## **Debt collection**

The debt collection industry is still marked by the growing competition that has been in evidence in the past few years. There is a tendency for debt collection agencies to seek new markets, offer new products and pinpoint new customer groups.

In 1996 on-site inspections focused on agencies' financial strength, accounting routines, treatment of recovered funds and procedures applied at customers and debtors. Experience shows that most agencies have no problems in complying with the statutory requirements governing their activities.

Twenty-nine new debt collection licences were issued during the year, while one licence was handed in in connection with an on-site inspection.

At the end of 1996, 126 debt collecting agencies were under supervision, of which 10 were housing cooperatives. Seven new agencies were registered during the year, while 22 agencies discontinued debt collecting in the same period. Much of the reduction is the result of a review of housing cooperatives which showed that the activities pursued by many of these undertakings should not be defined as debt collection. Thirteen housing cooperatives are no longer under supervision partly for this reason. There were no other changes of note in the number of supervised entities.

Reports from the periods January-April and May-August show a marked increase in incoming and completed debt collection assignments compared with previous years. Figures for incoming and completed debt collection assignments in May-August were the highest since Kredittilsynet started supervising debt-collection activities. However, the number of debt-collection cases in process of execution and the volume of debts due for collection as at the reporting dates showed a very moderate increase. The explanations for this could be complex. A possible reason may be a general

increase in consumption on the part of households and the business sector, and credit sales to consumers have probably played a major role. Since the volume of credit sales is growing, an increase in the number of debt-collection cases is also likely, but the size of these claims makes them easier to collect. Another possible explanation may lie in the general tendency for businesses to bring in debt-collection agencies at an earlier stage. Normally the earlier the collection process is initiated, the quicker a case is resolved.

## **Estate agency**

In 1996 as in 1995 the property market was marked by buoyant activity and continued general increase in property prices, clearly leading to a further rise in the number of estate agency businesses. Fifty new agencies were established in 1996, while 23 closed down. The total number currently operating is 345.

Moreover, more agencies have opened branches bringing the total number of registered entities to 121. The majority of these are branches of bank-owned estate agencies. In addition about 900 lawyers have provided security for estate agency activities that are to a greater or lesser degree ancillary to their principal business.

The trade primarily features small-scale businesses. However, in recent years some chains have been established headed by individual commercial and savings banks and two or three private undertakings. Bank-owned estate agencies account for about 25 per cent of the market both in terms of the value and number of properties handled.

Lawyers and recent start-ups were targeted for on-site inspection since experience shows that these categories are more likely than others to show flawed accounting and estate agency routines. Irregularities uncovered in 1996 included negligence in obtaining and communicating all statutory information about a property,

