FINANSTILSYNET
THE FINANCIAL SUPERVISORY AUTHORITY OF NORWAY

Equity Certificates in Norwegian Savings Banks

Proposal for amendments in the law

Presentation to SGOF 19th February 2025

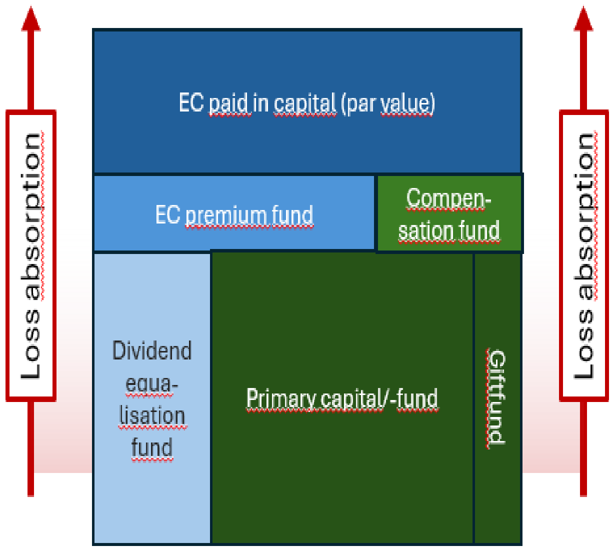
Background

- 80 of 100 banks in Norway are savings banks, including some of the largest banks (one O-SII)
- Equity/own funds in savings banks consisted originally of the Primary capital (capital paid in when establishing the bank, «ownerless capital») and retained earnings.
- Since 1988: Savings banks may issue «equity certificates» (EC) and pay dividends on these certificates. Holders of the certificates may select representatives to take part in the General Assembly (GA), however their influence is restricted to 40 per cent of all votes.
- 2/3 of the savings banks have issued EC. Several banks have ECs listed on Euronext Oslo Børs (stock exchange).

Equity certificates – main features today

- Originally ECs had characteristics like an AT1-instrument, paying an "interest" decided by the board. Over time the regulation has been amended in order to make the instrument more similar to ordinary shares. Several funds have been introduced:

➢ **EC paid in capital**: instruments at par value x number of instruments issued.
➢ **EC premium fund**: any premium paid on issued instruments (to be shared with the compensation fund if above book value, see below)
➢ **Dividend equalisation fund**: retained earnings allocated to the EC-capital, may be used to pay dividends later on.
➢ **Compensation fund**: fund allocated to the Primary capital. Reflects share of premium paid on issued instruments, if above book value.
➢ **Gift fund**: retained earnings allocated to the Primary capital which is earmarked for future gifts.
➢ **Primary capital fund**: Paid in Primary capital and retained earnings allocated to the Primary capital (ex. the gift fund).



Equity certificates - main features today (cont.)

- To classes of capital: EC and Primary capital

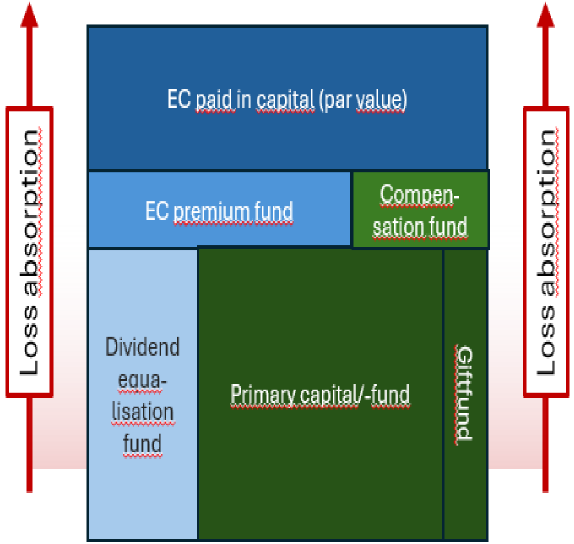
EC capital = EC paid in capital + EC premium fund + Dividend equalisation fund

Primary capital = Primary capital fund + Gift fund + Compensation fund

- The profit is divided between the **Primary capital** and the **EC capital**, based on the size of paid-in capital and all the funds allocated to the two classes of capital.

