



Ministry of Finance
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Financial institutions' distribution of profits for 2019

The spread of the coronavirus and measures to limit the contagion have, within a short period, caused extensive financial market turmoil and a sharp deterioration in the economic outlook. The Norwegian economy is also affected by the significant decline in oil prices. A pronounced economic downturn internationally and in Norway must be taken into account. Many industries are already strongly affected. The crisis and uncertainty are also reflected in extraordinary support measures from the political authorities and central banks to stimulate the economy, including measures aimed at banks.

Financial institutions' profits represent their first line of defence to cover higher losses. In a situation where profits have been or look set to be drastically reduced, it is important that profits are retained to strengthen the institutions' financial position.

The boards of directors of a number of institutions have proposed large dividend payments and other distributions of funds on the basis of the 2019 financial statements, including authorisations to repurchase own shares. In banks (including holding companies in bank-dominated financial services groups), the boards' original proposals for dividend payments and other distributions of profits totalled more than NOK 20 billion. In insurance undertakings (including holding companies in insurance-dominated financial services groups), the original dividend proposals came to approximately NOK 10 billion.

However, after the boards approved the proposals for the distribution of annual profits for 2019, the conditions underlying the proposed distributions have changed completely.

Against this background, Finanstilsynet sent a letter to the boards of directors of all banks and insurance undertakings on 16 March regarding the allocation of profits for 2019, see <https://www.finanstilsynet.no/en/news-archive/news/2020/letter-to-institutions-on-the-distribution-of-profits-for-2019/>.

According to the letters, Finanstilsynet expects the institutions' boards of directors to review the distribution of profits for the 2019 financial year in light of the current crisis and economic uncertainty and, if necessary, submit new proposals to the institutions' general meetings on dividend payments and other payouts. Finanstilsynet asked for the boards' assessments by 23 March 2020.

Finanstilsynet has now received the institutions' responses. Some institutions have already made dividend payments, while other institutions plan to retain all profits. A few institutions report that their general meetings are scheduled for a later date and will consider changing the board's dividend proposal during the period leading up to the general meeting. In several institutions, the boards will maintain their original distribution proposal or only make minor adjustments.

A number of the boards of the institutions where the board will either not propose lower payouts or propose somewhat lower payouts refer to the fact that the institution meets prevailing capital requirements by an ample margin and that this provides a basis for distributions.

With effect from 31 December 2019, the rules on capital requirements for banks were adapted to EU rules. This entailed that capital requirements for Norwegian banks were reduced. For the largest banks, which use internal models when setting capital requirements, there was an average reduction in the capital requirement of approximately 2 percentage points, while there was a somewhat lower reduction for small and medium-sized banks. The lowering of the countercyclical capital buffer rate on 12 March 2020 gave a further reduction in the capital requirement for Norwegian exposures of 1.5 percentage points, corresponding to approximately NOK 27 billion. Banks with exposures in other EEA countries, including a large proportion in other Nordic countries, were also subject to lower capital requirements on such exposures as the countercyclical capital buffer was reduced in several of these countries. In consequence of the reduced capital requirements, the banks' margins to the statutory requirements are significantly wider than they would have been on the basis of the rules in effect until the end of 2019.

However, lower capital requirements do not mean that banks' need for capital to absorb future losses has been reduced. The reason for the reduction in the countercyclical capital buffer is that it will make banks better able to provide loans to creditworthy customers.

Finanstilsynet regularly conducts stress tests that illustrate how a severe economic downturn, including a significant fall in the oil price, may affect institutions' financial soundness. The analyses show that banks may be exposed to significant losses under such conditions. Finanstilsynet has pointed out that high debt levels in Norwegian households and high property prices in recent years constitute a particular vulnerability that may amplify the effects of a negative trend.

Considerable uncertainty attends developments in the Norwegian economy and in the financial markets over the coming weeks. The shock that has now hit the economy and the markets is of a different nature than the shocks that have triggered financial crises in the past, and the negative effects on the institutions may be far more serious than assumed in Finanstilsynet's stress tests.

This is an extraordinary situation. The banks may suffer extensive losses, and lower interest rates and declining asset values will make it more challenging for life insurers to meet future obligations. Non-life insurers may also be affected as a result of increased claims payments. Apart from establishing that the institutions generally may suffer heavy losses, it is currently not possible to say how individual institutions will be affected in the period ahead.

In Finanstilsynet's opinion, it is now important that Norwegian banks and insurance undertakings do not make allocations that impair their financial strength. For the time being, the institutions

should therefore not pay dividends or make other profit distributions. A ban on dividend payments and other distributions will have a profound impact. However, in view of the widespread crisis the country is in, Finanstilsynet is nevertheless of the opinion that such a measure is necessary to promote financial stability.

Pursuant to Section 10-6 (4) of the Financial Institutions Act, Finanstilsynet may, when necessitated by a financial institution's financial position, order the institution not to pay out dividend or to pay less dividend than that proposed by the board of directors or adopted by the general meeting. Use of Section 10-6 (4) of the Act requires a specific assessment of the individual institution's financial position, and any order will be in the form of an individual decision. Finanstilsynet considers whether certain institutions shall be subject to restrictions on dividend payments pursuant to this provision. However, in light of the current high level of uncertainty and the risk that the crisis will have broad ramifications, Finanstilsynet finds it necessary to introduce a general restriction on the institutions' distribution of profits.

Pursuant to Section 1-7 of the Financial Institutions Act, the Ministry of Finance may make regulations concerning further requirements on financial institutions in the interest of promoting financial stability. Finanstilsynet assumes that this provision gives the Ministry a legal basis for adopting regulations on a general restriction of financial institutions' right to distribute profits in a situation where they need to strengthen their financial position to promote financial stability.

Against this background, Finanstilsynet advises the Ministry of Finance to adopt regulations pursuant to Section 1-7 of the Financial Institutions Act in line with this.

Finanstilsynet would also like to emphasise that a general requirement to retain profits for 2019 does not mean that profits are confiscated, but that distributions are deferred. The institutions will have the opportunity to distribute funds to owners and customers and gifts for the public good on a later date provided that the individual institution's financial soundness and profit performance warrant such action.

As mentioned above, the outcome of the ongoing crisis is highly uncertain. The regulations on the retention of profits for 2019 may be revoked later this year if this is in the interest of financial stability, whereby the individual institutions may resolve to distribute profits at an extraordinary general meeting.

Regulation of the institutions' distribution of profits for 2019 should be adopted quickly to ensure the institutions' financial soundness and to clarify the limits for their distribution of profits for 2019 before the general meeting is held. It should be noted that several institutions have held their general meetings, but not made dividend payments. General meetings are scheduled in a number of institutions during the current week. Finanstilsynet's proposed regulations entail that a resolution on dividend payments passed by the general meeting cannot be effected after the regulations have entered into force.

Some institutions have already made dividend payments for the 2019 accounting year. Regulations on a temporary ban on the distribution of profits will not affect payments that have already been made.

In light of the current circumstances, there will be no time to circulate the proposal for public consultation, cf. the Public Administration Act, Section 37, fourth paragraph, letters a and b, cf. Section 3-3 of the Instructions for Official Studies and Reports.

Conclusion

Finanstilsynet recommends that the Ministry of Finance adopts regulations pursuant to Section 1-7 of the Financial Institutions Act on the retention of profits for 2019, see attached draft regulations.

A copy of this letter has been sent to Norges Bank.

Yours sincerely

Finn Arnesen
Board Chair

Morten Baltzersen
Director General

This document has been electronically approved and does not require handwritten signatures

Attachment: Draft regulations