

# **KREDITTILSYNET**

Norway

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*This translation is for information purposes only. Legal authenticity remains with the official Norwegian version as published in Norsk Lovtidend.*

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Regulation no. 875 of 22 October 1990 (as amended)

## **Regulations on Minimum Standards of Capital Adequacy for Financial Institutions and Investment Firms**

### **Section 1 Scope**

These regulations apply to commercial banks, savings banks, finance companies, mortgage institutions, investment firms and insurance companies, as well as other companies or institutions encompassed by Act no. 39 of 10 June 1988 on Insurance Activity and by Act no. 40 of 10 June 1988 on Financing Activity and Financial Institutions.

These regulations stipulate minimum capital ratios for institutions mentioned in the first paragraph, as well as how risk-weighted assets are to be calculated.

### **Section 2 Required capital ratio**

Institutions shall at all times maintain a capital ratio of at least 8 per cent of risk-weighted assets as these are stipulated in section 4.

**Section 3** (Revoked by regulations no. 24 of 17 January 1992)

### **Section 4 Risk-weighted assets and method of calculation**

In respect of the required capital ratio, risk-weighted assets comprise both on-balance sheet and off-balance sheet items. The various items are risk-weighted according to the credit risk they are assumed to represent. The book value of on-balance sheet items and the converted value of off-balance sheet items, cf. sections 6 and 6a, shall be multiplied by the respective risk weight and thereafter summated to arrive at the risk-weighted assets. In the case of derivatives classified as assets, risk-weighted assets shall be calculated in accordance with the provisions governing off-balance sheet items

Risk-weighted assets shall not include on-balance sheet and off-balance sheet items included in risk-weighted assets in respect of capital requirements for market risk linked to the institution's trading portfolio pursuant to Regulations No. 780 of 17 July 1996<sup>1</sup> on Minimum Capital Requirements for Market Risk, etc., Incurred by Credit Institutions and Investment Firms.

The composition of own funds is subject to the provisions set out in Regulations No. 435 of 1 June 1990 on Measurement of the Own Funds of Financial Institutions.

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<sup>1</sup> Revoked, see Regulations No. 632 as of 22 June 2000

## Section 5 Risk weights assigned to asset items

The various asset items shall carry the following risk weights:

- A. 0 per cent
- Cash holdings and assets of a similar nature
  - Claims on and claims guaranteed by The European Communities and OECD central governments and central banks except central governments that have renegotiated their foreign national debt during the past five years
  - Claims collateralised by securities issued or guaranteed by The European Communities and OECD central governments and central banks except central governments that have renegotiated their foreign national debt during the past five years
  - Claims on central governments and central banks outside the OECD that are denominated in the debtor's currency and funded in the same currency
  - Claims guaranteed by central governments and central banks outside the OECD that are denominated and funded in the guarantor's and the debtor's common currency
  - Claims collateralised by the financial institution's own borrowing.
- B. 10 per cent
- Claims on and claims guaranteed by Norwegian state enterprises entered into prior to 1 January 2003.
- C. 20 per cent
- Claims on and claims guaranteed by multilateral development banks
  - Claims collateralised by securities issued or guaranteed by multilateral development banks
  - Claims on and claims guaranteed by domestic financial institutions and foreign credit institutions incorporated in the OECD except central governments that have renegotiated their foreign national debt during the past five years, that are not included in these institutions' own funds
  - Claims on and claims guaranteed by banks incorporated in countries outside the OECD with an original maturity of up to one year that are not included in these institutions' own funds
  - Claims on and claims guaranteed by Norwegian municipalities
  - Claims on and claims guaranteed by non-domestic OECD public entities, except central governments that have renegotiated their foreign national debt during the past five years, other than central governments and central banks
  - Claims on and claims guaranteed by OECD investment firms, recognised third-country investment firms or recognised clearing houses and exchanges, and that are not included in these institutions' own funds
- D. 50 per cent
- Loans secured by mortgage on residential property that is or will be occupied by the borrower or that is rented, up to 80 per cent of prudent valuation
  - Interim assets (earned income not yet due and prepaid costs). Items that are distributed on debtor sectors are given a risk weight according to the category of the counterparty.

- E. 100 per cent
- All other items in the balance sheet, except items deducted from the financial institution's own funds, cf. Regulations no. 435 of 1 June 1990 on Measurement of the Own Funds of Financial Institutions.

Assets connected with a unit-linked life insurance contract where the company has not offered a guaranteed return shall carry a risk weight of 20 per cent of the risk weight stated in the first paragraph of this section.

#### **Section 5a Units held in investment funds (shares, bonds etc)**

Upon application of the rules of section 4, third paragraph, cf. Regulation no. 435 of 1 June 1990 on Measurement of the Own Funds of Financial Institutions and Investment Firms, and the rules of section 5, any units held in a securities fund or similar collective investment fund shall be regarded as direct ownership of an identical share of the assets managed by the fund

- a) if the fund's resources are confined to holdings which under section 5 carry a risk weight of 0 per cent,
- b) if the fund's resources are confined to holdings which under section 5 carry a risk weight of 20 per cent,
- c) if the fund's resources are confined to holdings which under section 5 carry a risk weight of 50 per cent,
- d) to the extent the fund's resources are invested in the own funds of financial institutions or investment firms.

