



Norwegian Ministry
of Finance

Summary

Meld. St. 24 (2018–2019) Report to the Storting (white paper)

Financial Markets Report 2019





Norwegian Ministry
of Finance

Summary

Meld. St. 24 (2018–2019) Report to the Storting (white paper)

Financial Markets Report 2019

Financial Markets Report 2019

Meld. St. 24 (2018–2019) Report to the Storting (white paper)
Summary

*Recommendation of the Ministry of Finance of 26 April 2019,
approved by the Council of State on the same day.
(Government Solberg)*

Summary and key developments

Introduction

The Government submits an annual financial markets report to the Storting. This summary corresponds to chapter 1 of the report, which provides an overview of key financial market policy developments, and a summary of the other chapters. Chapter 2 of the report addresses the financial stability outlook. Chapter 3 discusses the financial markets from an industry perspective, and addresses both the financial sector as an industry in its own right and the financial sector as a capital source for other industries. Chapter 4 provides an overview of how consumer protection is attended to in financial market regulations, and discusses the need for changes. An overview of the activities of Norges Bank, Finanstilsynet, Folketrygdfondet and the International Monetary Fund (IMF) in 2018 can be found in chapters 5 to 8 of the report. Chapter 9 outlines amendments to regulatory frameworks and licences in 2018.

Main functions and key figures for the Norwegian financial sector

The financial markets account for a major portion of the Norwegian economy, and provide services of importance to people's lives. The main function of banks is to receive savings in the form of deposits,

and to make loans to households, businesses and municipalities. Deposits with Norwegian banks amount to about NOK 2,500 billion, which corresponds to almost two Norwegian fiscal budgets. Banks lend about twice as much as they hold in deposits, and fund the difference through capital market borrowing.

Each year, life insurance companies and pension funds receive pension savings in excess of NOK 110 billion, and have invested about NOK 1,700 billion in general lending, securities and other assets on behalf of their customers.

Norwegian securities markets, where large businesses and municipalities raise loans and equity directly from savers, represent values of about NOK 5,000 billion. The saving and borrowing opportunities provided by Norwegian financial markets offer households, businesses and municipalities the discretion to allocate their investments and consumption over time, irrespective of when income is received. This possibility of choice is valuable to individuals, and is fundamental for value creation and economic growth.

The scope for insuring against risk provides predictability for households, and is a prerequisite for stability and profitability in businesses. Last year, non-life insurance companies in Norway paid more than NOK 40 billion in compensation for anything from personal injury to theft and damage to buildings and cars. In addition, businesses use various financial instruments to reduce their financial risk, e.g. relating to changes in commodity prices, exchange rates and interest rates. Life insurance companies also sell insurance policies that pay compensation in the event of disability or death, either separately or as part of pension plans.

More than two billion card payments are processed through the Norwegian payment system every year, and the average Norwegian resident uses payment cards more than 400 times a year. This system, as structured in Norway, processes payments in a secure manner and at a low cost. This promotes stability and efficiency in the Norwegian economy.

Financial stability outlook (chapter 2)

Stable access to financial services is important for the well-functioning of modern economies. The welfare costs of financial market turbulence and crises can be large and persistent. In particular, the interaction between the banking sector and the rest of the economy may result in the accumulation of financial imbalances, and trigger turmoil and deep economic setbacks. The Government is therefore committed to ensuring that the financial markets are robust in the face of disturbances, and have the capacity to maintain their services through challenging times.

The Norwegian financial stability outlook is affected by Norwegian and international economic developments and by international financial market developments. The Ministry will present its assessment of the Norwegian and international economic outlook in the revised national budget in May. The Norwegian economy is experiencing a cyclical upturn, with high employment growth, lower unemployment, expanded investment on the Norwegian continental shelf and in mainland businesses, higher purchasing power and household optimism. The setback in the wake of the oil price slump in 2014 is behind us, and the Government has focused on normalising fiscal policy in line with the resumption of growth in the Norwegian economy. Norges Bank has increased the key policy rate and has announced that it anticipates further rate increases.

International economic growth has been strong in recent years, although it has tapered off somewhat recently. Norway's trading partners are expected to see their economic growth level off to its long-term trend over the next couple of years. However, the risk of substantial trade barriers being erected in a number of countries, the slowdown in China and the uncertain effects of Brexit create uncertainty about the international growth and financial stability outlook. International market turbulence may have repercussions for Norwegian financial undertakings, which may e.g. experience an increase in their funding costs.

Household vulnerabilities

The average debt of Norwegian households is now more than two times disposable household income. This is a high level, both historically and compared to other countries. A sustained increase in the debt burden is an indication that financial imbalances have been accumulating. This is one of the most important vulnerabilities in the Norwegian financial system. Although debt increases have levelled off somewhat over the last year, household debt increases are still outpacing income increases. Consumer loans only represent 3 percent of such debt, but the interest expenses account for no less than 14 percent of total interest expenses, and add to the vulnerability.

This debt accumulation is linked to steep housing price growth over many years. Housing prices declined in 2017, and thereafter rose again towards the summer of 2018. Housing price developments have been more moderate since then.

Most financial crises in Norway and internationally have occurred after periods of strong growth in asset prices and rapid debt accumulation. One of the risks is that many households might choose to curtail consumption if incomes were to decline or interest rates increase. Experience shows that households accord priority to servicing their residential mortgage loans, even when incomes are in decline. Lower consumption may reduce the earnings and debt servicing capacity of businesses, which may then result in increased losses on the part of banks, thus impairing their capacity to make new loans to both households and businesses.

The Government has in recent years introduced a number of measures to limit the risk posed to financial stability and the Norwegian economy by high household indebtedness. In addition to the general strengthening of capital requirements for banks, the capital requirements for residential mortgages have been raised further. The countercyclical capital buffer requirement shall vary over time in response to the financial cycle, and was activated for the first time with effect from June 2015. The buffer requirement has been tightened thrice since then, most recently in December 2018 with effect from yearend 2019.