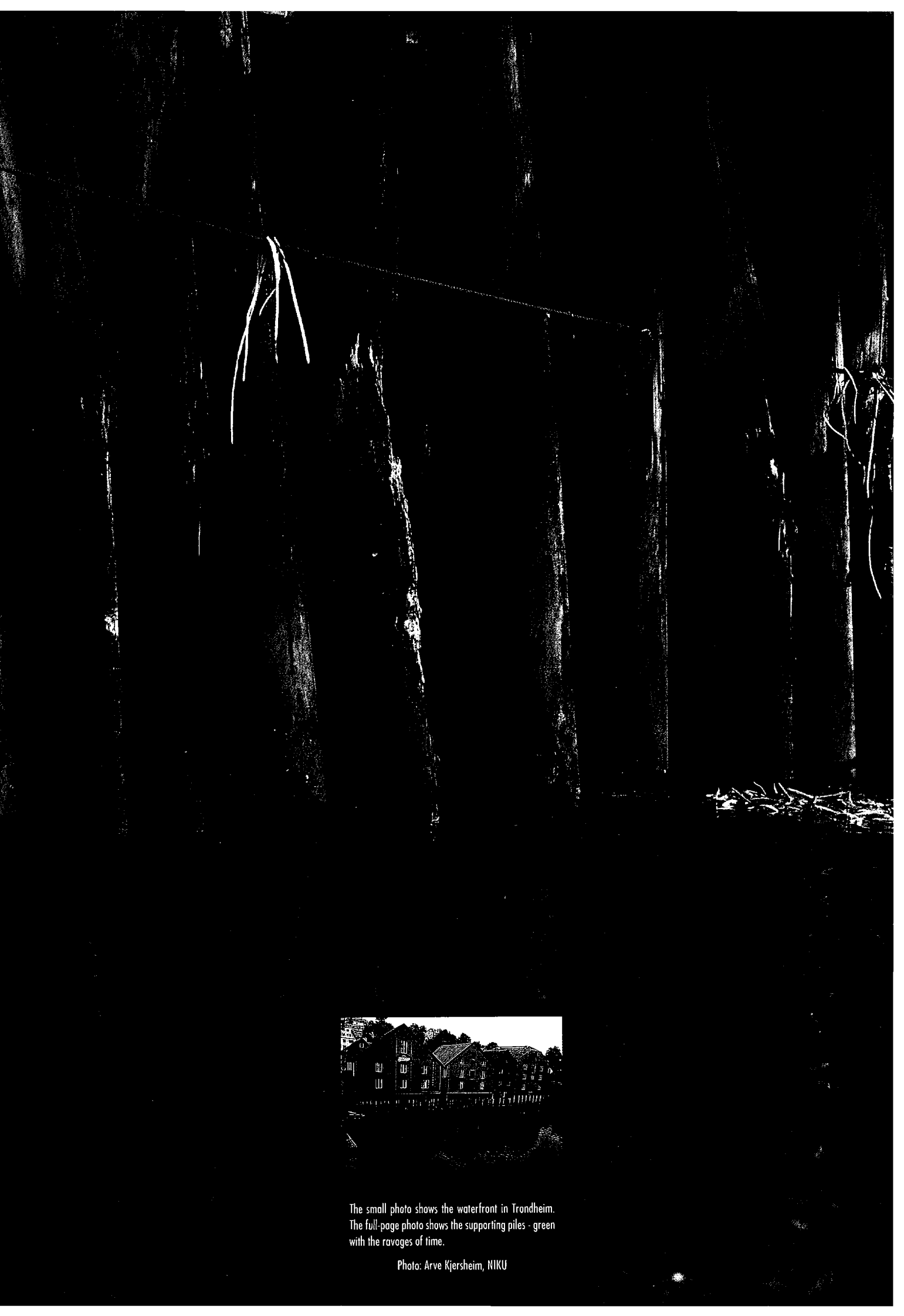
**Marked increase in debt-collection in the first eight months compared with previous years**

**High activity levels and further general price increase in the property market in 1996 as in 1995**

inadequate keeping of accounting records as well as unsatisfactory (or lack of) reconciliation of client accounts. Eighty-six on-site inspections were carried out during 1996, of which 51 were restricted in scope.

Two undertakings had their estate agency licences withdrawn. In both cases irregularities involving client funds were brought to light. One lawyer who had failed to maintain proper accounts and misused client funds was deprived of his right to carry on estate agency based on his lawyer's licence. The handling of a complaint filed against another lawyer brought to light possible misuse of client funds in connection with property sales. This case was referred to ØKOKRIM for investigation and possible prosecution.

Estate agency reporting to Kredittilsynet changed in 1996 with the introduction of a new report form. Like the previous one, the new form is to be submitted every four months. It is designed to provide a far better basis for evaluating estate agencies' financial position. Concurrently a separate form was introduced for estate agency auditors. Auditors are *inter alia* required to formally state the amount of funds entrusted to the agencies and to answer a number of questions in connection with the keeping and administration of accounting records.



The small photo shows the waterfront in Trondheim.  
The full-page photo shows the supporting piles - green  
with the ravages of time.

Photo: Arve Kjersheim, NIKU

# Overview of international activities

**Tighter collaboration among supervisory authorities required by internationalisation of financial markets and harmonisation of legislation**

Internationalisation of financial markets and harmonisation of legislation require ever closer collaboration among supervisory authorities in the financial sphere. Structural changes in the market and the establishment of cross-border financial conglomerates also necessitate collaboration across sectoral divides. This led in 1996 to the establishment of the Joint Forum comprising representatives from the IAIS (International Association of Insurance Supervisors), the IOSCO (International Organisation of Securities Commissions) and the Basle Committee on Banking Supervision. The Joint Forum is headed by Tom de Swaan.