If more than 50 per cent of the fund's resources consist of holdings coming respectively under first paragraph, litra a); first paragraph, litra b); or first paragraph, litra c); Kredittilsynet (the Banking, Insurance and Securities Commission) may decide that the provision of the first paragraph shall apply correspondingly.

#### **Section 6 Off-balance sheet items and derivatives classified as assets**

Off-balance sheet items and derivatives classified as assets shall be converted to credit risk equivalents by multiplying the nominal amounts by a conversion factor. The resulting amounts - i.e. the assumed credit risk arrived at - are then weighted directly into the risk-weighted assets using the risk weights set out in section 5.

The following conversion factors apply:

1. Direct credit substitutes (e.g. loan guarantees, general guarantees of indebtedness and acceptances) shall have a 100 per cent credit risk conversion factor. Loan guarantees and sureties which are in the nature of credit substitutes may carry a risk weight of 50 per cent where they are fully secured by mortgage on real property that meets the requirements of section 5 first paragraph litra D first indent, provided the guarantor has a direct claim against such security.

2. Asset sales with a repurchase agreement and asset sales with recourse where the credit risk remains with the financial institutions, and endorsed loan documents (e.g. rediscounted bills and hire-purchase agreements) that do not carry the binding signature of another financial institution, shall have a conversion factor of 100 per cent. The measured credit risk is to be weighted using the risk weights - set out in section 5 - applicable to the category of the counterparty.
3. Forward asset purchases, forward deposits and the unpaid part of partly-paid shares and securities shall have a conversion factor of 100 per cent. The measured credit risk in respect of forward asset purchases is to be weighted using the risk weights - set out in section 5 - applicable to the category of the counterparty.
4. Transaction-related contingent items (e.g. contract guarantees, payment guarantees and guarantees for tax payments) shall have a conversion factor of 50 per cent.
5. Note issuance facilities and revolving underwriting facilities with an original maturity of more than one year shall have a conversion factor of 50 per cent.
6. Documentary credits and other trade-related contingent items shall have a conversion factor of 20 per cent.
7. Other commitments with an original maturity of more than one year (e.g. formal standby facilities and credit lines with an original maturity of more than one year) shall have a conversion factor of 50 per cent. Commitments with an original maturity of less than one year, or which can be unconditionally cancelled at any time, shall not be included.
8. Derivatives shall be converted to their credit risk equivalents by calculating the replacement cost in the market and adding the potential future exposure over the residual lifetime of the contract (replacement cost method). Derivatives that are traded on recognised stock exchanges where they are subject to daily margin requirements, and foreign exchange contracts with an original maturity of 14 calendar days or less, are excepted. Derivatives that are traded outside a recognised stock exchange and that are cleared by a clearing house authorised by Kredittilsynet are excepted until 31 December 2006. The addition in respect of potential future exposure shall be calculated by multiplying the nominal outstanding capital sum in the contract by the following factors:

**Table 1**

Contract type	Residual maturity		
	One year or less	Over one year, less than five years	Over five years
Interest rate contracts	0.00	0.005	0.015
Contracts concerning foreign exchange rates and gold	0.01	0.05	0.075
Contracts concerning equities	0.06	0.08	0.10
Contracts concerning precious metals except gold	0.07	0.07	0.08
Contracts concerning commodities other than precious metals	0.1	0.12	0.15

Institutions with limited trade in such instruments may with the consent of Kredittilsynet calculate the credit equivalent amount by multiplying the nominal amounts by a conversion factor depending on the original maturity (original exposure method). The following factors shall be employed:

**Table 2**

Contract type	Agreed (original) maturity		
	One year or less	Over one year, less than two years	For each additional year over two years
Interest rate contracts	0.005	0.01	0.01
Contracts concerning foreign exchange rates and gold	0.02	0.05	0.03

The converted value shall be weighted in accordance with the provisions of section 5 but such that these contracts receive a risk weight of 50 per cent where other on- and off-balance sheet items receive a weight of 100 per cent.

### **Section 6a Netting of derivatives**

For the purpose of converting derivatives to their credit risk equivalents as mentioned in section 6 second paragraph subparagraph 8 (conversion by the replacement cost method), bilateral netting agreements as mentioned in Act No. 79 of 19 June 1997 on Securities Trading section 10-1, and netting agreements regulated in another jurisdiction which may be brought to bear in a bankruptcy in this jurisdiction, may be approved as risk-mitigating on the following conditions:

1 The institution must have concluded a netting agreement with its counterparty to create a single legal commitment that embraces all transactions in derivatives so that the institution, in the event of the counterparty's inability to honour its commitments, will have a claim on or obligation to pay the net amount of such transactions' positive and negative

market value.