The Government has imposed restrictions on banks' lending practices in order to promote a more sustainable development in household debt. A temporary regulation on residential mortgage lending was adopted in the summer of 2015. This regulation was renewed, subject to some tightening, with effect from January 2017, and again from 1 July 2018. The Government will decide whether to extend the regulation and, if so, whether any modifications are needed, before the current regulation expires on 31 December 2019. On 12 February 2019, the Ministry also adopted a temporary regulation on banks' consumer lending practices, largely mirroring the residential mortgage regulation.

The resilience of banks, insurance companies and pension undertakings

The improving Norwegian economy is reflected in several years of low loan loss and high earnings on the part of banks. The profitability of Norwegian and other Scandinavian banks is high compared to that of banks elsewhere in Europe. Norwegian banks have also achieved about the same return on equity as Danish and Swedish banks, despite significantly higher equity.

Capital requirements for Norwegian banks have long been stricter than in many other countries, partly in reflection of experience from the Norwegian banking crisis in the 1980s and 1990s. Strong bank solvency benefited the Norwegian economy during the international financial crisis. After the crisis, Norway increased requirements in line with the Basel III standards more rapidly than most countries. This was feasible because of relatively strong banks and healthy performance in the Norwegian economy, but also reflects a political prioritisation of financial sector resilience.

Norwegian banks have strengthened their solvency significantly in recent years, in line with stricter capital requirements, and banks' ability to withstand a potential setback in the Norwegian economy has been strengthened. However, Norwegian banks must continue to prioritise solvency maintenance and adaptation, in order to keep up a good margin on the sum total of the general and additional requirements.

The current EU prudential framework for banks (CRR/CRD IV) was enacted in 2013, and has in all key respects been implemented in Norway, although it has yet to be incorporated into the EEA Agreement. The Norwegian capital requirements will need to be amended in some respects upon the framework being incorporated into the EEA Agreement this year. The so-called Basel I floor, the purpose of which has been to ensure that internal model-based requirements are not too low, will be abolished. The solvency requirement for banks' lending to small and medium-sized enterprises (SMEs) will also be reduced. The amendments imply that solvency figures for Norwegian banks become more comparable to international figures, but also that requirements for many banks will be more lenient in real terms. The Ministry of Finance is currently assessing the totality of capital requirements for banks, including the need for regulatory modifications to prevent unwanted lowering of the capital level accumulated in Norwegian banks after the international financial crisis. The Ministry is also examining the scope for more equal capital requirements for Norwegian and international banks' operations in Norway under the CRR/CRD IV.

Market funding enables banks to manage their liquidity risk in a manner not feasible with deposits, but also makes them vulnerable to market turbulence. In recent years, a somewhat higher proportion of market funding has taken on a long-term nature, and banks meet both the liquidity coverage requirement (LCR) introduced in 2017 and an upcoming net stable funding requirement (NSFR). This strengthens the resilience of banks.

Covered bonds currently account for about half of banks' market funding. Covered bonds have thus far turned out to be a secure and stable source of funding, but also entail new vulnerability. Housing market developments are a risk factor for banks' scope for using covered bonds to fund themselves, and banks also make considerable investment in each other's covered bonds to comply with the liquidity reserve requirement. If many banks need to sell covered bonds simultaneously, both value and liquidity may suffer. Housing market setbacks may exacerbate such a development.

The amendments to deposit guarantee and bank recovery and resolution legislation entered into effect on 1 January 2019. This regulatory framework shall facilitate more secure bank deposits, enhanced preparedness and lower risk in the banking sector. Finanstilsynet shall prepare resolution plans for how each bank may be dealt with in a more severe crisis. Bail-in is a key resolution measure. This involves debt being converted to equity, thus covering the bank's losses and strengthening its solvency enough to keep it in operation. Finanstilsynet aims to impose a minimum convertible debt requirement; a so-called MREL requirement, on most Norwegian banks in the bank-specific resolution plan.

The capital of the Norwegian Banks' Guarantee Fund will this year be transferred to two new funds set up to finance the deposit guarantee scheme and resolution measures, respectively. The fund capital totalled NOK 35.5 billion as at yearend 2018, which is much more than is required under the EU directives. Well-capitalised funds enable possible problems in the banking sector to be managed appropriately. The Government is in dialogue with the EU to retain the NOK 2 billion guarantee when the Deposit Guarantee Schemes Directive is incorporated into the EEA Agreement.

Solvency requirements for insurance companies and pension funds have also been strengthened in recent years. Increasing life expectancy and the persistently low interest rate level have highlighted the need for improved solvency in the undertakings and a more risk-sensitive regulatory framework. The undertakings have accumulated reserves to account for higher life expectancy, and meet new solvency requirements.

Climate risk in financial markets

Climate change, as well as society's adaptation to climate change, may give rise to new vulnerabilities in the financial system. The physical impact of climate change, such as more frequent extreme weather, may result in more damage to real estate and infrastructure and larger claims for non-life insurance companies. It may also result in impairment of the investments of financial undertakings and the mortgaged

assets that secure banks' lending. The transition to a low-carbon economy also entails risk. Political decisions and technological breakthroughs may entail sudden changes in the value of major financial asset classes. Experience has shown that such sudden changes in asset values may have implications for financial stability.

Initiatives have been launched both internationally and in Norway to improve our understanding of how climate change may affect the functioning of financial markets and what role regulatory authorities, supervisory authorities and central banks have in managing and limiting the risks posed by climate change. In December 2017, eight central banks and supervisory authorities established a Network for Greening the Financial System. The network shall contribute to the development of systems to manage environmental and climate risk in the financial industry, and generate industry support for the transition to a sustainable economy. Norges Bank was admitted to the network in December 2018, followed by Finanstilsynet in February 2019. The Task Force on Climate-related Financial Disclosures (TCFD) appointed by the Financial Stability Board has made recommendations on how companies can report on climate-related risk in a better and more systematic manner. The TCFD recommendations have gained widespread international support.