## **International cooperation outside the European Union and the European Economic Area**

International cooperation on banking supervision is primarily the domain of the Basle Committee whose members are drawn from major industrial countries and the secretariat to the Bank of International Settlements (BIS). Every two years the committee arranges an international conference for banking supervisors (International Conference of Banking Supervisors). Kredittilsynet attended the conference in Stockholm in June 1996 which drew up new, more precise guidelines for cooperation on cross-border banking supervision. In 1996 Kredittilsynet also established contact with the International Monetary Fund (IMF) which is now enhancing its focus on banking supervision.

Kredittilsynet is a member of the International Association of Insurance Supervisors (IAIS). As from 1997 the IAIS will have a permanent secretariat attached to the BIS in Basle. At the annual meeting in Paris in October 1996 new statutes were adopted for international standards to guide the regulation and supervision of insurance. Norway was assigned a place on the Technical Committee and on the sub-committees dealing with insurance law, regulations and practices and supervision of conglomerates.

In the securities field Kredittilsynet is a permanent member of the International Organisation of

Securities Commissions (IOSCO) and of the International Securities Market Association (ISMA).

As regards the OECD Kredittilsynet regularly attend meetings of the Capital Markets Committee and Insurance Committee. The basic object here, as in the EEA, is to achieve increased harmonisation and liberalisation of financial markets. Moreover, the GATS talks have led to increased international contacts and harmonisation.

Collaboration with other Nordic supervisory authorities plays a vital role for exchanging practical experience in the work of supervision. Nordic supervisors met in Iceland in 1996 and will meet in Norway in 1997. Moreover, 14 ad hoc meetings and seminars were held on specific areas of supervision.

Contacts with the US and Canadian authorities were strengthened. Meetings were held with the US Federal Reserve as a step in macroeconomic surveillance and other supervisory work. A separate visit was paid in 1996 to the Office of the Superintendent of Financial Institutions (OSFI) in Canada, the only country apart from Norway, Sweden and Denmark operating joint supervision of banking and insurance.

## **Cooperation within the European Union and the European Economic Area**

The EEA Agreement has led to a considerable increase in international activity since 1993. In 1996 Kredittilsynet attended a total of 58 meetings abroad under EU and EEA auspices compared with 46 in 1994. Since 1994 Kredittilsynet has attended meetings of the liaison bodies Groupe de Contact (banking supervision) and the EU Conference of Insurance Supervisory Authorities as an observer. Norway, Iceland and Liechtenstein have formally signed the conference's protocol relating to the collaboration of the supervisory authorities of the member states of the European Union. In the autumn of 1996 it was decided that EFTA and EEA members states can host conferences in the future. In 1996 Kredittilsynet was for the first time invited to attend, as an observer, the Informal Group of Chairmen of EU Securities Commissions with a view to practical cooperation on securities supervision.

As a member of the EEA, Norway attends consultative meetings in advance of meetings of the Banking Advisory Committee and the Insurance Committee under the EU Commission. We also attended the High Level Securities Supervisors Committee, an informal committee under the EU Commission. A Directive on the establishment of a securities committee on a par with the Banking Committee and the Insurance Committee is still in process.

On the banking front collaboration among supervisory authorities is organised through bi-

lateral agreements or Memorandums of Understanding (MoUs). MoUs have been signed with the supervisory authorities in all Nordic countries as well as England, France, Luxembourg, Germany and the Netherlands. In 1996 Kredittilsynet held bilateral meetings with the banking supervision authorities of France, Germany and the Netherlands, among others. On the securities front special MoUs were signed with the authorities of the USA and the UK. Work on a joint Nordic MoU is in progress.

**Table 8: Participation in international organisations and EU- and EEA-related committees:**

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

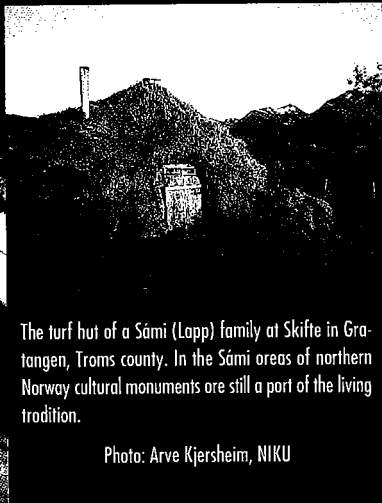
<b>Insurance</b>
IAIS (International Association of Insurance Supervisors)
OECD's Insurance Committee
EU's Insurance Committee (IC) - consultative meetings
Conference of Insurance Supervisory Authorities of the member states of the European Union (EEA)
Conference of European Insurance Supervisory Services (not EU-related - no meetings in 1996)
Nordic supervisors' meetings

