



KREDIT TILSYNET

The Financial Supervisory Authority of Norway

Norway and Norwegian banks facing international financial turmoil

Finn Hvistendahl, Chairman of the Board,

**The Financial Supervisory Authority of
Norway**

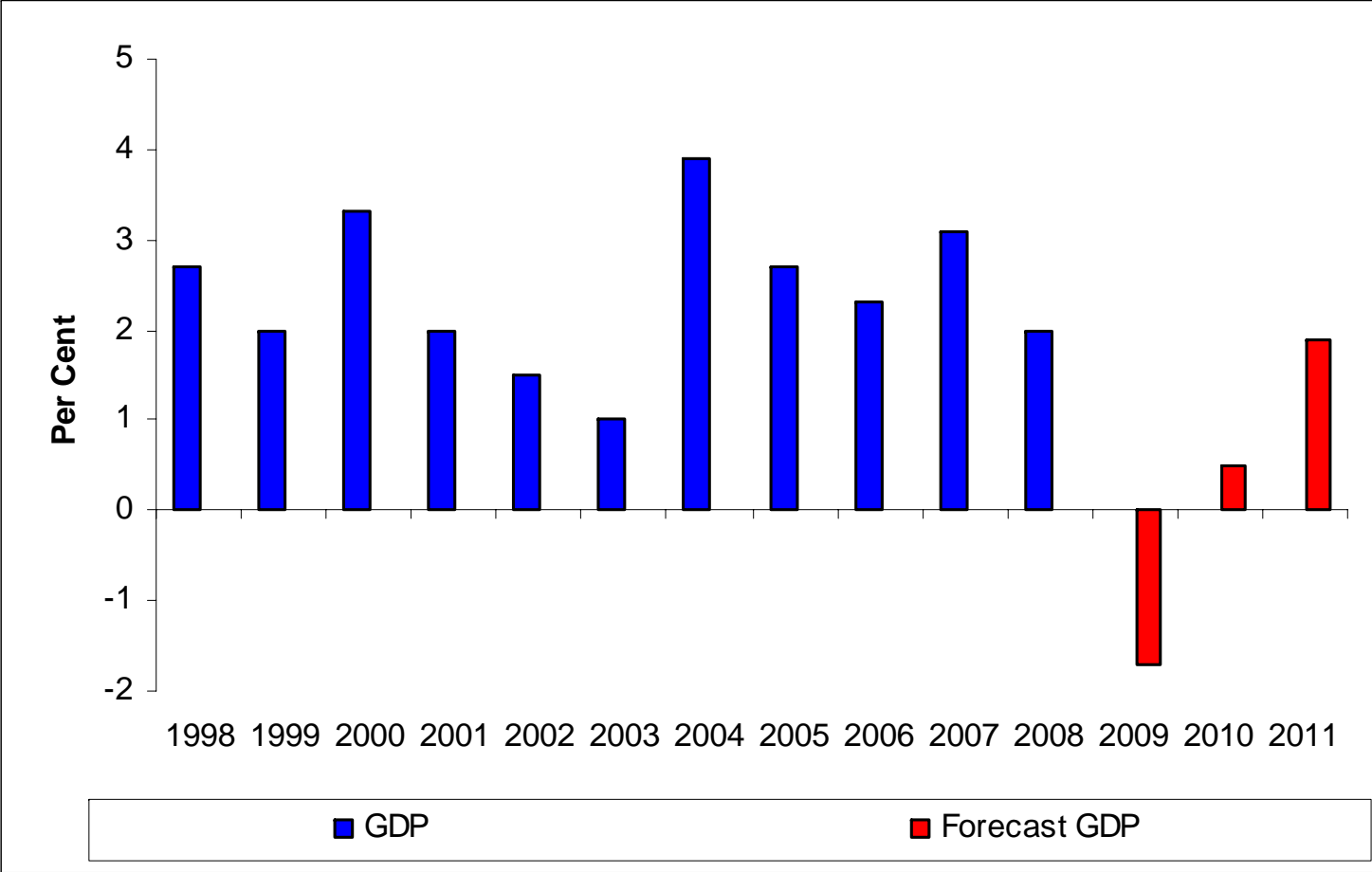
Tromsø, 11 June 2009

The Norwegian economy

- Recession – GDP has fallen the last two quarters
- Increasing unemployment
- Large current account and government surpluses
- Declining credit growth to households and enterprises
- Fall in house prices 2nd half 2008 – growth so far in 2009
- Declining commercial property prices
- Stock prices have increased since March
- Key policy rate lowered since October 2008

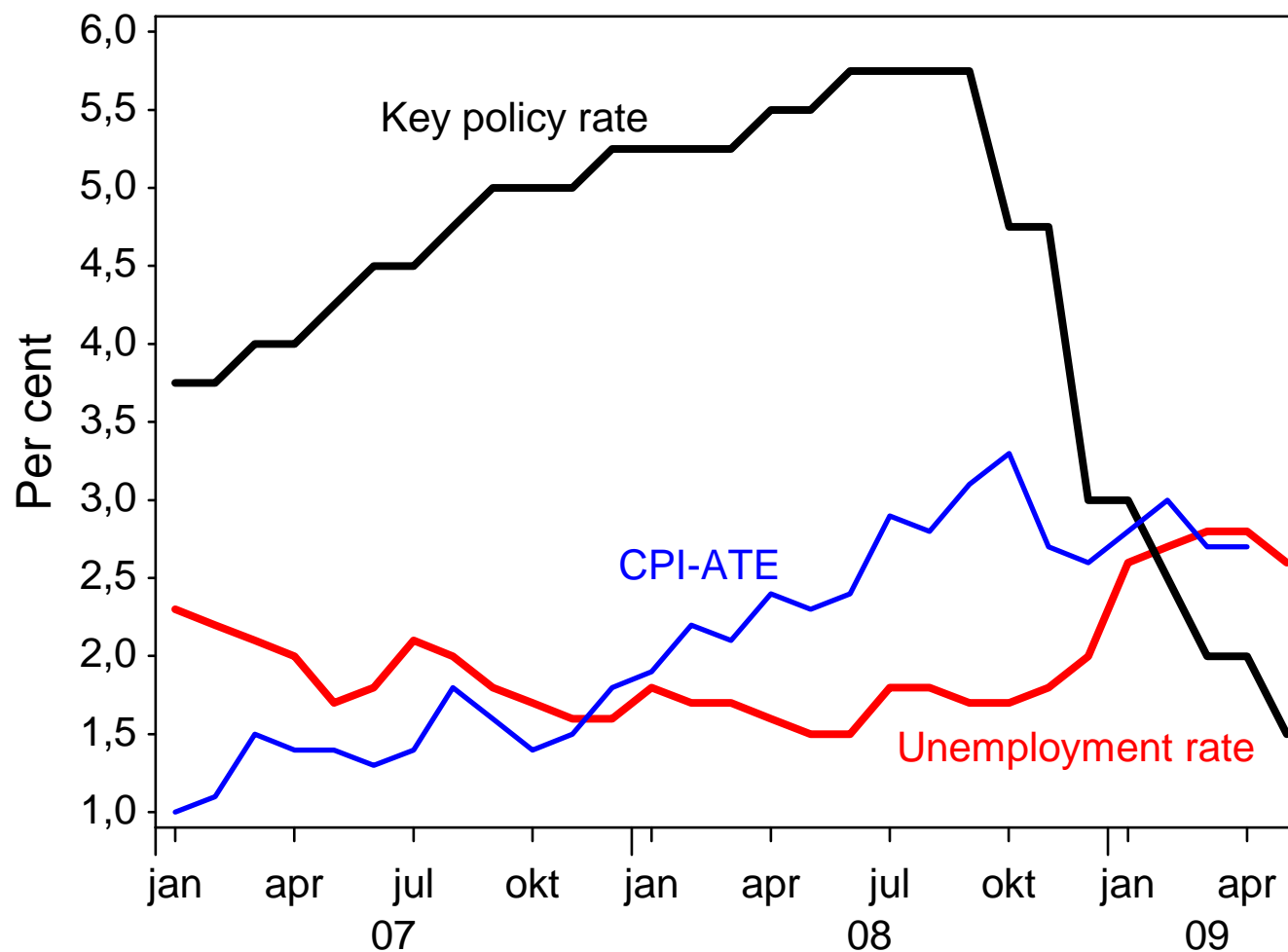
GDP is expected to shrink in 2009 but regain positive growth in 2010