In the autumn of 2017, the Government appointed a commission to address the significance of climate-related risk factors for the Norwegian economy, including for financial stability. The Climate Risk Commission submitted its report to the Ministry of Finance on 12 December 2018. The Commission's financial market assessments and recommendations are discussed in this report, while the consultative statements and the direction of the Government's follow-up of the remainder of the report are discussed in the Revised National Budget for 2019.

The Commission believes that more knowledge is needed on climate risk in the financial markets and how it should be managed, and recommends that Norwegian authorities accumulate climate risk expertise and participate in international debates and efforts. The Commission notes in the report that the financial industry plays a key role in private sector climate risk management and the transition to a

low-carbon economy by channelling capital and facilitating risk diversification and risk management. If the economic impact of climate change is major, it is also reasonable to expect a major impact on financial markets. Financial market turbulence may in itself exacerbate the negative impact of climate change on the real economy.

The Government agrees with the Commission that financial market climate risk should be addressed by accumulating expertise in both the private and the public sector. The Ministry notes in the letter of allocation to Finanstilsynet for 2019 that the authority has an important role in mapping and analysing potential implications of climate change for the financial industry. Supervisory authorities need to tailor their follow-up of financial undertakings to new risks and vulnerabilities that are identified, and to international policy measures and recommendations.

The Commission notes that financial market participants need relevant information about the climate risk enterprises are facing. A lack of readily available information on the climate risk facing various enterprises makes it difficult for the market to price risk. The Commission believes that the TCFD recommendations provide a good climate risk reporting framework, and recommends that Norwegian businesses make use of the TCFD framework in their corporate reporting. The Commission believes, at the same time, that it would be premature for the Norwegian authorities to introduce detailed statutory climate risk reporting requirements, since national requirements would come into conflict with the TCFD objective of uniform and comparable climate risk reporting across companies, sectors and countries.

The Government agrees with the Climate Risk Commission's assessment that the TCFD recommendations provide a good climate risk reporting framework. This has also been broadly endorsed in the consultative comments on the Commission's report. Large Norwegian businesses should report on climate risk in line with the recommendations, but the Government also agrees with the Commission that it would be premature to introduce a statutory requirement for such reporting. It is a sensible approach in an early phase to leave it to the market to develop standards for what constitutes decision-relevant

information, and how this should be reported. The Norwegian authorities will monitor regulatory developments in the EU and the degree to which the TCFD recommendations are followed up in the market.

The Government endorses the objectives of the European Commission's action plan on financing sustainable growth, which was published in March 2018, and monitors EU follow-up of the plan. The establishment of a taxonomy for sustainable economic activity may serve to direct capital towards sustainable investments and prevent greenwashing of financial products. This initiative is supported by a number of consultative bodies, including Finanstilsynet and the Norwegian Consumer Council, although Finanstilsynet notes that it is challenging to develop uniform standards. The Government is of the view that the classification system should not be more complex than is necessitated by its purpose, and it should not inadvertently impede company restructuring.

Some consultative bodies have commented on the potential integration of sustainability into the EU prudential framework for banks and insurance companies. Finanstilsynet is sceptical about supporting factors in the prudential framework to promote certain types of investment, and observes that climate risk should be addressed through supervision of the industry's risk assessments and solvency. The Government agrees with the Commission that the prudential framework should continue to reflect lending risk as correctly as feasible. It is therefore important to develop the solvency framework to capture changes in risk.

Digital vulnerability

Financial stability might be threatened if a major financial undertaking, a key infrastructure undertaking or numerous banks are knocked out for more than a brief period of time as the result of operational fault or cyberattack. The Government has identified financial services as one of 14 critical societal functions, thus meriting special attention to vulnerabilities, security and preparedness.

The financial infrastructure in Norway is considered robust in all key respects. The number of ICT incidents reported to Finanstilsynet

was at about the same level in 2018 as in 2017. The number of reported attacks has remained low, and consequences have been limited. Although a significant increase in unwanted activity has been observed in recent years, only a minor portion of such activity has resulted in security incidents which need to be reported to Finanstilsynet.

Although the industry is held to be well prepared for handling incidents of both an operational and a malicious nature, certain developments may make the provision of financial services more vulnerable in coming years. This applies, in particular, to the increasing dependence on complex ICT systems in the sector, the growth in outsourcing of operational duties to a small number of key service providers, the digitalisation of customer-oriented services, as well as new technology and new regulation allowing for third-party providers. Both the authorities and the financial industry itself must continue to promote a robust financial infrastructure in the face of these developments.

Combating money laundering and terrorist financing

Efforts to combat money laundering and terrorist financing form part of society's overall effort against crime and terrorism. Besides, extensive money laundering activities have been uncovered in several banks on the international arena, which has resulted in considerable reputational loss and large fines, thereby illustrating that there is also significant operational risk in relation to money laundering. The new Norwegian Anti-Money Laundering Act entered into effect in October 2018, and implements major parts of the EU's Fourth Anti-Money Laundering Directive. The Act with appurtenant regulations also means that Norway is implementing a number of recommendations from the Financial Action Task Force (FATF) on measures to combat money laundering and terrorist financing. Finanstilsynet has strengthened its supervisory efforts in this regard in recent years.

The financial markets in an industrial perspective (chapter 3)

The Government is of the view that broad diversity in the range of service providers in all parts of the financial markets may serve to reduce the vulnerability of the service offering and promote sound competition. Norwegian markets shall be open to foreign financial undertakings, and there shall be low barriers to establishing new businesses. The regulatory framework should be stable and sound, out of consideration for both the significance of the financial sector to activity in other parts of the Norwegian economy and the important industry the financial sector is in its own right. This includes a stable and secure affiliation with international markets.