<b>Securities trading</b>
IOSCO (International Organisation of Securities Commissions)
Enlarged Contact Group on Supervision of Collective Investment Funds
ISMA (International Securities Market Association)
Informal Group of Chairmen of EU Securities Commissions
High Level Securities Supervisors Committee
Nordic meetings

<b>Accounting and Auditing</b>
IIA (Institute of Internal Auditors)
FEIA (The European Confederation of Institutes of Internal Auditing)
Nordic meetings

**Table 9: EU- and EEA-related meetings attended by Kredittilsynet:**

	NO. OF MEETINGS 1995	NO. OF MEETINGS 1996
Permanent supervisory bodies	5	8
Consultative meetings - BAC and IC	6	6
Working and expert groups under the EU	22	31
Other liaison meetings - seminars etc.	4	5
Bilateral meetings	9	8
<b>Total EU- and EEA-related meetings</b>	<b>44</b>	<b>58</b>



The turf hut of a Sámi (Lapp) family at Skifte in Grangangen, Troms county. In the Sámi areas of northern Norway cultural monuments are still a part of the living tradition.

Photo: Arve Kjerseim, NIKU



# Ten Years of Integrated Supervision

*This article is based on an address delivered by the Chairman of Kredittilsynet's Board, Mr. Erling Selvig, Professor, Dr. Jur.*

Norway's financial legislation is based on two main considerations. One is that financial institutions are primarily responsible for the management and control of their own activities, the other is that a chiefly privately-owned financial industry should be subject to some measure of public regulation if it is to be able to fulfil its social functions. This latter is reflected in statutory requirements as to financial strength and safety and, outside the banking sector, in rules based on other considerations. It is also reflected in the establishment and development of public supervision of financial institutions. The central task of supervision is to ensure that the institutions function in an appropriate and satisfactory manner in conformity with the requirements set out in the legislation.

The 1980s a period of innovation and modernisation of Norwegian financial legislation

With the merging of the Bank Inspection and the Insurance Council to form Kredittilsynet in 1985, an integrated supervisory authority was established for the first time, and without the benefit of an international model, to oversee the entire financial market.

In the context of Norwegian financial legislation the 1980s stand out as a period of innovation and modernisation. In 1985, when the Bank Inspection and the Insurance Council were merged to form Kredittilsynet, an integrated supervisory authority was for the first time, and without the benefit of an international model, established to oversee the entire financial market. This broad approach was continued through the major law review of 1988. An essential feature of the legislation governing financial institutions and financial markets is common solidity and safety requirements and other blanket regulation for all financial institutions. The 1988 Acts also provide for basic regulation of conglomerates which was the basis for the overall legislation on financial conglomerates passed in 1991.

Even prior to the Bill of 1985 an integrated supervision model based on a merger of the banking and insurance supervisory bodies was seen

to have clear-cut advantages:

- insurance companies played an important role as investment brokers, and there were signs of increased cooperation between banking and insurance
- supervision of banking and insurance shared common features as did legislation governing the two sectors
- collective supervision would lead to greater efficiency and better resource use, also in the context of collaboration with other countries
- coordination of licensing and structural tasks, rules etc.

It was on this basis that Kredittilsynet was established as an integrated supervisory body for banking, insurance and securities broking. In due course Kredittilsynet was also assigned other responsibilities, notably supervision of debt collection and auditing.

Partly because of the banking crisis and the need to strengthen supervision, the possibility of forging closer links with Norges Bank was considered by an expert committee appointed by the Ministry of Finance. The Storting's financial affairs committee came out in favour of the expert committee's minority (Mr. Erling Selvig) who believed that Kredittilsynet should continue as an independent and strengthened government agency. Between 1993 and 1996 Kredittilsynet was accordingly assigned greater resources and 36 new posts.

Substantial changes have taken place and activity levels have risen in Norway's financial markets since 1986. In the course of Kredittilsynet's ten-year history we have experienced the gravest financial crisis since the inter-war years. The biggest commercial and savings banks had to be bailed out, first by their respective guarantee funds, then by the State. The crisis assumed dimensions few had considered possible when Kredittilsynet was founded. Insurance companies got through the crisis without incurring heavy losses. Even so the major insurance groups felt its severity.