- Any deficit is first absorbed by the **Primary capital fund, the Gift fund** and **the Dividend equalisation fund**, (pro-rata to the size of the funds), then by the **EC premium fund** and the **Compensation fund** (pro rata to the size of the funds) and finally the EC paid in capital.

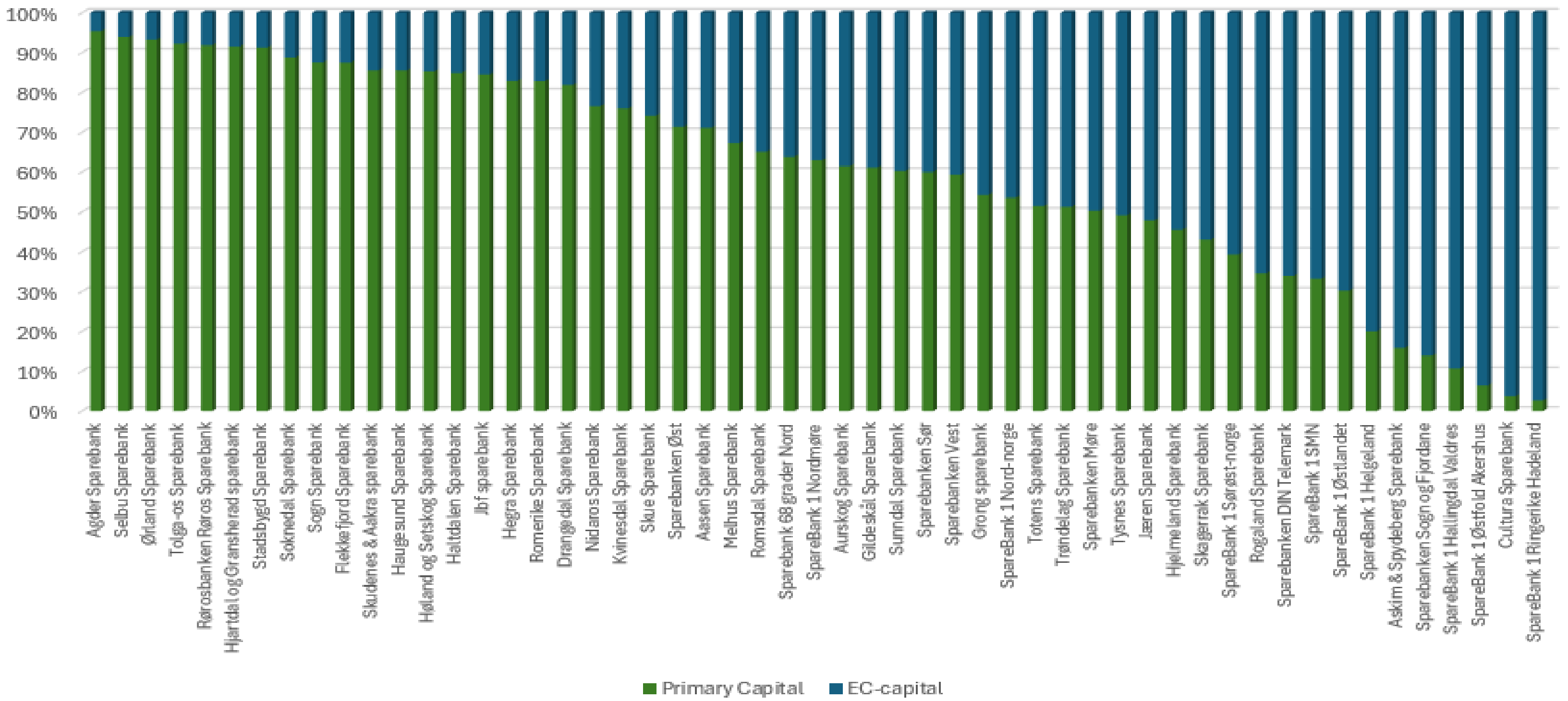
Blue boxes = EC capital
Green boxes = Primary capital