Financial market regulation in Norway is largely based on EEA provisions, which are themselves often aligned with international recommendations. It is important for the single market affiliation of Norwegian undertakings and markets that relevant EU provisions are swiftly incorporated into the EEA Agreement and implemented in Norwegian law. There is currently an above-average backlog of legal acts awaiting incorporation into the EEA Agreement. The reason for this is, in addition to the growing complexity of EU financial market regulation, that it took time to reach agreement on EEA adaptations to the European System of Financial Supervision (ESFS), on which many recent EU legal acts are based. The incorporation rate has increased after the matter of the ESFS was resolved. Almost 300 legal acts have been incorporated since the autumn of 2016, thereby bringing the total number of legal acts incorporated into Annex IX (Financial Services) of the EEA Agreement to 479. The backlog, i.e. the number of legal acts not yet incorporated into the agreement, has been halved to 156 over the course of the last 12 months.

In sum, the quality of international financial market regulation has improved in recent years. Nonetheless, national authorities will often be best placed to assess the implications of various legal acts in their own markets. Hence, there will still be a need for assessing the extent to which the scope for tailored solutions under the EU/EEA provisions should be used to have stricter requirements where merited by national circumstances, as has been done by Norwegian authorities to

e.g. ensure appropriate bank solvency requirements. At the same time, the rules shall not be such as to place Norwegian banks at a disproportionate competitive disadvantage internationally.

Access to capital for businesses

Norwegian businesses rely on a well-functioning capital market to fund projects at prices that reflect expected return and risk. The Government will continue to promote a well-functioning capital market, thereby providing businesses with access to funding at prices that reflect expected return and risk.

The overall impression of the capital market in Norway is that Norwegian securities markets are well-functioning, that Norwegian financial undertakings are solvent and liquid, and that government schemes serve to fund projects which would not readily attract ordinary market funding. The Norwegian supply side and integration with international markets provide businesses with a diversified range of funding, and the overall outcome appears to be that profitable projects have good access to funding. The Capital Access Commission reached the same conclusion in its report NOU 2018: 5, but identified room for improvement in certain respects. The Government will revert to follow-up of the Commission's recommendation in connection with the fiscal budget for 2020.

The Government will continue its efforts to simplify access to risk capital and competent investors as stated in the Granavolden political platform. Bank loans have over time been the dominant source of debt funding for Norwegian businesses. Whilst Norwegian banks and major Norwegian businesses may raise capital in international securities markets as well as from international financial undertakings, new and small business may be more dependent on Norwegian and local sources of capital. Securitisation, which involves bundling and converting bank loans into transferable securities, may increase the efficiency of the capital market, but also increase complexity and potentially also risk in the financial system. A working group appointed by Finanstilsynet shall by the end of May 2019 report on potential regulatory modifications to facilitate securitisation in line with new EU provisions.

The Government will contribute to making the Norwegian securities market an efficient source of funding for businesses and attractive to investors. This requires market participants to be confident that the market is well-regulated and transparent, that relevant information is available in the public domain, and that violations of regulations are prevented, uncovered and dealt with.

Financial markets shall channel society's capital where it generates the highest return, but also serve an important function in facilitating private savings, not least for Norwegian households. Such savings may, for example, take the form of bank deposits, or investments in funds and other securities, as well as pension savings in occupational pension schemes and individual pension schemes. The Government will facilitate private savings, and has for example introduced a new individual pension savings scheme with tax incentives and an equity savings account scheme, whilst also expanding the scope of the Young people's housing savings (BSU).

Banking sector structure

The structure of the banking sector is specifically addressed in this year's financial markets report. The banking sector constitutes a smaller portion of the economy in Norway than in many other countries, partly because Norwegian banks predominantly operate only in Norwegian markets. International banks have expanded their presence significantly since the EEA Agreement entered into effect in 1994. Norway currently has a somewhat larger proportion of international banks than the other Nordic countries, but smaller than many other European countries. The overall market share of international banks was just under 25 percent as at yearend 2018. The market share of international banks in the corporate market has increased in recent years, but remains below the level of a decade ago. Norwegian banks registered significantly higher lending growth in this market in 2018 than in previous years, whilst international banks saw growth decline to below 2 percent. Market shares in the retail market have remained fairly stable for quite some time.

A larger proportion of international banks may make the banking system less vulnerable to domestic shocks, but more vulnerable to international shocks. The emergence of international banks also affects the scope of Norwegian authorities for influencing risk management in the banking system, since international banks are largely subject to home state supervision and regulation. The international banks in Norway are predominantly Nordic banks, and there are considerable differences between Nordic authorities in how these have used the scope for tailored solutions under the EU/EEA provisions to regulate the solvency of banks. However, under the rules certain measures against systemic risk shall apply to all banks with operations in the country adopting such measures, and Nordic authorities also cooperate closely on banks with Nordic cross-border operations.

A diverse supply side is in the interest of Norwegian banking customers. Local and regional savings banks, Norwegian commercial banks and international banks perform different roles, in addition to competing with each other in most segments. Norwegian banks have fared well in competition with international banks, and are well placed to take on the competition in coming years as well. The regulatory framework governing financial markets should continue to facilitate sound competition, solvent banks and a diverse supply side.

The role of the financial industry in the transition to a low-carbon economy

Businesses and investors will address climate risk when assessing future opportunities and challenges in connection with investment decisions. Consequently, the financial industry's ability to assess how climate risk may affect the profitability of investments will make an important contribution to a successful transition to a low-carbon economy.

In June 2018, Finance Norway presented the report «Roadmap for Green Competitiveness in the Financial Sector». The roadmap points the way to a profitable and sustainable financial sector in 2030. Finance Norway makes a number of general and sector-specific recommendations for the financial industry and the authorities in its report. Finance Norway states in its report that the financial industry

may, as lender, insurer and investor, serve as a strong partner and driving force for transition in other industries, through both pricing and collaboration.

The financial industry currently offers a number of financial products with a «green» or sustainable profile aimed at the retail and corporate markets. The industry also has a role in managing the issuance of green bonds to fund projects which have positive climate and environmental effects or which facilitate climate change adaptation. It is a challenge for «green» finance that there are no universally accepted principles for classifying green financial products and services. The follow-up of the European Commission's action plan on financing sustainable growth is now focused on classifying sustainable economic activity and developing standards for green financial products and green bonds.

