

Annual report 2005



KREDITILSYNET
The Financial Supervisory Authority of Norway

Why regulate and supervise the financial system?

Financial market stability has received a great deal of attention in recent years. Many countries, including most of the Nordic ones, have seen serious problems in their financial sectors, with substantial costs for both the nation and the individual. The financial system redistributes capital and risk and attends to payment and settlement functions. Solid financial institutions and smoothly functioning financial and securities markets are essential if these functions are to be discharged in a satisfactory manner. Should confidence in the financial system fail, there could be substantial negative consequences for other sectors of the economy. Stability and confidence in the financial system are therefore a central aim of regulation and supervision.

Banks are key actors in the financial system, and appropriate regulation and effective supervision of banks is an important part of the effort to ensure financial stability. However, developments in share markets and other securities markets can also give rise to financial turbulence and stability problems. Regulation and supervision of market participants and their behaviour is therefore key to maintaining confidence in the financial system. Orderly and efficient securities markets can contribute to higher returns on savings and to ensuring that venture capital is available to business and industry. A sound insurance sector can make important contributions to long-term saving and capital accumulation and to curbing the risk faced by enterprises and households. Regulation and supervision of insurance is crucial to the financial system's ability to discharge its core functions.

An efficient and effective supervisory regime whose primary aim is to ensure that banks, investment firms and insurance companies comply with applicable rules and maintain adequate management and control of their business and of risk, is key to maintaining the financial system's stability. Enterprises' provision of correct and relevant information on their financial situation is likewise crucial for market actors and authorities alike. Financial reporting supervision of listed companies and effective regulation and supervision of audit companies and external accountants are at centre-stage in this context.

A further main goal of regulation and supervision is to protect consumers and other users of financial services. Financial institutions in key areas manage their clients' assets by a variety of means. Clients may be bank depositors, insurance policyholders or investors in securities markets. Much consumer protection is provided through regulation and supervision of financial institutions' solvency and activity, and through various types of public guarantee schemes, such as the one covering bank deposits.

An important aspect of consumer protection comprises regulation and supervision of intermediary functions performed by investment firms, management companies, insurance brokers, real estate agents, debt collection agencies etc. Here the object is to prevent misuse of client assets along with any other behaviour that promotes the interests of an intermediary at the expense of clients' interests.

Contents

Why regulate and supervise the financial system?	2
Preface	4
Functions and main objectives	6
Important events in 2005	7
Organisational set-up and resource use	10
Reports from supervised sectors:	
– Banking and finance	20
– Insurance	30
– Securities market	38
– Financial reporting supervision	46
– Auditing	50
– External accounting services	54
– Estate agency	58
– Debt collection	62
Other issues	66
International activities	70
Organisation chart	77

For analyses of financial market trends, see *The Financial Market in Norway 2005: Risk Outlook*.

"Kredittilsynet shall ensure that the institutions it supervises operate in an appropriate and proper manner in accordance with law and provisions issued pursuant to law and with the intentions underlying the establishment of the institution, its purpose and articles of association."

(Financial Supervision Act, section 3)

Kredittilsynet is responsible for the supervision of banks, finance companies, mortgage companies, e-money institutions, insurance companies, pension funds, insurance intermediaries, investment firms, securities fund management, stock exchanges and authorised market places, clearing houses and securities depositories, real estate agencies, debt collection agencies, external accountants and auditors. Kredittilsynet also oversees listed companies' financial reporting and market conduct in the securities market.

Preface

Once Parliament (Storting) had given Kredittilsynet responsibility for oversight of listed companies' financial reporting, the agency built up in the course of 2005 the competence and supervisory machinery needed to discharge this task. Preparations for financial reporting supervision, along with wide-ranging legislative drafting for the securities market and the insurance and banking fields, were a major feature of Kredittilsynet's work in 2005. A regulatory framework comparable to that being developed elsewhere in Europe is important for Norway's financial sector and business and industry in general. That said, adapting to European rules can in some areas produce a more complicated body of rules than warranted by Norway's needs alone.