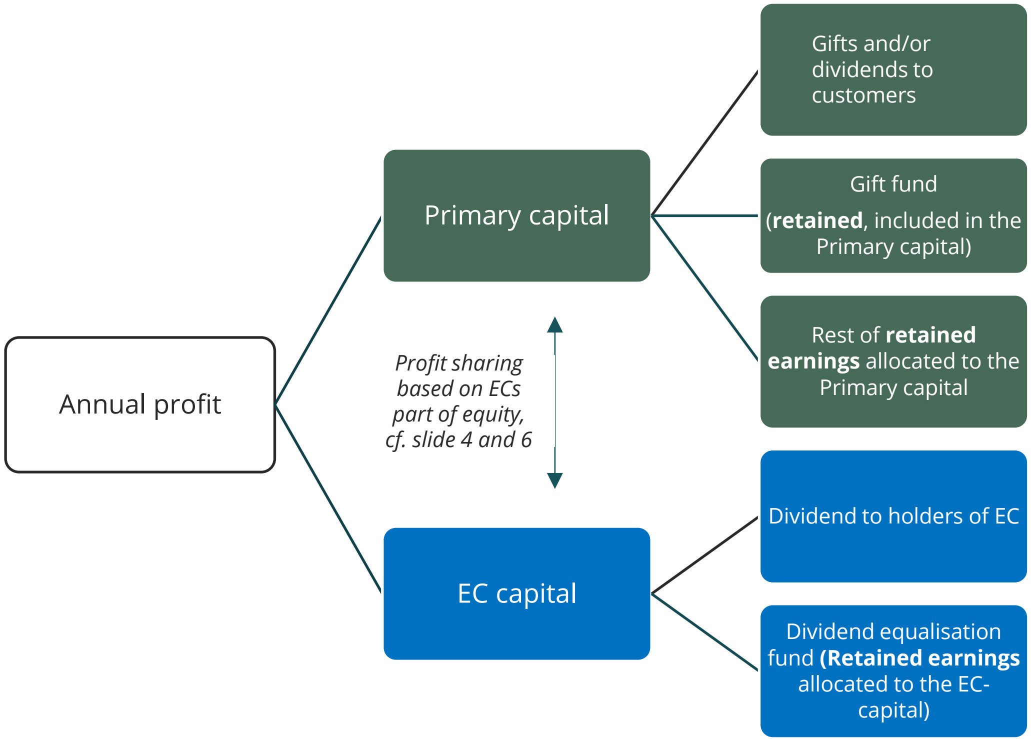
Main features (cont.)

- The legal set-up is based on an ambition to make ECs similar to “common shares” in an ordinary joint stock company. Some “deliberate” exemptions:
    - Limit on voting rights (cf. slide 2).
    - Loss absorption (cf. slide 4).
    - EC premium paid when issuing EC to be shared between EC (“premium fund”) and Primary capital (“compensation fund”) if premium is above book value. No “sharing” if premium is below book value. Issuances at a price below book value dilutes existing EC holders, but not the Primary capital.

Composition of equity in different banks



Distribution of profits

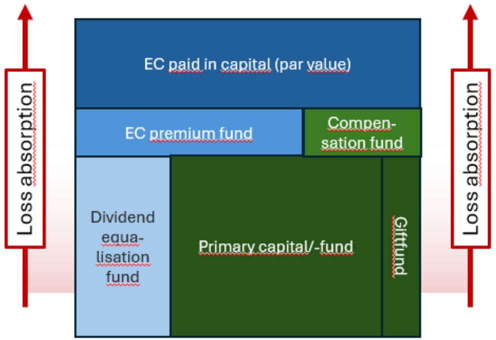


According to the law, the banks should endeavour equal pay-out-ratios from the two classes of capital, however different pay-out-ratios are not prohibited. Different pay-out-ratios will change the “ownership-ratio”.

Pay-out-ratio Primary Capital = gifts/dividends as share of profits allocated to the Primary Capital.

Pay-out-ratio EC = dividends to holders of EC as share of profits allocated to the EC capital.