Growth in GDP



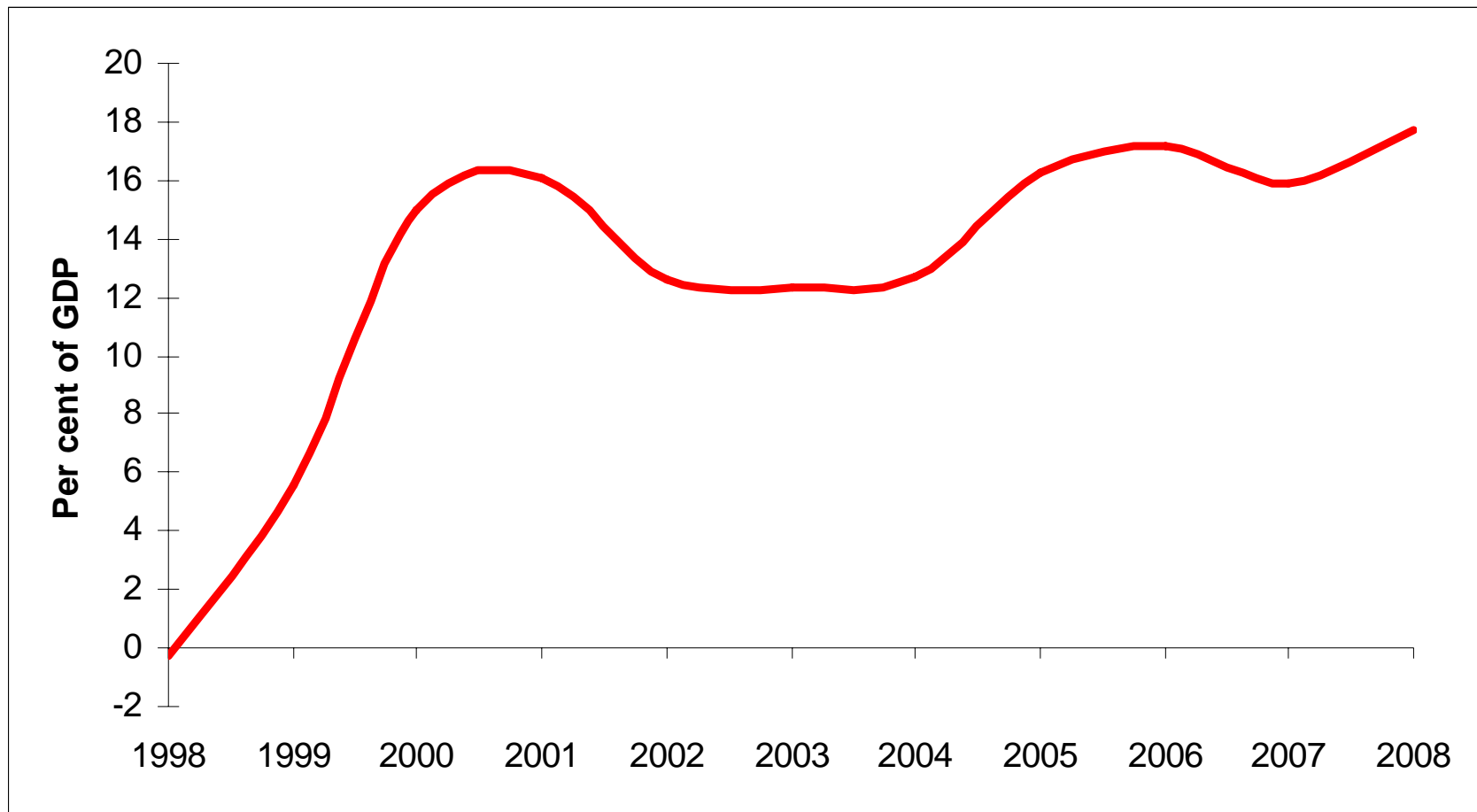
Source: Statistics Norway

Unemployment, inflation and key policy rate



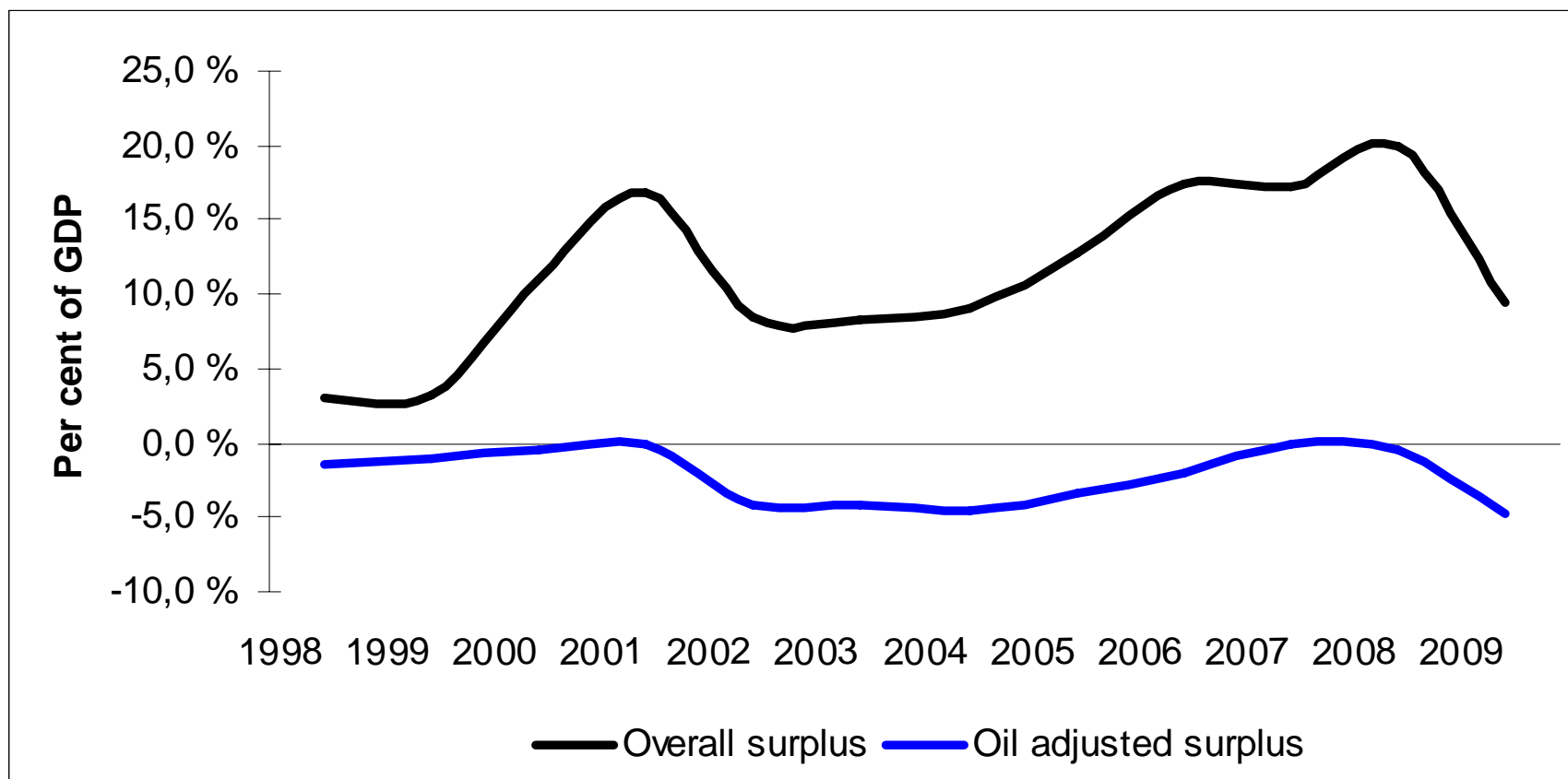
Source: Reuters EcoWin

Current account