The first stage in establishing the open, internationalised financial markets of today was

**The 1980s a period of innovation and modernisation of Norwegian financial legislation**

**With the merging of the Bank Inspection and the Insurance Council to form Kredittilsynet in 1985, an integrated supervisory authority was established for the first time, and without the benefit of an international model, to oversee the entire financial market**

**EEA Agreement subsequently led to removal of most constraints on cross-border activities in Europe**

deregulation of the national credit markets in the 1980s. The gradual liberalisation of establishment and licensing policy started at about the same time, enabling foreign institutions to set up business in Norway and make acquisitions. However, financial markets were still in the main national markets. Only with the deregulation of the currency market in the early 1990s was the stage set for internationalisation. The EEA Agreement subsequently led to the removal of most barriers to cross-border activities in Europe.

Throughout this period, and in parallel with internationalisation, the breakdown of traditional sectoral divides has continued. Where credit and savings products and investment services are concerned, competitive markets drawing players from a number of industries are the order of the day.

The banking crisis, liberalisation of licensing policy and increased competition have led to fewer and larger conglomerates. While some have a dominant position in the Norwegian market, they are relatively modest in the Nordic and international context.

The banking crisis and internationalisation have provided the weightiest arguments for a liberal approach to enforcement of the new legislation on financial conglomerates passed in 1991, an approach which laid the basis for the emergence of mixed financial groups offering a full range of financial and insurance services.

In the initial years supervision focused largely on the banking and financial sector and on institutions hit by the crisis. Kredittilsynet's overall capacity could and had to be concentrated on this work, thereby confirming an important advantage of integrated supervision. The insurance sector was largely left to its own devices in this period; insurance supervision proper started in earnest in 1992. On the other hand it turned out that much of the knowledge and experience gained by Kredittilsynet in the banking sector was transferrable. In areas such as solidity and prudential requirements, investment management and institutions' management and control systems, the supervision could largely follow the same pattern as in the banking sector.

The new financial markets legislation lays a good basis for integrated supervision. Supervision of financial conglomerates has therefore not prompted the discussions witnessed in other

European countries. Norway is so far the only country with collective legislation on financial conglomerates. The legislation builds on basic considerations of solidity and safety, and the requirements as to financial conglomerates' organisational set-up reflect these considerations.

The legislation on financial conglomerates represents a continuation of the thinking underlying integrated supervision and benefits from the experiences gained with integrated supervision in the crisis years. Structural changes made in the financial and insurance industry during and after the crisis emphasise that this approach must continue to underlie the legislation on financial markets and the way the supervisory authority is organised.

While Kredittilsynet can now, five years after the banking crisis, devote more of its resources to preventive and standard-enhancing supervision, an awareness and knowledge of what happened before and during the banking crisis remains important in preventing a repeat of the problems that afflicted the 1980s.

**New legislation on financial markets lays a good basis for integrated supervision**

*Kredittilsynet celebrated its 10th anniversary in 1996. The jubilee was marked by a seminar in Oslo on 22 May 1996, where the Chairman of Kredittilsynet's Board, Mr. Erling Selvig, Professor, Dr. Jur., gave a talk on his experiences with crisis management and integrated supervision over ten years. His address is reproduced in extenso in Kredittilsynet's Småskrift series No. 4, which also contains the following addresses in English from the seminar:*

**The End of Financial Crisis?**  
Assistant Director and Chief,  
Capital Markets Division,  
International Monetary Fund,  
David Folkerts-Landau

**The Supervision of Financial  
Conglomerates**  
Tom de Swaan,  
Executive Director of  
De Nederlandsche Bank, NV

*Publications in the småskrift series may be ordered from Kredittilsynet*

The redeveloped Aker Wharf in Oslo is a good example of urban architecture of the 1980s combined with existing industrial buildings adapted to new uses. Are we looking at a future historical monument?