EBA assessment 2022



Major findings:

- Complexity

- Loss absorbency : Need to improve loss absorbency of EC by increasing the dividend equalisation fund ("first-loss-tranche").

Cf. CRR article 28 (1) i) :
"Compared to all the capital instruments issued by the institution, the instruments absorb the first and proportionately greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other Common Equity Tier 1 instruments"

EBA assessment 2022 (cont.)

Other comments from EBA:

"Section 10 of the Financial Institution Act does not explicitly require any reduction of the equity capital being subject to the competent authority's prior approval. On the contrary, Article 28(1)(f)(ii) CRR makes the institution's discretional repurchasing of CET1 instruments or other means of reducing CET1 capital being subject to the competent authority's prior approval in accordance with Article 77 CRR. "

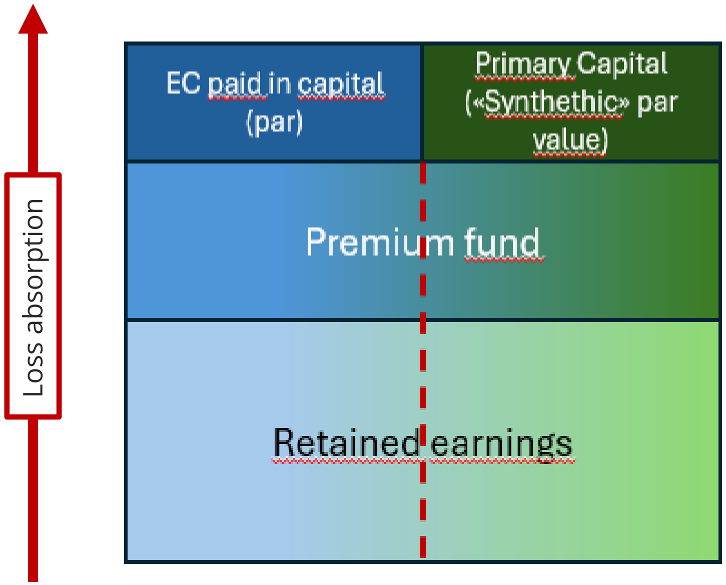
The Financial Institution Act explicitly requires that a reduction of the equity capital is subject to approval from Finanstilsynet. However, the law is not clear on whether a reduction of the dividend equalisation fund needs approval.

Official Norwegian Report on savings banks (NOU 2024: 22)

- Conclusion of the Commission:
    - The loss absorbency of ECs need to be amended in order to comply with the CRR requirements.
    - An increase in the dividend equalisation fund (as indicated by EBA) by requiring the banks to not pay dividends for decades is not recommended.
- Proposal for amendments in the law:
    1. The EC-capital to absorb losses pari passu with the Primary Capital (deficits are treated the same way as surpluses).
    2. A new “set-up” (model) in order to reduce complexity and increase transparency.

Official Norwegian Report on savings banks (NOU 2024: 22) cont.

- Proposal for a new model for equity certificates
  - Primary fund capital converted to a “synthetic” instrument in the legislation in order to simplify equal treatment of the two classes of capital. “Ownership ratio” decided by the articles of association.
  - Premium fund and retained earnings (incl. gift fund) merged to common funds.
  - EC absorbs losses “pari passu” with the Primary capital.
  - Any reduction in paid in equity and funds will be subject to approval from Finanstilsynet, as the case is for any reduction of paid in capital and funds in joint stock companies.



Comments in the consultation related to EC

- Finance Norway and Norwegian Savings Banks Association: EBA's legal assessment need to be challenged before any changes in the regulation. Argument: Savings banks have only issued one instrument (EC). Loss absorbency relatively to the Primary capital not relevant as there are no issued instrument in relation to the Primary capital (cf. article 28 (1) i) "compared to all the capital instruments…").

- Finanstilsynet: Supports the proposals for amendments in the law. Proposes certain additional minor clarifications in the law (considered not relevant in the assessment of EC in relation to CRR).

- Other views: Mixed, some supporting the view of Finance Norway/Norwegian Savings Banks Association, others supporting the proposal.

Any comments from the SGOF-members?

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