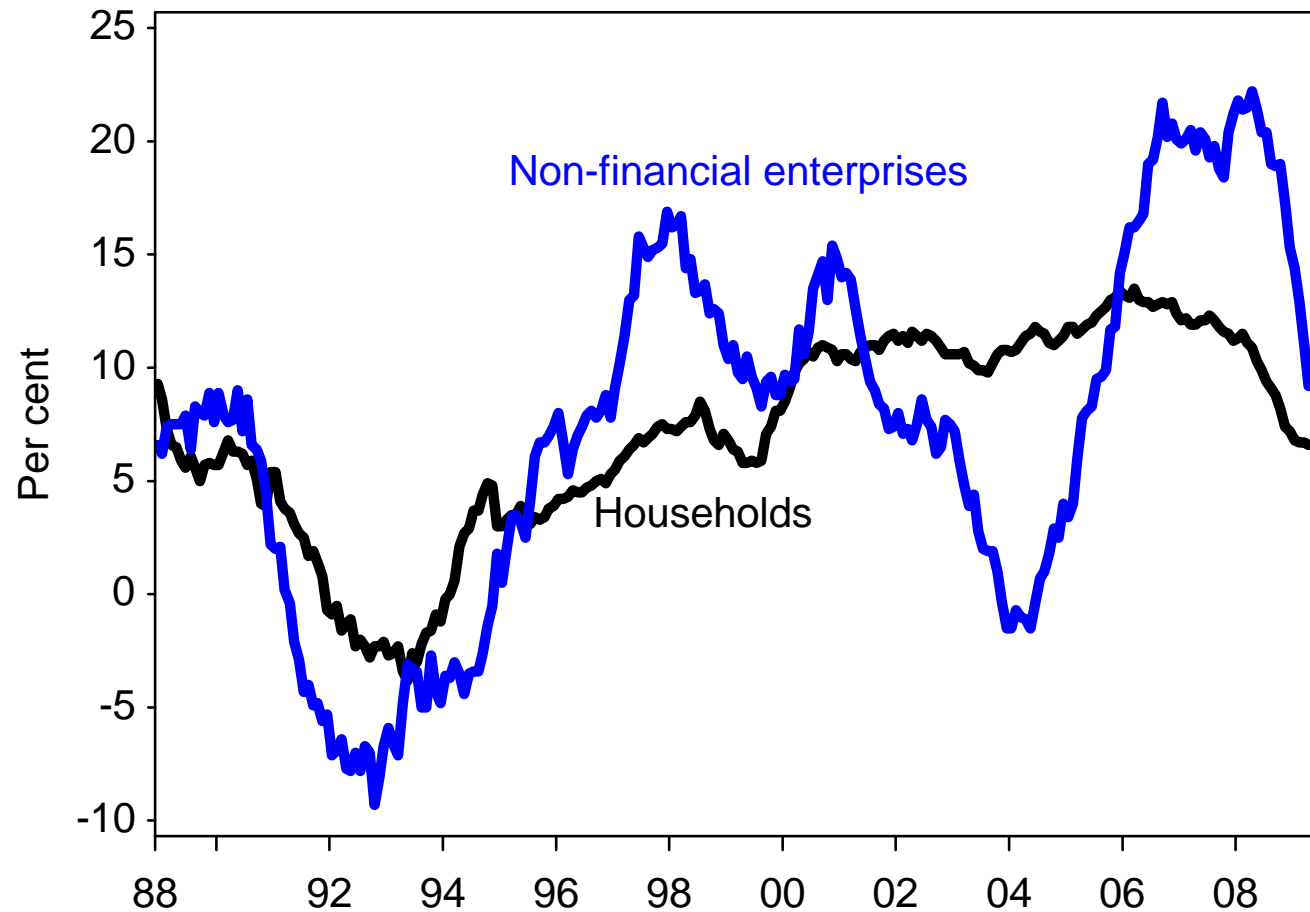
Source: Statistics Norway

Government surplus



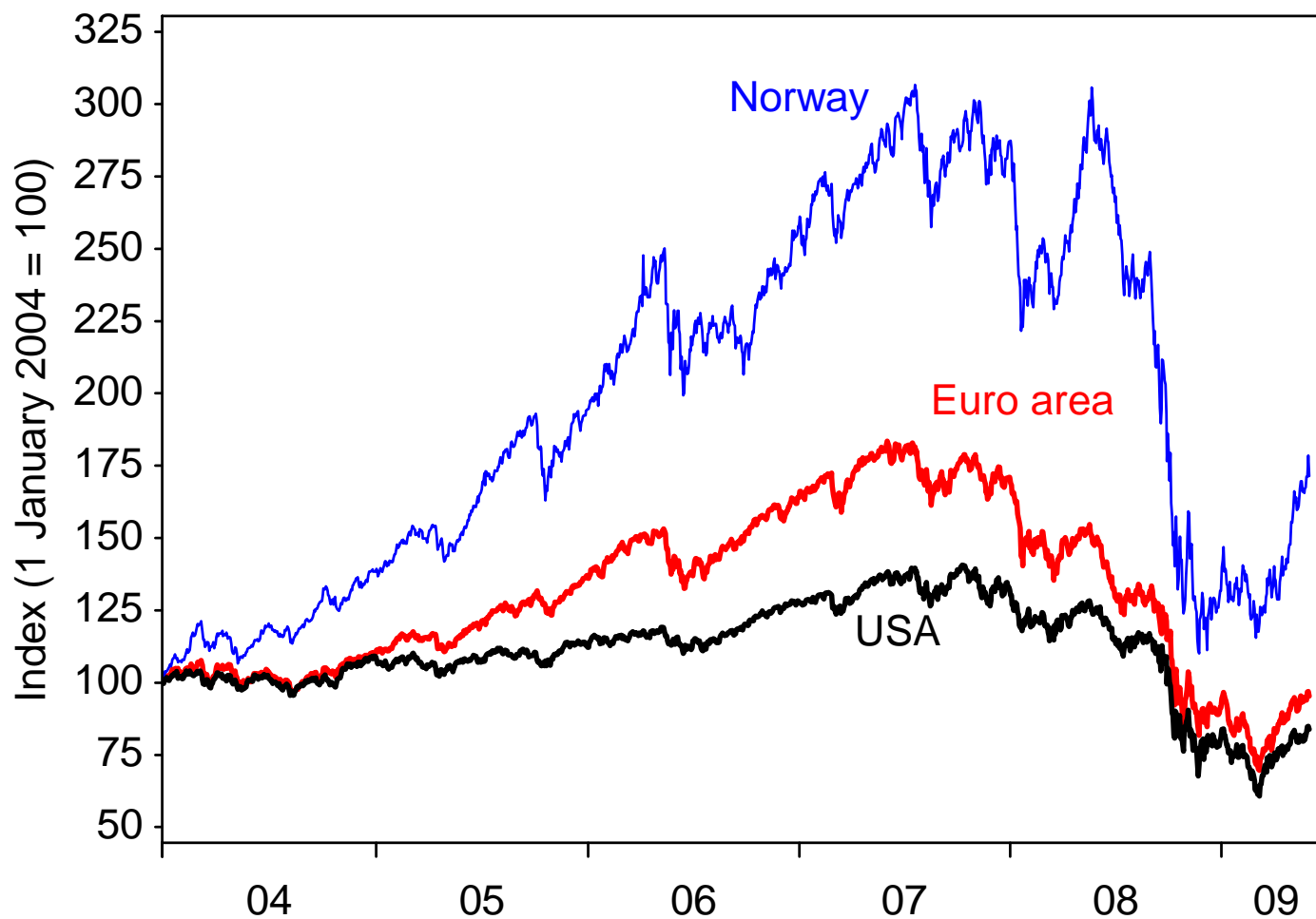
Credit growth

Households and non-financial enterprises



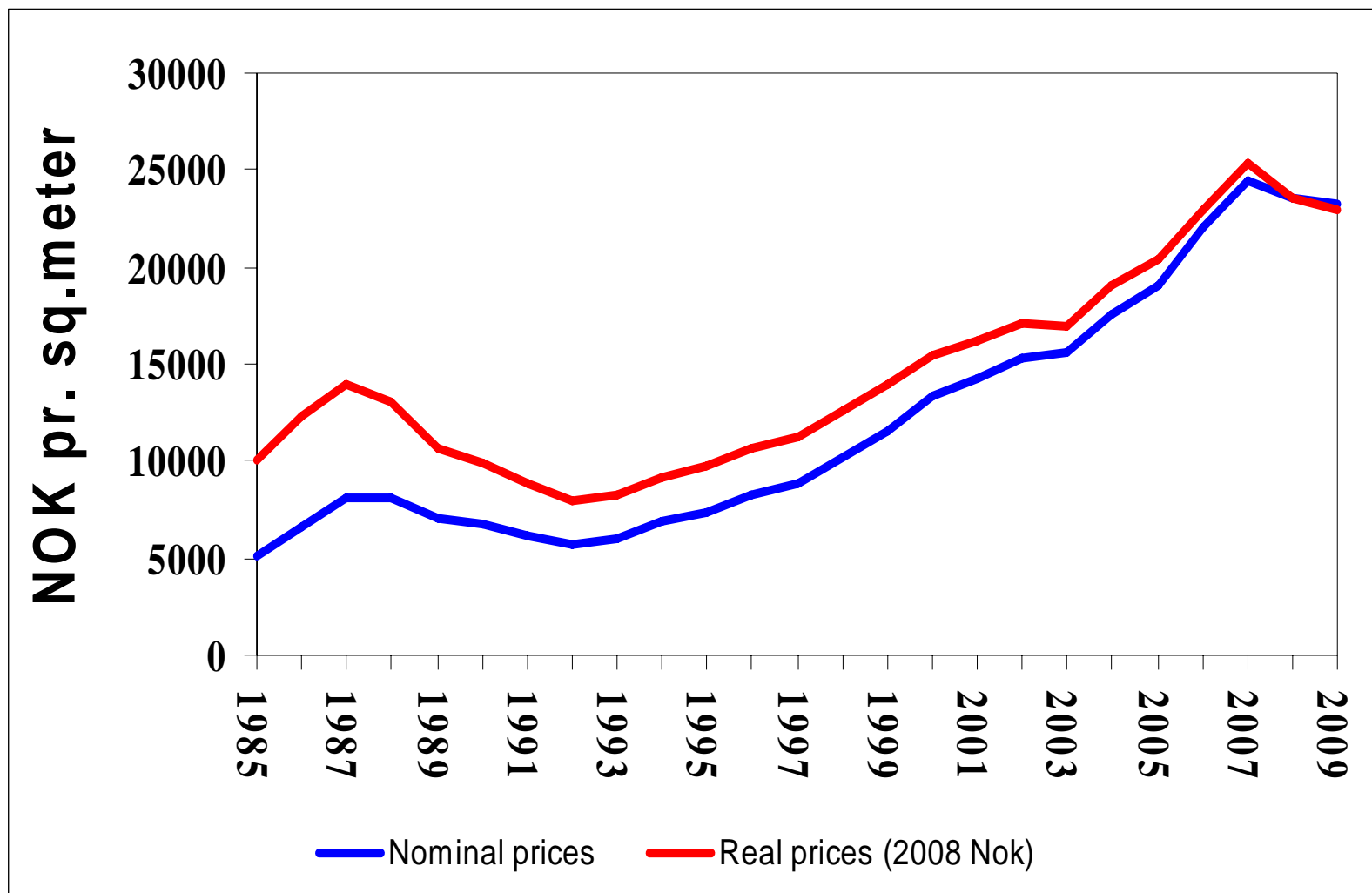
Source: Statistics Norway