Photo: Arve Kjerfveim, NIKU



# *Kredittilsynets organisational set-up*

## **The Board**

Kredittilsynet is headed by a board of five members. Members and alternates are appointed by the King for a four-year term. At the start of 1996 the board was composed as follows:

Mr. *Erling Selvig*, professor, dr.juris., chairman

Ms. *Else Bugge Fougner*, supreme court justice, deputy chair

Mr. *Asbjørn Rødseth*, professor

Ms. *Mary Kvidal*, deputy director of education

Mr. *Ingebrigt Børsheim*, managing director

## *Alternates:*

Ms. *Turid Hundstad*, director

Mr. *Steinar Undrum*, director

*Mary Kvidal* withdrew from Kredittilsynet's Board upon her appointment to the post of state secretary at the Ministry of Energy and Industry at end-1995. A new member, Ms. *Eli Aas*, lawyer, was appointed to the Board by the Ministry of Finance on 19 August 1996.

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

Two members elected by and from among the employees supplement the Board when administrative matters are dealt with. Employee representatives in 1996 were:

Ms. *Kjersti Elvestad*, adviser

Mr. *Erik Johansen*, adviser

The Board met 13 times in 1996. In addition some matters were dealt with by circulation to board members. The Board handled a total of 120 supervisory and 66 administrative matters, in addition to 97 matters submitted to the Board for their information only.

## **Administration and staff**

Kredittilsynet acquired four new positions in 1996, bringing the total number to 139. The Storting's treatment of a White Paper (Innst.S.nr.246 (1991-

92)) resulted in a resolution to progressively strengthen Kredittilsynet's resources. With the increase from 103 positions in 1992 to 139 in 1996, this process has been brought to completion. At year-end the permanent staff numbered 134 compared with 129 at the end of 1995.

Twenty-eight vacancies were advertised in 1995, including four internally. Applicants totalled 511.

Kredittilsynet has a satisfactory supply of highly qualified applicants with recently completed university training or the equivalent. Kredittilsynet also considers it important to recruit staff with broad experience from and knowledge of sectors and trades under its supervision. At end-1996, 26 staff members had such experience. Seventy-eight per cent of the staff have higher education.

## **Organisational set-up and competence**

Only a small number of organisational adjustments were made in 1996. A continuing evaluation of Kredittilsynet's organisation is designed to ensure that it functions as well as it possibly can in relation to the guiding objectives and strategies. Kredittilsynet is a knowledge-based agency with a high proportion of staff with higher education. Its ability to recruit and retain able staff members is therefore crucial. To this end Kredittilsynet further developed its pay and personnel policy in 1996. Systems were introduced to facilitate feedback and competence assessment through manager-staff interviews and job appraisals. The latter, together with assessments of staff members, constitute important elements of Kredittilsynet's pay policy whose main features were introduced in 1996.

Kredittilsynet largely recruits well qualified recent graduates. The insight into financial markets that they acquire in their work fairly quickly renders them attractive on the labour market, and turnover in this category is fairly high. It is important for Kredittilsynet to provide these staff members with solid experience and personal development and to retain strategically important competence within the institution. To

this end a salary scale has been developed for recent graduates as an element of overall pay policy.

Work on alternative career paths, competence- and organisation development will continue in 1997. This is important with a view to meeting future challenges in financial markets. An important objective is to develop overall competence that is less dependent on individuals and is incorporated into systems for problem-solving and learning. A focus on leadership, leadership roles and leadership development will be a necessary consequence of this. In view of increased international cooperation, staff language training was given priority in 1996 as in 1995.

New ethical guidelines were prepared and introduced for Kredittilsynet's staff in 1996.

### Public relations

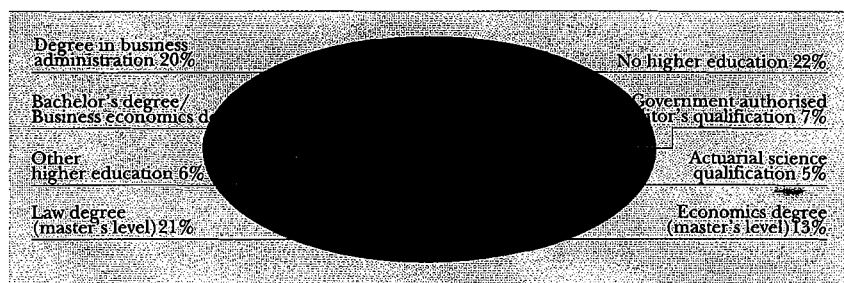
Providing information, formulating premises and dispensing advice are important elements of Kredittilsynet's strategy. Information activity is defined as a strategic tool on a par with other instruments of supervision and is utilised in various forms in the work of prevention. Kredittilsynet communicates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

A central element in this work is ongoing contact with the press. Kredittilsynet maintains a policy of accessibility and openness in its dealings with the media. Alongside ongoing contact with the press in 1996, one press conference was held in conjunction with the presentation of Kredittilsynet's annual report for 1995 and a sizeable seminar in connection with Kredittilsynet's 10th anniversary. In the wake of the celebration two new booklets were published in the "småskrift" series containing material from the seminar. Twenty-three press releases were distributed and 42 circulars were sent to supervised institutions. Management and staff gave lectures and contributions in various specialist fora.