Non-life insurance companies are directly exposed to the physical effects of climate change in the form of increased compensation payments due to more frequent natural disasters. The insurance industry was ahead of the curve in analysing the potential implications of climate change for its business models. The knowledge accumulated by non-life insurance companies may be of considerable value for public planning purposes, as well as for natural disaster prevention and climate change adaptation of existing infrastructure, as also noted by the Climate Risk Commission. The Ministry of Finance will assess, in consultation with the insurance industry, whether there is a need for measures to facilitate improved loss data sharing for preventive purposes.

Digitalisation, new services and new business models

The Norwegian financial industry has been an early adopter of digital solutions and of digital services, which its customers have been quick to start using. The rate of financial services innovation remains high and may trigger further market structure changes in coming years. The EU's revised Payment Services Directive (PSD 2) is expected to increase competition in the payment services market over the next few years. Statutory and administrative provisions implementing the

key aspects of the directive in Norway entered into effect on 1 April 2019.

Established financial undertakings are challenged by both new fintech operations and large technology companies that have started to provide financial services in recent years. The Financial Stability Board has noted that the entry of major technology companies into the financial services market may increase competition in the short run, although there is a risk of new market concentration in the longer run.

Access to large amounts of customer data may represent a competitive advantage for companies outside the financial sector, but also raises customer data protection issues. It is important for the authorities to ensure adequate data protection, irrespective of whether customer data are processed in established financial undertakings or by new market entrants. Surveys carried out by the Norwegian Data Protection Authority show that Norwegian consumers are much more confident that Norwegian financial undertakings are committed to adequate data protection than international financial undertakings or technology companies, and Norwegian consumers express little enthusiasm for using banking services provided by large technology companies.

New market participants and the use of new technology in financial services production may increase demand for regulatory guidance, especially from new providers with little experience of regulation and supervision, but also from established financial undertakings wishing to provide services in new ways through the use of technology. Supervisory authorities in several countries have in recent years sought to facilitate innovation through the establishment of innovation hubs and regulatory sandboxes. In September 2017, Finanstilsynet established, at the request of the Ministry of Finance, a contact point for fintech firms.

Regulatory sandboxes enable selected businesses to test specific products, technologies or services on a limited number of customers, for a limited period of time and under the watchful eye of the supervisory authority. Businesses admitted to the sandbox need to meet a number of criteria. Admission to the sandbox does not imply exemp-

tion from licensing or regulatory requirements, but need not be limited to activities subject to a licencing requirement. Businesses providing services and products to supervised undertakings may also be admitted. In November 2018, the Ministry of Finance requested Finanstilsynet to establish a regulatory sandbox as part of a broader information and guidance initiative. It shall open for applications no later than 31 December 2019. The intention is to expand Finanstilsynet's understanding of new technological solutions in financial markets, while at the same time expanding innovative businesses' understanding of regulatory requirements and how the regulatory framework is applied to new business models, products and services.

Crowdfunding platforms that connect investors with businesses and others who need capital have emerged as a supplement to traditional financial undertakings and marketplaces. The Government will facilitate crowdfunding through both simplifications for the industry and increased safeguarding for consumers. Regulatory uncertainty should not be an unintended impediment to the expansion of loan-based crowdfunding in Norway. The Ministry of Finance will monitor market developments in Norway and experience in countries that have introduced specific crowdfunding regulation, such as the UK, and will assess the need for further regulatory amendments on an ongoing basis. The Ministry will in this context also monitor regulatory developments in the EU, as well as the implications of potential pan-European crowdfunding regulations, for future Norwegian regulation of financial crowdfunding platforms.

The emergence of Bitcoin and other virtual currencies has raised a number of new issues. There is a broad international consensus that virtual currencies pose a money laundering and terrorist financing risk. The scope of the new Anti-Money Laundering Act is, in line with signals in last year's financial markets report, expanded to providers of exchange service platforms and virtual currency custodianship services. The Financial Action Task Force (FATF) has since June 2018 been assessing how the recommendations on measures to combat money laundering and terrorist financing should be applied to virtual currency. FATF reached agreement on all key requirements applicable to providers of services relating to virtual currency in February 2019. In

essence, the changes to the FATF recommendations mean that virtual currency service providers will face the same requirements as other undertakings and individuals encompassed by the FATF recommendations. The Ministry of Finance will assess which regulatory amendments are necessary in view of the new requirements.

Safe and sound financial services for consumers (chapter 4)

Consumers need special protection and adequate rights in financial markets. Consumers may not be well placed to assess the risks, costs and yield potential of some financial services before entering into contracts. Decisions with a major impact on personal finances, such as taking up residential mortgage loans and choosing pension plans, are only made a few times in a lifetime and there may be little room for trial and error. Consumer protection is therefore a key aspect of financial market regulation and supervision. It shall ensure that consumers can trade securely with professional financial undertakings, but does not exempt consumers from risk or responsibility. The Government is focused on consumers having the knowledge and information to enable them to make prudent decisions regarding their own finances.

Customer mobility and dispute resolution

It has become easier to switch banks and insurance companies in recent years, partly because Norwegian banks have signed up to Finance Norway's provisions on bank switching cooperation. The Ministry of Justice and Public Security is preparing a proposal for a new Financial Contracts Act, which will also imply a codification of most of Finance Norway's provisions. The proposed statute shall facilitate swift and secure bank switching, in line with the EU Payment Accounts Directive. The proportion switching residential mortgage provider has been about 8–10 percent in recent years, whilst the proportion renegotiating their residential mortgage has been approximately 25 percent, according to a survey by Kantar. The main reasons customers give for not switching or renegotiating are that they are satisfied with their bank or that they think there is little to be gained. Few

people state that they believe bank switching to be difficult. Even fewer state that they believe that it is difficult to switch non-life insurance company, and switching is indeed more frequent in this market.