Stock markets



Source: Reuters EcoWin

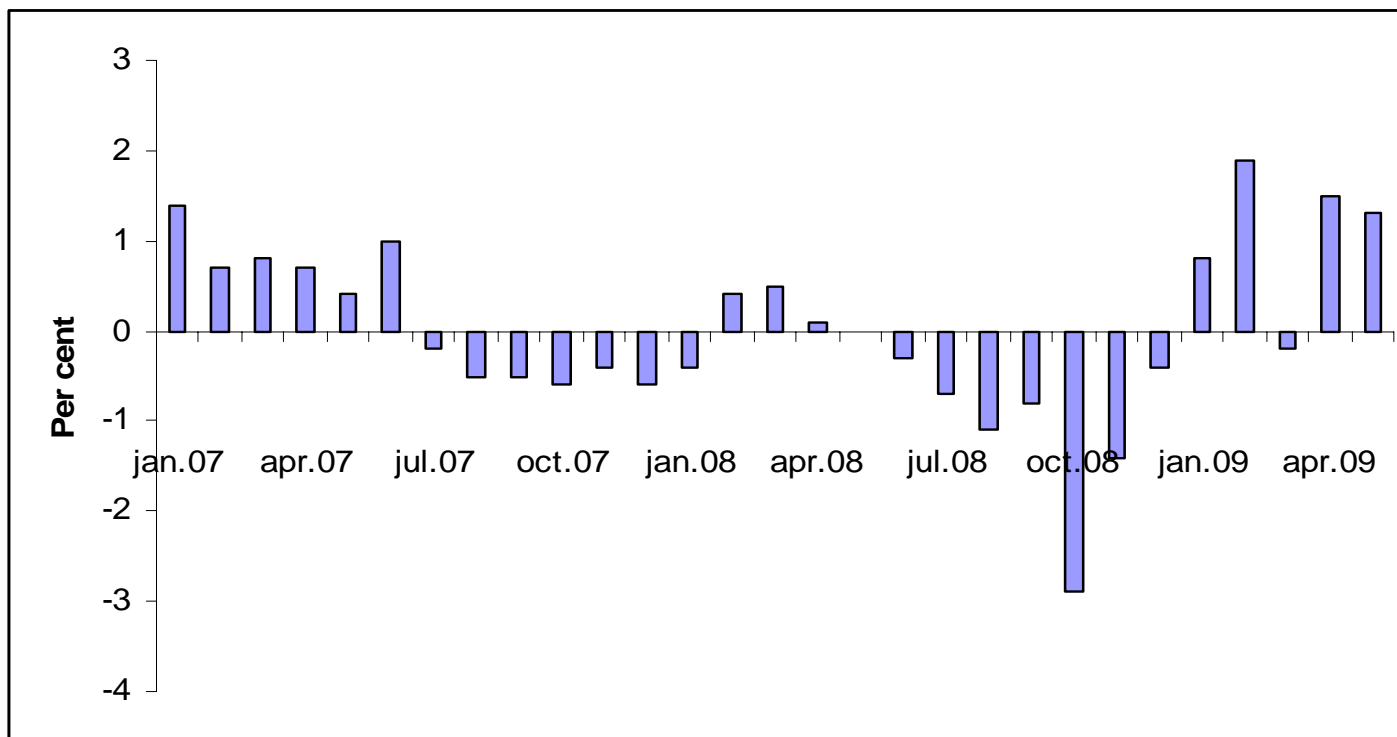
Housing prices



Sources: NEF, EFF, FINN.no and Econ Pöyry

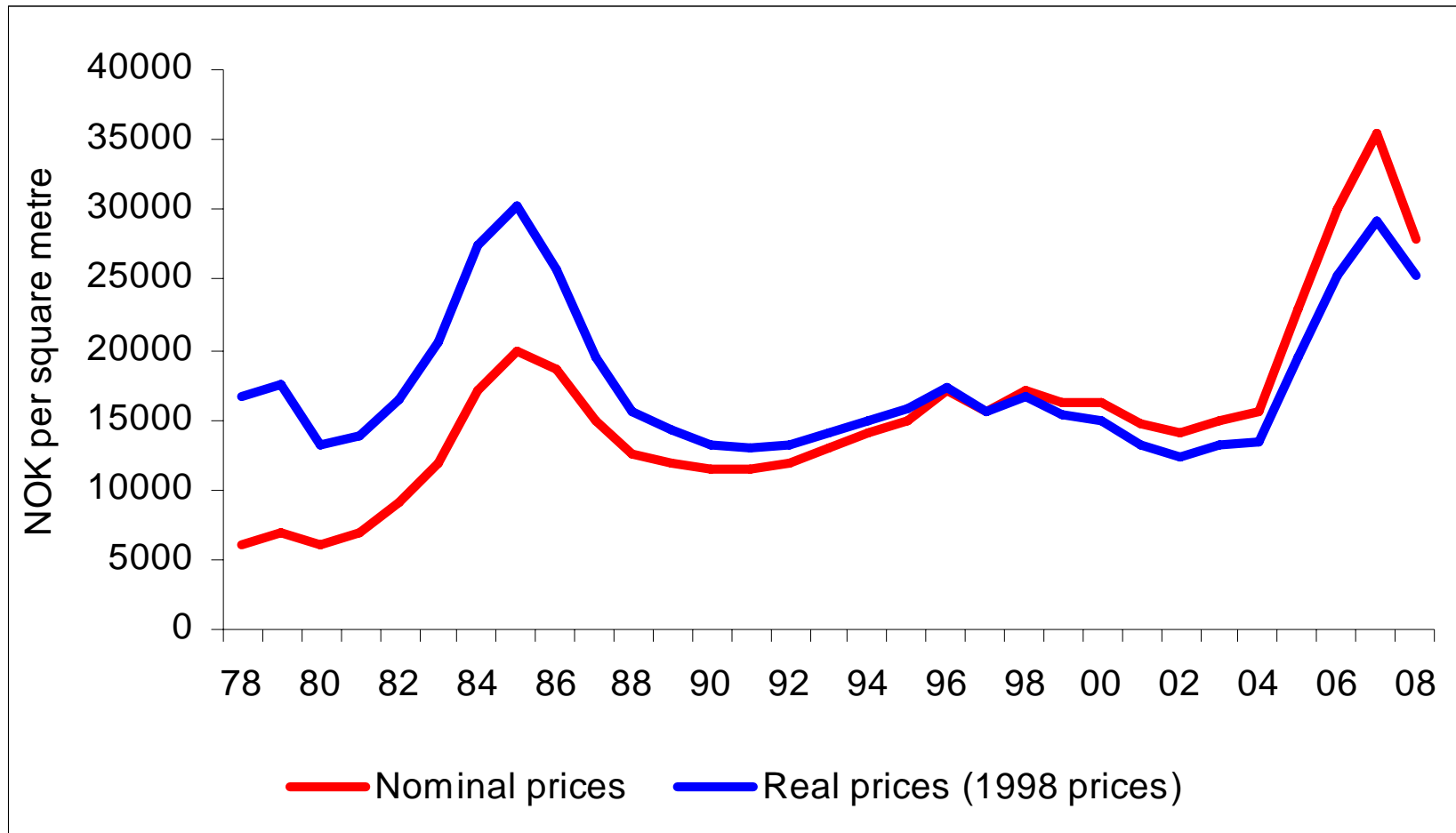
Housing prices

Growth rates m/m, s.a.