### Information technology (IT)

A key challenge for Kredittilsynet is to adapt internal IT systems to developments in

Chart 9: Staff educational background, 31 December 1996



information technology in the community in general and the financial sector in particular. This is a prerequisite for Kredittilsynet's ability to communicate effectively internally and externally and to exploit information technology as an active tool of supervision and analysis. A new IT strategy was adopted early in 1996. This forms the basis for efforts ahead, and work on modernising IT facilities was given priority during the year.

Work on facilitating communication between various internal databases through a switch to a new database platform is well under way with a view to improving the efficiency of analysis work. Internet access has been installed and its use in public relations is being improved. Active use of the Internet and e-mail is accompanied by security challenges. Kredittilsynet attaches great importance to introducing procedures and routines that can prevent sensitive data from going astray. Use of external electronic communications will therefore grow on a cautious and gradual basis. An overall review of the security inherent in Kredittilsynet's IT regime was initiated partly for this reason. Network investments designed to ensure stability and reduce vulnerability have been made. Staff can now access a client/server-based filing system which will provide the basis for electronic archives.

### Finances:

#### Expenditure

Kredittilsynet's budget for 1996 totalled NOK 76.3 million. Total expenditure came to NOK 73.8 million, i.e. an increase of 7.0 per cent on

**Table 10: Kredittilsynet's expenditure  
1992 - 1996**

YEAR	FINAL ACCOUNTS MNOK	CHANGE FROM PREVIOUS YEAR IN %
1992	49.0	9.6
1993	54.6	11.4
1994	65.7	20.3
1995	69.0	5.0
1996	73.8	7.0

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

1995. Salaries and salary-related costs amounted to NOK 48.0 million (65 per cent of total expenditure). Expenditure on operations, travel, competence training, consultancy services and organisation development came to NOK 21.9 million (29.6 per cent of the total). IT outlays totalled NOK 3.9 million or 5.4 per cent of overall expenditure.

An overview of the growth in Kredittilsynet's expenditure in recent years is given in Table 10. The growth is mainly due to staff increases. The increase in the number of posts is mainly due to the plan to progressively expand Kredittilsynet's resources drawn up after the Storting's decision in 1992 to retain an independent and stronger institution. The increased resources have enhanced Kredittilsynet's capacity and competence, thereby raising the quality of its operations.