The Government is committed to making it easy to switch banks, insurance companies and other service providers. This requires financial industry participants to agree on adequate solutions, and legislation and other aspects of the regulatory framework to be tailored to market developments. Implementation of the Payment Accounts Directive and the Payment Services Directive will make it even easier in coming years to switch banks and use services from multiple banks. However, when the impact of new technology in a more open market have materialised, it will be appropriate to assess the need for additional regulatory modifications and other measures. The Government will also assess the European Commission's announced review of the issue of account number portability, which is expected in September this year. The Government therefore aims to address this in more detail in the Financial Markets Report 2020.

The *Finansportalen* financial services portal is operated by the Norwegian Consumer Council, and is one of the services that has made it easier to get an overview of financial services. Price data from *Finansportalen* is also used as a basis for interest rates used by the authorities for tax purposes and to calculate the interest rate on government loans. The Government is of the view that *Finansportalen* serves an important function in gathering and providing good and readily available information. It is crucial that both consumers and authorities can rely on *Finansportalen* to provide price information which is of a high quality and which is updated at any given time. It must therefore be a priority for the Norwegian Consumer Council, which manages *Finansportalen*, to safeguard the quality and accuracy of the interest rate data *Finansportalen* provides to the market, including to the authorities.

Finanstilsynet has uncovered that many financial undertakings are not affiliated with an approved dispute resolution scheme, such as the Norwegian Financial Services Complaints Board. This applies, in particular, to branches of international undertakings and undertakings with cross-border operations in Norway, but also to some Norwegian

undertakings. This implies that the customers of such undertakings have weaker protection of their rights and interests, for example because of the inapplicability of provisions on covering the consumer's legal costs in certain cases. The Ministry of Finance has therefore instructed Finanstilsynet to prepare regulations requiring such affiliation.

Pension

The persistently low interest rate level and the increasing life expectancy of the population has affected the pensions market. Lower expected return and a longer payment period has made it more expensive to fund a given lifelong annual pension benefit. Traditional defined benefit schemes have been phased out over time, whilst new pension accruals are largely taking place in defined contribution schemes. There nonetheless remains considerable capital behind pension rights under defined benefit schemes, and especially under paid-up policies.

The Government will facilitate a secure and predictable framework for private pension savings through regulation of both pension providers and pension products. A sound regulatory framework needs to be maintained and evolved for both the growing defined contribution portion of the market and the management of the funds backing the rights already accrued. For defined contribution schemes, the introduction of an individual pension account and the question of including all wage income in the calculation basis for pension earnings are important issues, whilst the focus is on pension capital management regulations as far as defined benefit schemes are concerned. The overarching objectives for the regulatory effort are safeguarding accrued pensions, efficient and rational pension capital management, good information and scope for influencing own pension, as well as effective competition in the pensions market.

Consumer loans and review of interest rate caps and cost caps

Consumer loans are unsecured retail customer debts, and also include credit card debt. The market for such loans has grown steeply

in recent years. The growth rate has been more than twice the overall debt growth rate for an extended period of time. As at yearend 2018, consumer loans to Norwegian households amounted to about NOK 113 billion. This is still a small portion of overall household debt; just over 3 percent, but household interest expenses on such loans account for about 14 percent of overall household interest expenses.

Finanstilsynet has conducted a survey of the market for small consumer loans with short maturities in Norway. This is a form of consumer loan that tends to carry a very high effective interest rate. There is, unlike in countries such as Sweden, Denmark, the UK and Finland, little to suggest that the granting and acceptance of small expensive loans is particularly widespread in Norway.

The Government has introduced several measures to address challenges in the consumer loan market in Norway. The requirements introduced in 2017 on the marketing of credit and the invoicing of credit card debt, mean that customers now receive more accurate and clear information on their existing or potential debt, and serve to reduce the risk of hasty borrowing and inadequate understanding of one's own financial situation. All banks and finance companies offering consumer loans shall be ready to report debt information to debt information service providers by 1 July this year. Access to information on the unsecured debt on loan applicants will make it considerably more difficult for banks to grant consumer loans to individuals who are already highly indebted. The lending practice requirements under the new Consumer Loan Regulations will also serve to prevent consumers from taking on debts they will not be able to service. The Government's upcoming proposal for a new Financial Contracts Act will include provisions that strengthen consumer protection upon the conclusion of credit agreements. After the proposal for a new Financial Contracts Act has been submitted to the Storting, the Government will examine, for example, the need for stricter rules on credit marketing. The Debt Collection Act is also under review, with the objective being to reduce debt collection fees and ensure adequate debt collection procedures.

The Government is monitoring the consumer loan market closely to assess the need for additional regulation. An interest rate cap is a

form of price regulation on credit, which caps the level of the nominal or effective interest rate applied to a loan. In last year's financial markets report, the Government presented an assessment of the scope for, and appropriateness of, an interest rate cap. The Government concluded that this may be a relevant policy measure, especially if the volume of small loans with short maturities were to increase significantly in Norway. It was noted, at the same time, that an interest rate cap is an invasive policy measure, which should only be considered when more experience has been gained with the implemented and planned measures, and if these measures turn out not to be effective enough.

This year's report includes, in response to a petition resolution from the Storting, a review of various interest rate cap models. In addition, it discusses the scope for capping the total cost that may be incurred as the result of borrowing, as a policy measure to protect consumers in payment difficulties against unreasonably high costs and uncontrolled debt escalation. In some countries that have introduced an interest rate cap, such as Sweden, one has chosen to combine this with a cap on the total loan cost. Finanstilsynet has assisted in the review of interest rate caps and cost caps. Finanstilsynet is of the view that no interest rate cap or cost cap should be introduced for consumer loans, whether generally or targeting small loans with short maturities.

The Government believes, like Finanstilsynet, that no interest rate cap or cost cap for consumer loans should be introduced in Norway at present. Special weight is attached to these measures not being sufficiently targeted to justify the risk of unwanted implications, given the current state of the Norwegian market. Although an interest rate cap may in principle limit lending to the individuals posing the highest credit risk, it may also have consequences for other customers than the most vulnerable ones, and it will not effectively prevent some customers from accumulating too much debt either. Furthermore, an interest rate cap may affect the pricing of loans that start out with an interest rate below the cap. Banks may use the maximum interest rate as a coordination measure, and increase consumer loan interest rates to bring these close to the cap. Poorly informed customers may, at the same time, perceive the loan interest rate to be reasonable as long as it is below the level «approved» by the authorities. This means that a

cap may even result in higher interest rates on consumer loans as a whole. The lower the cap, the higher the risk of market distortions.