Sources: NEF, EFF, FINN.no and Econ Pöyry

Price of office premises in Oslo



Sources: OPAK and Kredittilsynet

Norwegian Financial Markets

- Financial conglomerates and alliances with high market shares
- Less concentrated banking market than in other Nordic countries
- Foreign ownership of importance in banking and non-life insurance
- Banking results declined in 2008 after high profitability for several years
- Increasing loan losses and levels of non-performing loans, but levels still low
- Declining net interest income
- Declining lending growth, especially to the corporate sector
- Stable tier-1 capital ratios – increasing in medium-sized and small banks

Structure of the Norwegian financial market (end 2008)

Per cent of total assets	Banks	Finance	Mortgage	Life insurance	Non life insurance
DnB NOR (incl. Nordlandsbanken)	39	31	20	30	0
Nordea Bank Norway	14	8	2	6	0
Sparebank1 Group*	12	7	8	3	6
Storebrand	1	0	1	27	1
Terra-Group*	5	1	2	0	1
Total financial groups	70	47	36	66	9
Other companies**	30	53	64	34	91
Total	100	100	100	100	100
- of which foreign branches in Norway	19	19	5	1	34
- of which foreign subsidiaries	14	41	2	6	2

*For Sparebank1 Group and Terra-Group, market shares include the owner banks.

**Savings banks accounted for 9 per cent, and commercial banks (incl. branches of foreign banks) for 20 per cent of other banks.

From financial crisis to an international recession ...

- Bank losses, particularly in the US and UK, have significantly reduced banks' ability to serve their clients and lend money
- The credit bubble has to be deflated to a sustainable level
- This process creates a period of reductions in GDP in all major industrial countries
- The crisis in the real economy creates further losses for the financial industry, reducing lending capacity
- Significantly higher risk premiums in credit markets reduce trade and investments.

Impacts for Norwegian financial institutions

The impacts fall into four main categories, which are somewhat interlinked:

- 1. Direct exposures to failing financial institutions and instruments**
- 2. Reduced access to international liquidity**
- 3. Higher international capital requirements**
- 4. Reduced economic activity internationally and domestically**

The latter will be the most important

1. Direct exposures to failing financial institutions and instruments

- No direct exposures to US sub prime-loans and CDOs built directly on them
- Most Norwegian banks and insurance companies had limited or moderate exposures to other financial instruments hit by the crisis
- Eksportfinans experienced a significant loss on their liquidity portfolio
- Limited exposures (significantly smaller than other European institutions) to failing institutions like Lehman Brothers and Icelandic banks. No significant Madoff-exposure

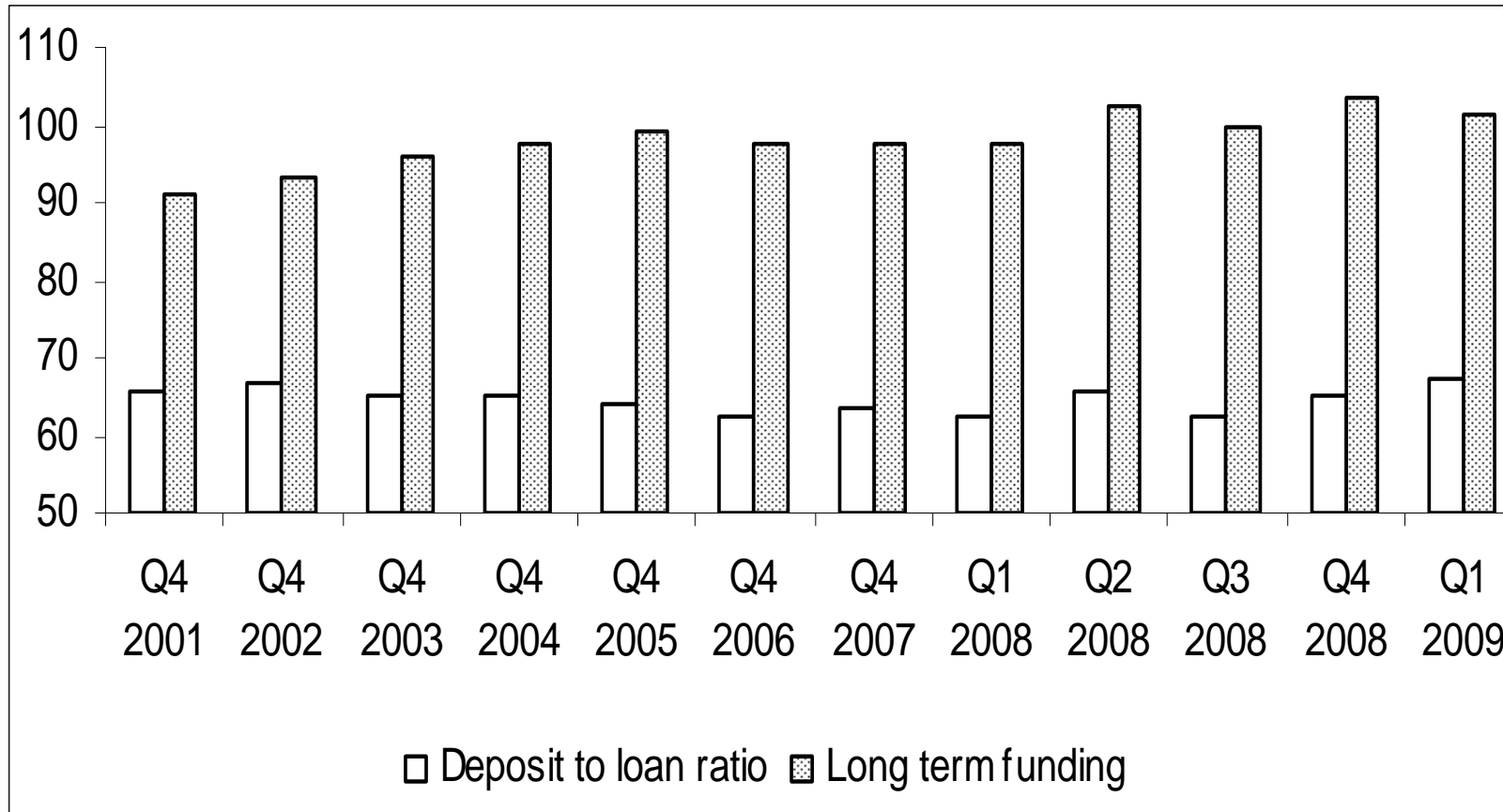
Victims: Icelandic banks

- The three Icelandic banks were placed under public administration in Iceland at the beginning of October 2008
- Glitnir Bank Norge received NOK 5 bn. in liquidity support from the Norwegian Banks' Guarantee Fund, and was sold to Sparebank 1 Gruppen. No depositors or other clients incurred losses
- Kaupthing's branch in Norway was placed under public administration
 - The Norwegian Government guaranteed for the part of the deposits to be covered by the Icelandic guarantee scheme and advanced the payments
 - All deposits under NOK 2 million were transferred to other banks and made available to the depositors
- Landsbanki dealt mainly in securities, and had no deposits
- British and German banks had large exposures to Icelandic banks and the fall exacerbated the financial crisis in Europe

2. Reduced access to international liquidity

- Nearly two thirds of bank loans are covered by deposits
- More than 60 per cent of market funding is borrowed internationally
- The collapse of the international interbank money market demonstrated an unexpected vulnerability of Norwegian banks and caused a steep rise in money market rates
- Liquidity reserves were adequate, but uncertainty for future access to liquidity affected bank lending
- Information and rumours of guarantees and other Government measures abroad led to some unrest and transfer of large deposits (>2 mill NOK) from Norwegian banks