**Table 11: Cost of supervision distributed  
on supervised**

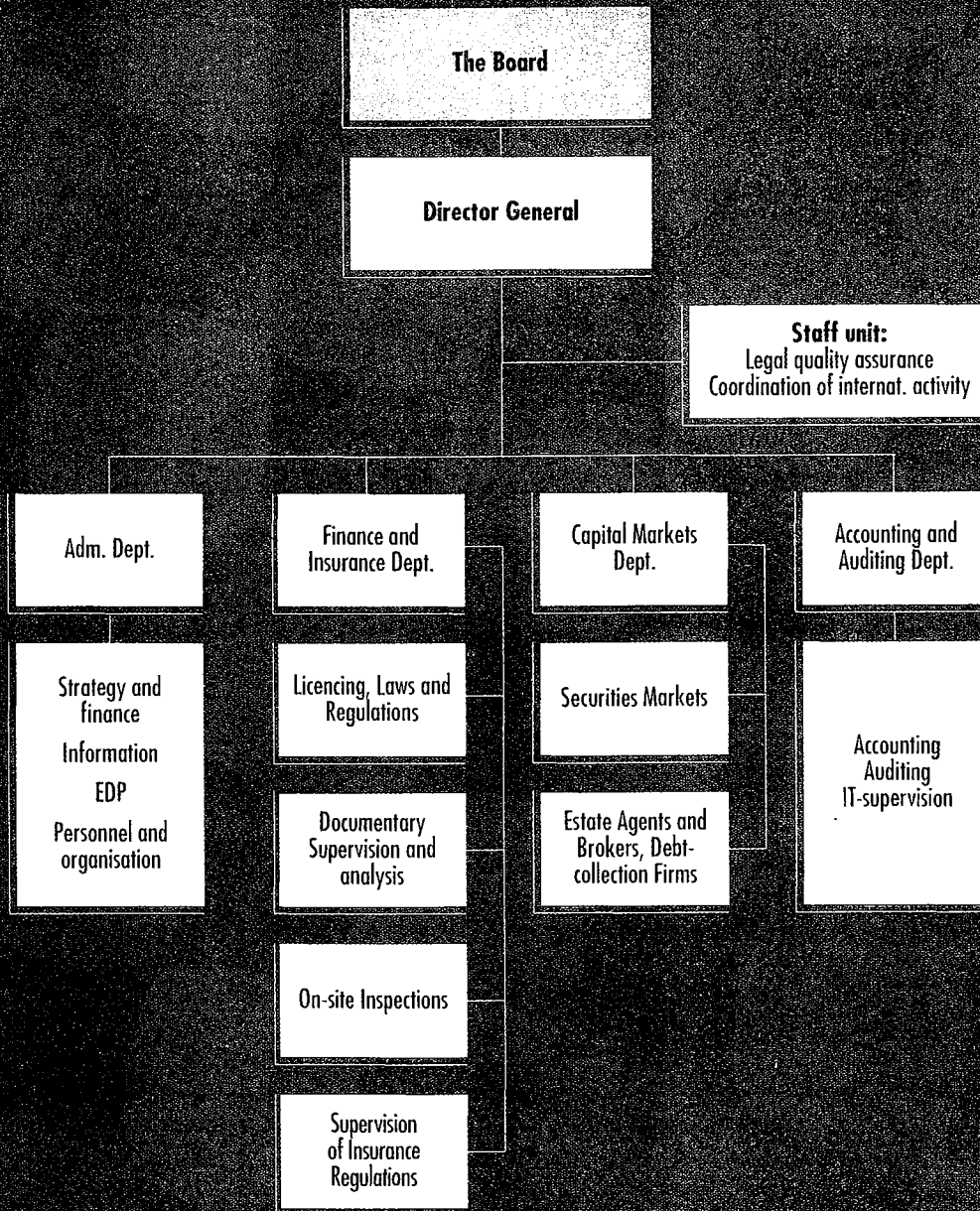
SUPERVISED GROUP	PERCENTAGE OF TOTAL LEVY IN 1995
Banks	37.85
Insurance companies	26.82
Pension funds	5.95
Finance companies, mortgage companies	5.18
Auditor firms/auditors	5.79
Securities trading	9.27
Estate agencies	4.87
Debt collection	3.43
Miscellaneous	0.84
<b>Total</b>	<b>100.00</b>

### Revenues

Under section 9 of the Act on Supervision of Credit Institutions, Insurance Companies and Securities Trading, etc., Kredittilsynet's expenses are covered by the institutions under its supervision at the start of the financial year. The expenses are apportioned among the various institutional groups based on the extent of the supervision, and are payable the year after they are incurred. The total amount levied for 1995, i.e. NOK 67.8 million, was approved by the Ministry of Finance on 15 October 1996. Supervised entities liable to pay the amount levied for 1995 numbered 2,733. The percentage distribution of the levy among the various categories of supervised entities is shown in Table 11.



# Kredittilsynet's organisation chart



What does our cultural heritage include? According to Norway's Cultural Heritage Act "all traces of human activity in our physical environment form part of our cultural heritage" - certainly an all-inclusive definition. In these pages we present a selection of what we conceive to be typical monuments and relics ranging from stave churches and rock carvings to (possibly less conventional) items such as steel ships and buildings of the 20th century. The Directorate for Cultural Heritage considers it imperative that examples of every type of monument or site from every period is preserved for future generations as part of the nation's cultural heritage.

The Government has designated 1997 as a national cultural heritage year, whose main themes will be:

- Cultural relics along the coast and waterways
- Technical and industrial relics
- Get to know your cultural heritage!

The photos in Kredittilsynet's annual report for 1996 have been selected in conjunction with the Directorate for Cultural Heritage.

# KREDITILSYNET

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