2 The institution must have notified Kredittilsynet that it possesses written and reasoned legal opinion to the effect that the type of netting agreement in question limits the institution's claims and obligations in such cases to the said net amount, pursuant to:

- a) applicable legislation in the state in which the counterparty is incorporated, and applicable legislation in the state in which a branch has its registered office,
- b) the legislation regulating the transactions in question, and
- c) the legislation regulating any contract or agreement required to implement the netting agreement.

3 The institution must have established procedures to ensure that the legal validity of its contractual netting is kept under constant review in the light of any changes in the relevant legislations.

Netting-by-novation agreements shall be converted to their credit risk equivalents by employing net replacement value and net nominal outstanding principal.

Netting agreements other than netting-by-novation agreements shall be converted to their credit risk equivalents by employing hypothetical net replacement value as per the agreement. Potential future credit exposure for contracts included in the netting agreement may be calculated using the following formula:

$$PFE = (0.4 \times PFE_{bto}) + (0.6 \times NBF \times PFE_{bto})$$

where:

PFE = potential future credit exposure for all contracts included in the netting agreement,  
PFE<sub>bto</sub> = the sum of potential future credit exposure for all contracts included in the netting agreement and calculated in accordance with Table 1 in section 6 second paragraph subparagraph 8,

NBF = "net-to-gross ratio": net replacement value for the contracts included in the netting agreement divided by the gross replacement value for the same contracts.

For purposes of calculating potential future credit exposure for forward foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, only net receipts falling due on the same date and in the same currency may be employed.

## **Section 6b Deductions**

- a) Where the equity method is applied in the annual account, any positive difference between an investment's book value and the investment's acquisition cost shall be deducted from the risk-weighted assets. This does not apply to life insurance companies or pension funds.

b) Deductions shall be made for provision for losses on loans and guarantees (both specific and general provisions).

c) Life insurance companies and pension funds may make a deduction in their risk-weighted assets in respect of unrealised gains on current financial assets. Such deduction shall be calculated as the difference between book value and acquisition cost for each short-term financial asset multiplied by the respective risk weight, cf. section 5. Where the equity method is applied in the annual account, unrealised gains on current financial assets in subsidiaries and associated companies shall be deducted from the risk-weighted assets in their entirety.

### **Section 7 Consolidation**

If an institution encompassed by this regulation has a holding in another financial institution representing more than 20 per cent of the equity or voting rights, the capital adequacy rules of these regulations shall also be applied on a consolidated basis, cf. section 2-6 of Act no. 40 of 10 June 1988 on Financing Activities and Financial Institutions (Financial Institutions Act) with appurtenant regulations. Kredittilsynet may also order consolidation in respect of holdings in companies which are not financial institutions and in respect of holdings of 10 per cent and more.

### **Section 8 Supplementary rules**

Kredittilsynet may lay down further rules concerning the implementation and delimitation of these regulations.

### **Section 9 Commencement**

This regulation comes into force on 31 March 1991. Regulations no. 435 of 1 June 1990 on measurement of the own funds of financial institutions comes into force on the same date, cf. section 10.

The institutions shall calculate their capital ratio as at 31 March 1991 in accordance with the present regulation.

### **Section 10 Transitional regulations**

The following transitional regulations apply:

#### *Commercial banks, savings banks and mortgage institutions*

Commercial banks and mortgage institutions which do not satisfy the capital adequacy requirements of this regulation by 31 March 1991 must satisfy the requirements of section 2 and section 7 by 31 December 1992.

Savings banks must satisfy the requirements of section 2 and section 7 by 31 December 1992. By 31 December 1991 commercial banks, savings banks and mortgage institutions shall have raised their capital ratio by a minimum of 30 per cent of the difference between the standard of 8 per cent set out in section 2 and section 7 and the ratio attained as at 31 March 1991.

#### *Finance companies*

Finance companies must meet the requirements under section 2 and section 7 by 31 December 1991. The capital adequacy requirement of 10 per cent as calculated under the previous rules will apply until 31 December 1991 such that general provisions, goodwill etc., and accelerated-depreciation reserves in the leasing portfolio are not included in own funds.

*Insurance companies and their parent companies*

Insurance companies and their parent companies must satisfy the requirements of section 2 and section 7 by 31 December 1997. Insurance companies and their parent companies shall have achieved a minimum capital ratio, as calculated under the rules of this regulation, of 3.5 per cent by 31 December 1991, 4.25 per cent by 31 December 1992, 5.0 per cent by 31 December 1993, 5.75 per cent by 31 December 1994, 6.75 per cent by 31 December 1995 and 7.5 per cent by 31 December 1996.

In the period between the date of commencement of these regulations and 31 December 1991, insurance companies and their parent companies must satisfy the capital adequacy requirements set out in section 4 of Royal Decree no. 825 III of 25 August 1989. Up to 31 December 1991 the definition of capital applying when Royal Decree no. 825 of 25 August 1989 was issued shall be applied.

The two preceding paragraphs do not apply to banks which are parent companies of credit insurance companies.

Section 6, final paragraph, of regulations no. 930 of 8 September 1989 is revoked.

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