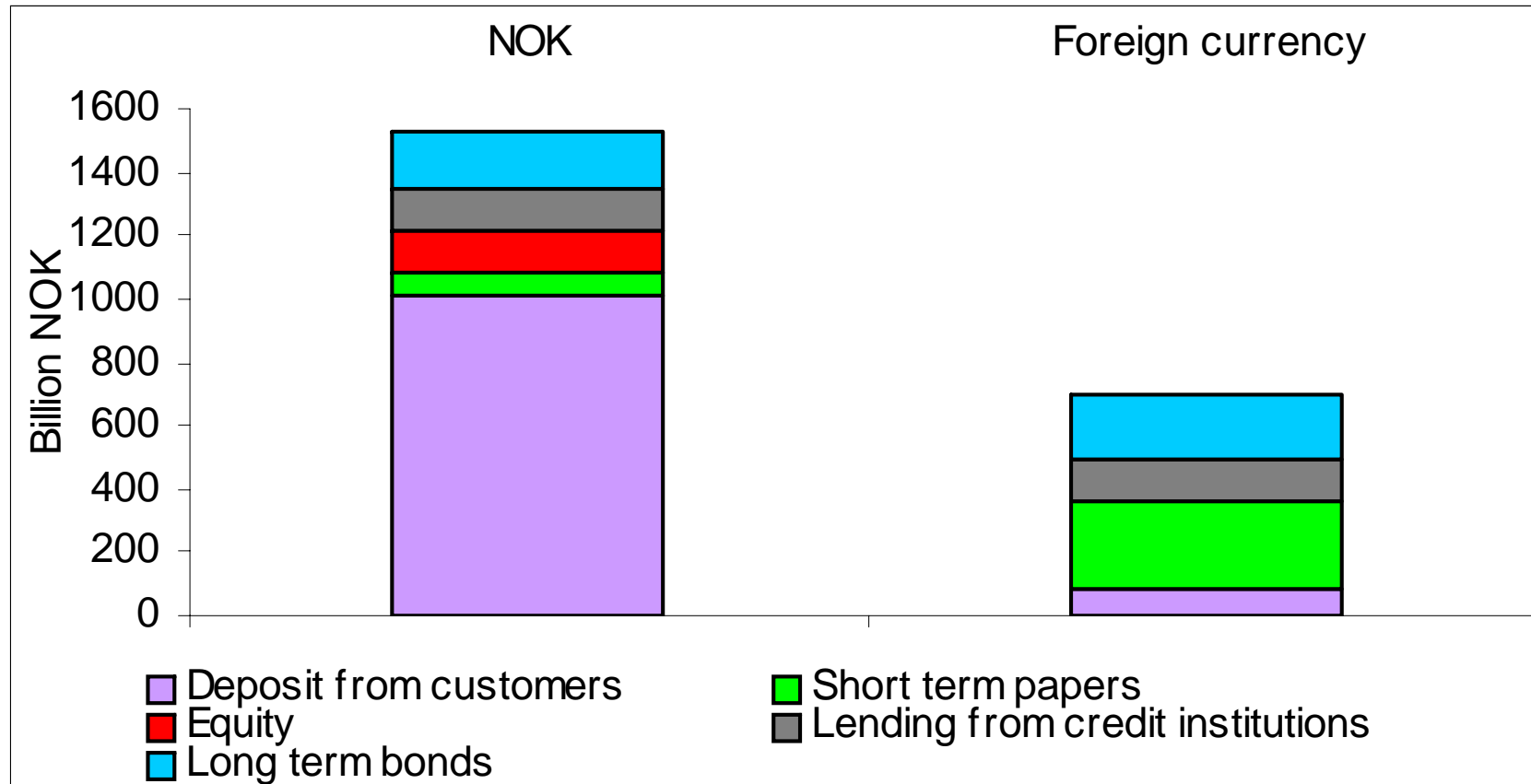
Funding – Norwegian banks



Long term funding: Funding with maturity in excess of 1 year as a share of illiquid assets

7 large Norwegian-owned banks

Norwegian-owned banks' funding

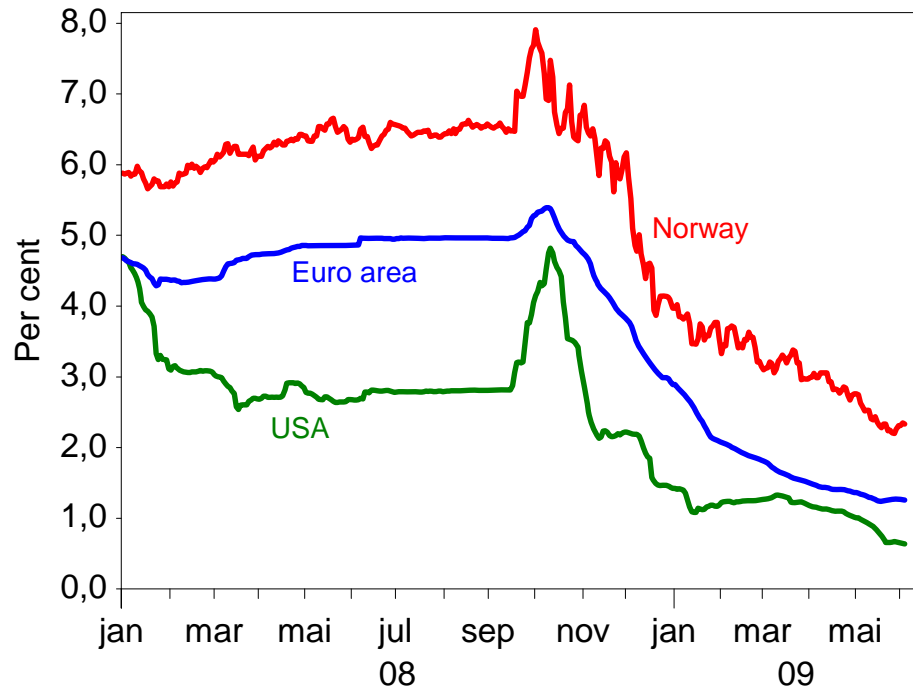


As of 31.03.2009

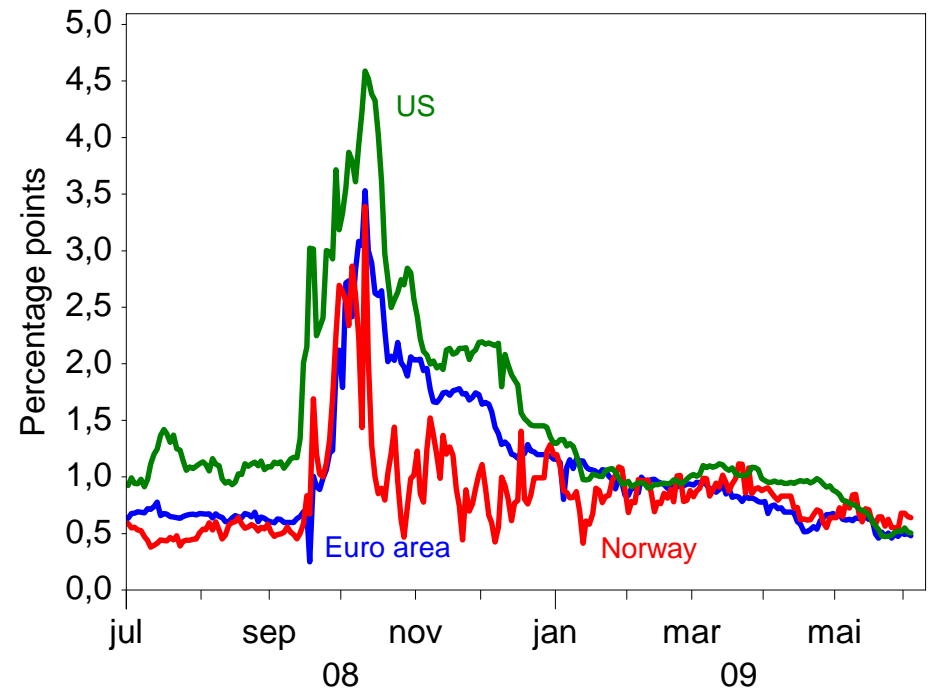
3-month interbank rates

1 January 2008 – 3 June 2009

Interest rate level



Spread interbank rate and treasury bill



Source: Reuters EcoWin

Liquidity measures

- The Norwegian Government took measures October 12, 2008 to ensure liquidity and a functioning money market
- Norges Bank supplied in 2008 42 bn NOK in government bonds and certificates by swapping with banks OMF's (preferential bonds). So far in 2009 another 80.7 bn NOK supplied
- From Oct. 2008 Norges Bank issued F-loan of longer duration by 37.2 bn NOK. (12.6 bn 2 years, 2.8 bn 6 months and 21.8 bn 3 months.) So far in 2009 further 22.6 bn F-loan (one auction of 3 years duration).
- 9 new mortgage companies licensed (previously 6)
 - by express procedures in Kredittilsynet: Møre, Sør, Nordea, Sandnes, Sogn og Fjordane, Plus, Øst, Helgeland and Fana.

The Norwegian Government Bond Fund

- Aims to contribute to an increased supply of capital and liquidity in the Norwegian bond market
- Established with a ceiling of NOK 50 billion and is managed by Folketrygdfondet (Government Pension Fund – Norway)
- Minimum requirements of risk diversification:
 - 25-65 % in banks and financial institutions
 - 35-75 % in non-financial enterprises (incl. industry)
 - Max. 30 % can be invested in non-investment grade bonds, however a lower limit has been specified (i.e. BB+ - B- in accordance with Standard & Poor's classification)
 - Max. 5 % can be invested in any individual company
- The fund shall invest on market-based terms
- Status mid - May: approximately NOK 2,5 billion in 20 new bond loans