The Government is of the view that other measures will be more effective in preventing borrowers from taking on loans beyond their means. The consumer loan market is to some extent characterised by customers in some cases being impulsive and easily swayed and not always being well-informed or making rational choices. Hence, a more targeted effort would be to regulate such lending directly, ensure better information for borrowers and banks, and prevent borrowers from being saddled with unreasonable costs. These are the objectives of the sequence of consumer loan measures introduced or pursued by the Government. The key focus is now on ensuring the sound implementation of these measures and gaining experience with their effects, whilst at the same time closely monitoring market developments and assessing the need for further regulation. The Government will also keep track of experience from Sweden and other countries that have introduced interest rate caps targeting small loans with short maturities. The Storting will be provided with an updated overview in next year's financial markets report.

Availability and use of cash

Most payments in Norway currently involve electronic solutions such as payment cards, mobile payment and online banking. Cash services in bank branches have largely been replaced by cash dispensers, deposit machines, cash withdrawals in shops and banking services through the postal system, and the use of cash has declined significantly in recent years. A survey by Finanstilsynet shows that banks themselves consider the availability of cash services to be satisfactory overall, and that several banks are planning to scale back the availability of cash services in coming years as well. Banks have thus far not taken any joint measures to ensure the satisfactory availability of cash services in coming years, but a project to assess specific solutions has been established. Both Finanstilsynet and Norges Bank believe that there is a need for stipulating in regulations that banks are required to ensure that their customers may deposit and withdraw cash.

The responsibility of banks for maintaining satisfactory cash services is probably most efficiently handled through joint services. It is therefore appropriate that banks are currently examining collaborative solutions. If such collaboration serves to maintain and evolve cash services that, all in all, meet the expectations and needs of banking customers throughout the country, this will reduce the need for regulating individual aspects of the overall availability of cash services. All banking customers should be ensured access to satisfactory cash services. Consequently, each bank should ensure that customers are able to deposit and withdraw cash, either under the auspices of the bank itself or through agreements with other cash service providers. Unless banks swiftly, and no later than by yearend 2019, agree appropriate joint services, or individually conclude agreements that otherwise ensure access to satisfactory cash services for all banking customers, the Ministry will look into how the obligations of banks should be clarified in legislation.

The Financial Contracts Act gives consumers the right to always settle up with a payee in cash. There have been major changes in access to various payment solutions and in how financial contracts are concluded since the Act was passed in 1999. Hence, there may be a need for examining whether the current rules are appropriate. The main rule should remain that consumers are entitled to pay in cash, but there is a need for looking into the scope, and any clarifications that might be appropriate. The Ministry of Justice and Public Security will examine the relevant provisions after it has submitted a proposal for a new Financial Contracts Act. Norges Bank is of the view that the right to pay in cash should be clarified by stipulating that it cannot be signed away by means of standard terms, and that the rule should be accompanied by a clearer scope for sanctions.

Last year, the Ministry of Finance adopted regulatory provisions on banks' preparedness for increased cash demand. The provisions require banks to tailor their cash solutions to documented and quantitative assessments of the risk of increased cash demand, and to specify these in a plan to be followed-up by Finanstilsynet. Banks may take electronic preparedness into account in dimensioning the cash solutions, thus enabling them to reduce potentially costly cash require-

ments by improving their electronic preparedness. Finanstilsynet will in 2019 follow up on banks' establishment of solutions in line with the requirements.

The activities of Norges Bank in 2018 (chapter 5)

Norges Bank is Norway's central bank, and shall promote economic stability and manage assets on behalf of society. Norges Bank monitors the stability of the financial system, and provides assessments of the financial stability outlook in public reports several times a year. It provides quarterly advice to the Ministry of Finance on the level of the countercyclical capital buffer requirement. The buffer requirement is currently 2 percent. In December 2018, Norges Bank advised that the requirement should be increased to 2.5 percent effective from 31 December 2019. The advice was given to, and adhered to, by the Ministry in December 2018. Norges Bank shall contribute to robust and efficient payment systems, and settles payments between banks in Norway. The central bank provides loans to banks and central counterparties, issues banknotes and coins, supplies banks with cash, and supervises the interbank systems. Norges Bank also manages the foreign exchange reserves.

Norges Bank is charged with the operational implementation of monetary policy pursuant to guidelines laid down in a regulation from the Government. A new regulation was enacted last year in replacement of the regulation from 2001. The regulation stipulates that the operational target of monetary policy shall be an annual consumer price inflation of close to 2 percent over time. The inflation targeting shall be forward-looking and flexible so that it can contribute to high and stable output and employment, and to counteract the build-up of financial imbalances.

On 10 April 2019, the Ministry of Finance submitted a proposal for a new Central Bank Act to the Storting in Legislative Proposition 97 (2018–2019) *Act relating to Norges Bank and the Monetary System, etc. (Central Bank Act)*. The legislative proposal includes a new object clause for the activities of the central bank and stipulates the duties of

the bank. In addition, it describes, for example, the organisation of Norges Bank and the supervision of the bank.

The key policy rate is the most important monetary policy tool. In the monetary policy meeting in September last year, Norges Bank decided to increase the key policy rate from 0.5 to 0.75 percent. The interest rate was kept unchanged for the rest of the year. The key policy rate forecast increased somewhat for the short run over the year, but declined somewhat for the longer run. Norges Bank further increased the key policy rate, to 1.0 percent, in the monetary policy meeting in March this year.

The Ministry of Finance performs an annual assessment of Norges Bank's monetary policy conduct. The Ministry is of the view that monetary policy conduct was sound in 2018. There is broad confidence in monetary policy among markets participants, academia and the general public.