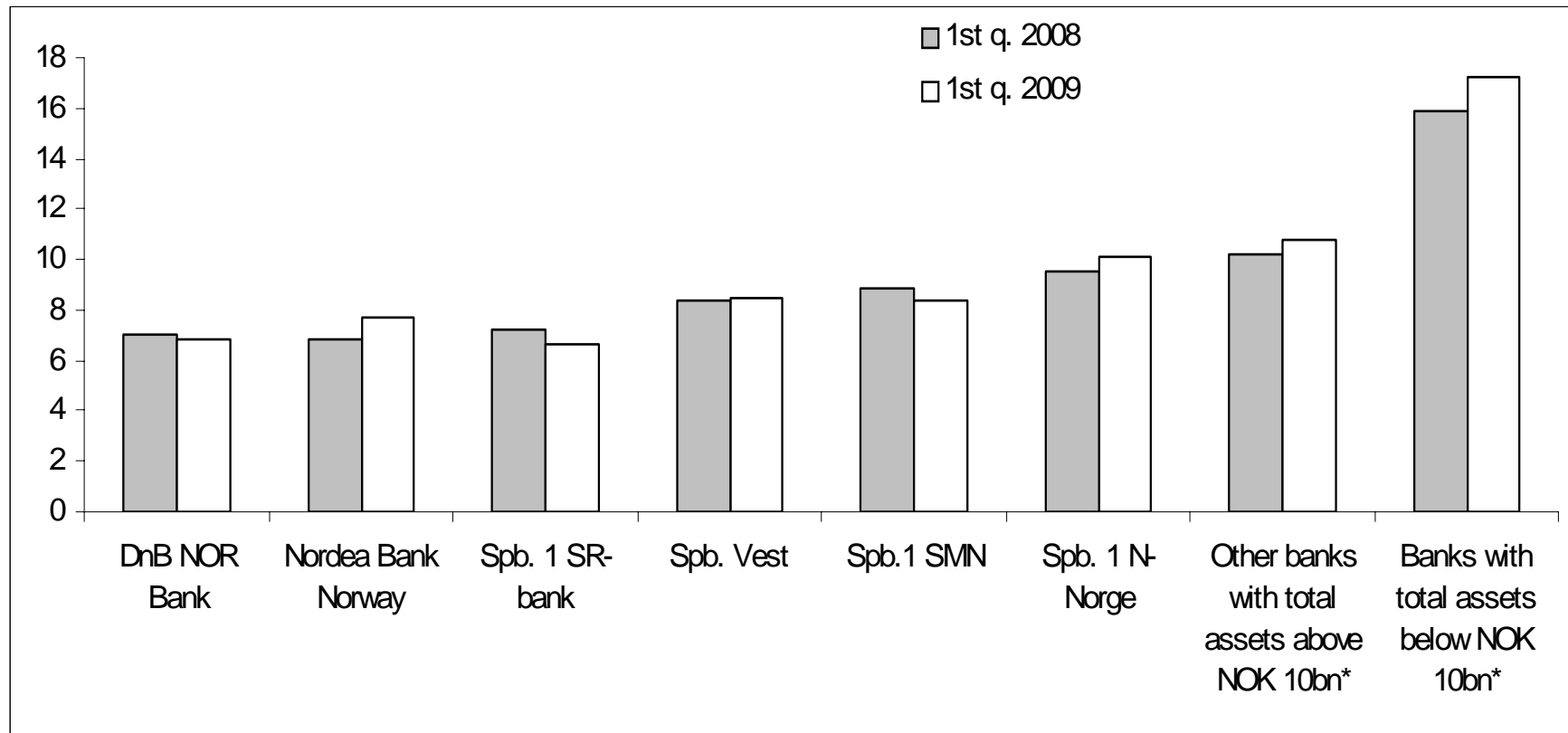
3. Higher international capital requirements

- Banks' solvency constitutes the basis for normal market funding and loan growth. There is a clear international trend towards higher capital levels that also affects Norwegian banks.
- Banks' credit risk has increased significantly due to the cyclical downturn, but also due to the very strong lending growth over several years, to households as well as to enterprises. There is a risk of significant losses that will reduce profitability and solvency.
- The capital buffers of Norwegian banks that were satisfactory in 2008 will in some banks not satisfy market requirements in 2009. Heavy losses and capital support for banks in several countries have increased the level and quality of capital required by the market.
- Kredittilsynet signaled in 2008, within pillar 2 in Basel II, that several banks should increase their planned capital adequacy ratios. For approx. half of the larger banks, Kredittilsynet signaled the need for increased actual capital adequacy ratios. Markets' capital requirement levels have since been set as high or higher than Kredittilsynet's indicated levels

The Norwegian State Finance Fund

- Has been established to contribute Tier 1 capital, on an interim basis, to Norwegian banks in order to strengthen the banks and to improve the ability of the banks to keep up normal lending activities
- Constituted as a separate entity with a capital of NOK 50 billion
- The Members of the Board were appointed 6 March and a small internal administration has been established
- The scheme will, in line with ESAs state aid guidelines, be open for a 6 month period (15. May 2009 – 30. September 2009)
- The Fund offers two financial instruments:
 - Core Tier-1 capital; important for banks' risk bearing capacity and their ability to offer loans
 - Hybrid Tier-1 capital; improves banks' funding and make the transition to normal market conditions easier
- It is likely that several banks will use the facilities of the Fund. Access to the Fund will strengthen banks' capital and reduce uncertainties in the market and ease banks' access to capital from the market.

Solvency of Norwegian banks: Tier 1 capital adequacy (group)



*Standardised approach under Basel II

4. Reduced real economic activity internationally and domestically

- **The international financial crisis is probably the most serious since the 1930s, and affects all countries and regions.**

Recession in the US, Euro-area and Japan, and gloomy prospects

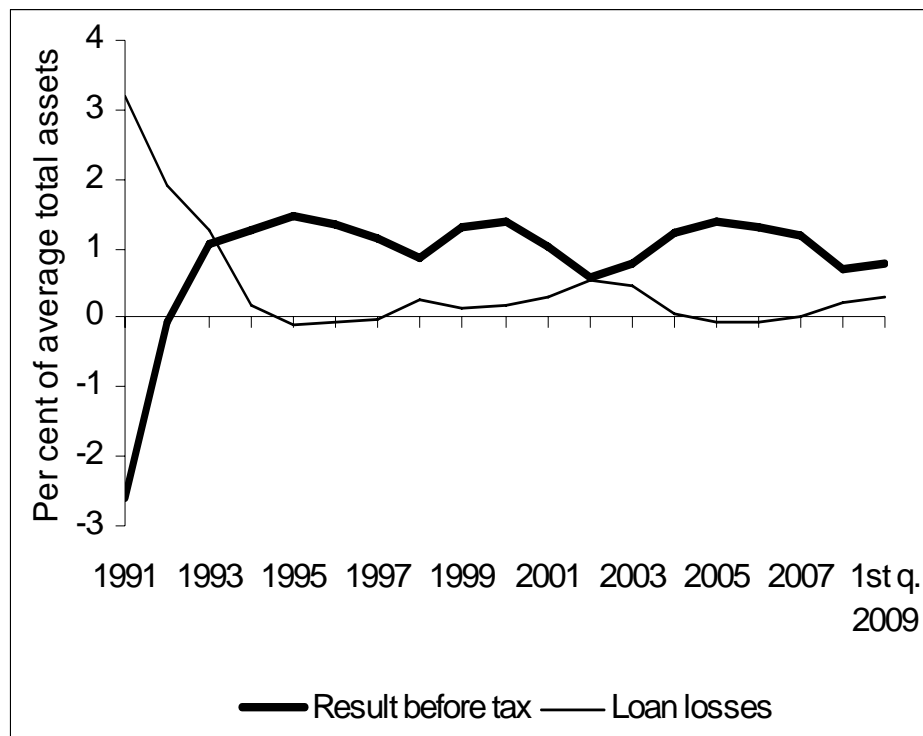
- **”Hard landing” of the Norwegian economy**

Falling manufacturing production and exports, falling housing and industrial investments. Increasing unemployment, but from a very low level

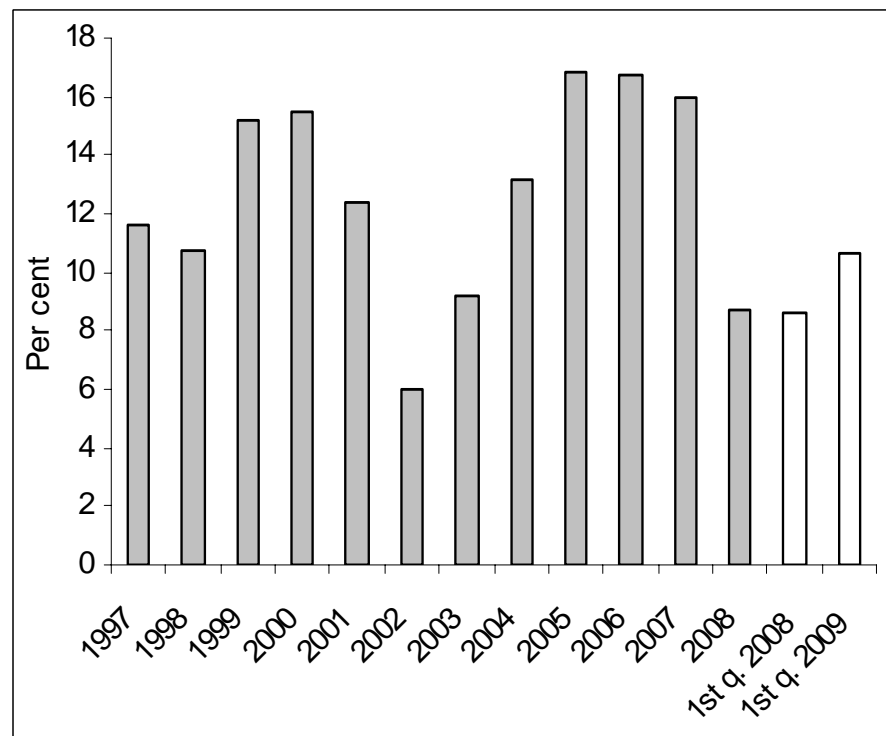
- Deteriorating profitability in the corporate sector – the number of bankruptcies is increasing rapidly
- A period of falling house prices on 12 month basis
- Reduced credit growth to enterprises and households

Banks' profit and return on equity :

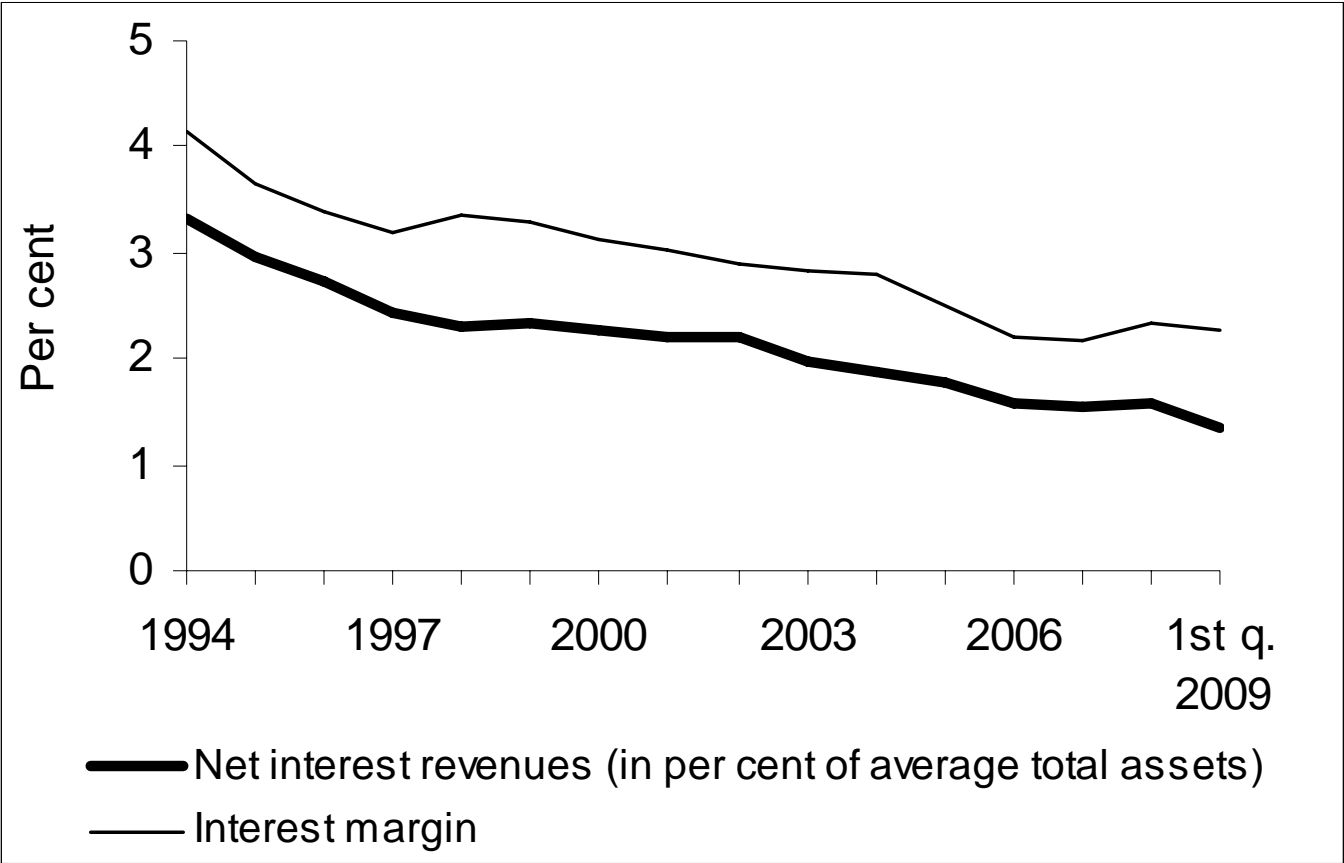
Banks' loan losses and pre-tax profits



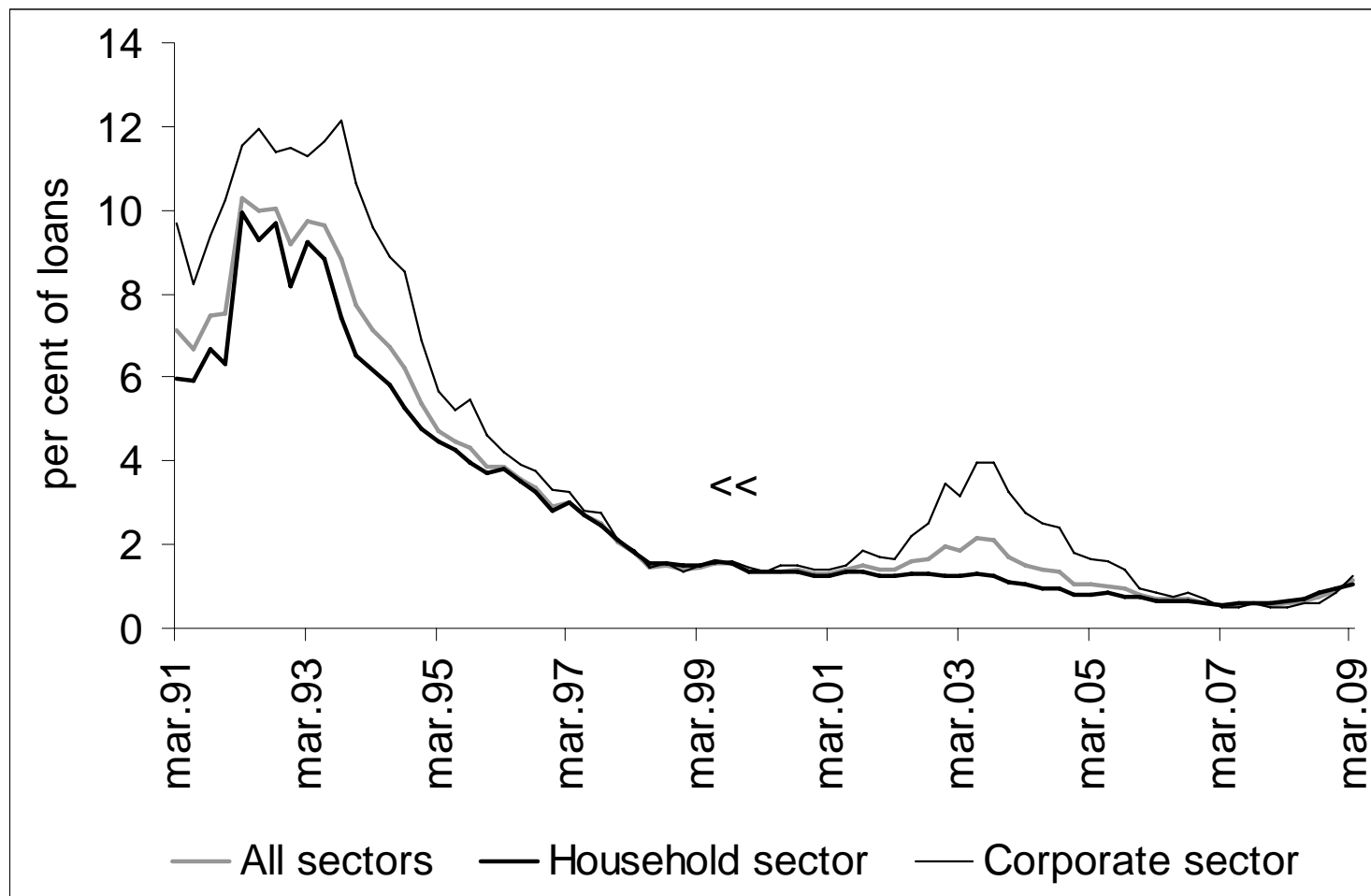
Return on equity



Net interest revenues and interest margin



Banks' non-performing loans



Norwegian banks – where do they stand?

- The Norwegian Government considers it vital to avoid a credit crunch with adverse effects on the real economy and employment. Norwegian banks are not in a crisis, and the authorities' measures reflect this. The banks themselves would in the end be negatively affected by a credit crunch
- Banks must ensure good credit standards to avoid problems ahead but overtightening of credit standards should be avoided
- It is likely that several banks will use the facilities of the State Finance Fund. Access to the Fund will reduce uncertainties in the market and make it easier for banks to raise capital from the market
- Norwegian banks are well situated to meet challenges ahead. It is most likely that Norway will avoid a banking crisis. However, it cannot be excluded that some banks will run into difficulties in 2009 or 2010, and that structural solutions may be necessary