Norges Bank is also charged with managing the Government Pension Fund Global (GPF) on behalf of the State pursuant to provisions laid down by the Ministry of Finance. The management of the GPF, including management performance and performance assessment, is addressed in Report to the Storting No. 20 (2018–2019) *The Government Pension Fund 2019*.

The activities of Finanstilsynet in 2018 (chapter 6)

Finanstilsynet is the financial supervisory authority of Norway, and oversees financial undertakings' compliance with legislation and regulations. Finanstilsynet regularly conducts analyses of financial industry developments and economic conditions, nationally and internationally. One of the key objectives of Finanstilsynet is to promote financial stability, and its activities are focused on both the risk faced by financial undertakings as the result of macroeconomic developments, and the risk to the financial system and the economy that may be generated by financial undertakings as a whole.

In 2018, Finanstilsynet continued to refine models used to assess developments in the Norwegian economy and for stress testing of banks. Finanstilsynet conducted stress tests of 19 Norwegian banking

groups and close to 90 smaller Norwegian banks. In addition, six consumer loan banks were stress tested, and the liquidity of seven Norwegian banks was also stress tested. Finanstilsynet participates in the European System of Financial Supervision, and works in close collaboration with other national supervisory authorities.

Finanstilsynet continually conducts document-based supervision on the basis of reporting from undertakings, and this forms the starting point, along with the monitoring of markets and the Norwegian economy, for a risk-based selection of undertakings for on-site inspection. On-site inspection is important in order to identify problems, and to establish close dialogue with senior managers and directors at an early stage, thus enabling necessary measures to be implemented in an effective manner. In 2018, Finanstilsynet carried out a total of 21 on-site inspections with banks, mortgage companies and finance companies, in addition to conducting document-based follow-up of the off-shore engagements of five banks. It also carried out four on-site inspections relating to follow-up of internal ratings-based (IRB) approvals and five on-site inspections relating to ICT infrastructure, disaster solutions and contingency planning. Moreover, it carried out 17 special inspections relating to ICT, and 10 on-site inspections with insurance companies and pension funds. Finanstilsynet carried out a number of inspections in other areas, such as securities trading, accounting and auditing, real estate business and debt collection.

The activities of Folketrygdfondet in 2018 (chapter 7)

Folketrygdfondet is a special legislation company wholly owned by the Norwegian state through the Ministry of Finance. Folketrygdfondet manages the Government Pension Fund Norway (GPFN) pursuant to specific management provisions laid down by the Ministry of Finance. The asset management objective is to maximise the return over time, measured in Norwegian kroner and net of costs. The market value of the GPFN was NOK 239.2 billion as at yearend 2018. The return on the Fund was -0.4 percent in 2018, which is 0.8 percentage points more than the return on the benchmark index defined by the Ministry. The management of the GPFN, including the fund's perfor-

mance and performance assessments, is addressed in Report No. 20 (2018–2019) to the Storting; *The Government Pension Fund 2019*.

The activities of the IMF in 2018 (chapter 8)

The International Monetary Fund (IMF) is charged with promoting international monetary corporation, strengthening financial stability globally and regionally, and facilitating international trade. IMF lending has increased steeply since last year's financial markets report. This is predominantly caused by the loan agreement the IMF has concluded with Argentina. As at the end of February, a total of 18 countries had agreements with the IMF under the general lending arrangements. The volume of new loan agreements under the concessional arrangements for low-income countries has been reduced since the end of the last financial year.

Norway is placing a total of SDR 11.7 billion (equivalent to just under NOK 140 billion) at the disposal of the general lending arrangements of the IMF. SDR 3.75 billion of this are quota resources which Norway is obliged to contribute. SDR 1.97 billion are made available through the multilateral borrowing arrangement of the IMF (the NAB arrangement) and SDR 6 billion are made available under a bilateral loan agreement. These contributions are voluntary, and the agreements will expire in 2022 and 2020, respectively. Norway also contributes voluntary resources to fund the special lending arrangements for low-income countries. Loans to the IMF are made through reinvestment of the Norges Bank foreign exchange reserve.

A review of IMF quotas and lending resources is about to be concluded. The IMF administration has wanted a major quota increase to reduce dependence on voluntary contributions. A quota increase can only take place if the US, which has a veto, votes in favour. The US authorities have now signalled that they do not favour a quota increase. This gives rise to uncertainty about IMF funding. The administration believes that lending resources need to be maintained, or ideally strengthened, and has requested member states to agree a funding plan. In its meeting on 13 April this year, the IMF advisory committee of finance ministers and central bank governors (IMFC)

reiterated that it wants the IMF to be a strong and quota-based institution, with sufficient financial resources to perform its role in the global financial safety net.

It is important for Norway to have stable international relations and a well-functioning global safety net. The Government is of the view that Norway should be willing to continue to contribute to maintaining the financial strength of the IMF, provided that there is a well-established need, broad international participation, a reasonable distribution of burdens and that the relationship between Norway's financial contribution and our representation and influence in the IMF remains satisfactory. New loan agreements with the IMF require the consent of the Storting.

Amendments to regulatory frameworks and licences in 2018 (chapter 9)

The financial market regulation predominantly takes the form of laws and regulations. The Ministry of Finance submits legislative proposals to the Storting, and adopts more detailed rules in regulations. The Ministry also grants licences for the establishment or reorganisation of financial undertakings, and stipulates conditions for such licences. An overview of the most important regulatory amendments in 2018 is provided in chapter 9. Said chapter also includes a discussion of licences granted in 2018.

Published by:
Norwegian Ministry of Finance

Additional copies may be ordered from:
Norwegian Government Security and Service Organisation
www.publikasjoner.dep.no
Telephone: + 47 22 24 00 00
Publications are also available on:
www.government.no

Cover illustration:
Stylisation of lending growth from Norwegian and international
banks to the corporate market from 2008 to 2018 (radar chart)

Print: 07 Media AS 05/2019 – Impression 25