Kredittilsynet's increased competence and capacity and the absence of serious problems in the financial industry have enabled rule drafting to be combined with a satisfactory regime of ongoing supervision. A system for assessing risk facing the individual supervised entity on an overall basis has been developed which heightens the quality of supervision of financial institutions. Improved methods and collaboration with ØKOKRIM (The Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime) and other police authorities have enabled several breaches of central provisions governing conduct in the securities market to be brought to light and prosecuted. With a view to enhancing its effectiveness and resource use, Kredittilsynet has called for administrative penalties to be applied to violations of a less serious nature.

A favourable economic climate contributed to an excellent year for Norwegian banks in 2005. Improved credit routines for business loans and more streamlined operations also played a substantial part in the good performances. Customers have also benefited from the trend thanks to efficient competition which has narrowed spreads between lending and deposit rates.

Keeping a vigilant eye and maintaining high-quality credit routines in a period of booming conditions and vigorous competition poses a challenge to the banks. 2005 saw a continued strong increase in corporate borrowing. Growth in lending to households was on the increase, reaching its highest level since the 1980s. Kredittilsynet's surveys show that almost 40 per cent of home mortgage loans exceeded 80 per cent of the property valuation, and 12 per cent topped 100 per cent of the property valuation. There is a close link between the vigorous debt growth and the rise in house prices. The danger is that debt burdens and house prices will rise to a point where even small changes in interest rates or other economic factors could trigger a correction in the housing market with spillover effects to financial markets and the wider economy.



In Kredittilsynet's view banks should not delay tightening their home mortgage lending practices. Delaying such a move to a point where it is likely to intensify any housing market downturn would be detrimental. It is encouraging to note Norges Bank's clear intention to raise interest rates to a more normal level. If the growth in debt is to be checked, a gradual normalisation of the interest rate must not take too long.

Norway's tax system strongly favours investment in housing as opposed to financial saving. The interests of the financial system and of the economy in general call for greater emphasis on achieving a neutral bias in the taxation of various types of financial wealth and property.

The high level of activity in the housing market has brought a strong increase in the number of real estate agents which Kredittilsynet will need to monitor. A substantial increase in the number of inspections at estate agencies is planned for 2006.

Five out of six independent commercial banks were acquired in the space of three quarters of a year from autumn 2004 to summer 2005, four by foreign banks and one by a Norwegian bank. Three new Norwegian commercial banks were concurrently established. In the final months of 2005 Kredittilsynet received a number of queries concerning possible takeovers of small savings banks. After a long period of minor changes in the savings bank structure there may be a need for structural adjustments. Even so, applications to acquire savings banks must be carefully assessed in relation to preserving savings banks' traditions and independence to which Norwegian legislation aspires.

The new capital adequacy framework (Basel II) which is to become operational from 2007 onwards will bring a significant reduction in the minimum capital requirements. The reduction is based on the premise that real risk is now measured and controlled more effectively than previously. A substantial effort will be needed on the part of the individual institution and of Kredittilsynet alike to ensure that this premise is fulfilled. Transitional rules will prevent a precipitate fall in the minimum capital requirements in the years immediately ahead.

A wide-ranging project has been initiated within the EU to establish new solvency requirements for insurance, the Solvency II framework, which will probably not become operational until 2010 at the earliest. Responding to the delay, Denmark, Sweden, the Netherlands and the United Kingdom have introduced provisional rules. Using stress testing, these rules are more successful than the current Solvency I framework at uncovering various types of risk in insurance, and at the same time they point ahead to Solvency II.

In Norway, insurers have both to square up to EU solvency rules and to comply with the Basel I capital adequacy framework. The latter regime is also not particularly well geared to the types of risk now facing insurers. Kredittilsynet has accordingly formulated a proposal for provisional capital adequacy rules for insurers, designed as an invitation to a broad-based debate with a view to improving the Norwegian insurance industry's regulatory framework and to facilitating the transition to the EEA-wide rules coming in a few years' time.

Much of the legislation administered by Kredittilsynet aims to safeguard consumer interests in the financial market. Kredittilsynet has in recent years stepped up its activity in this area in collaboration with the Consumer Council and the Consumer Ombudsman. A sound regulatory framework needs to be combined with a sound approach on the part of the institutions that mediate financial services and give advice to the general public. Enquiries made by Kredittilsynet into sales of complex savings products accompanied by loans to purchase these products unfortunately show that a number of institutions are falling short of society's rightful expectations as regards objectivity and sound advice.

The thorough IMF evaluation completed in spring 2005 gave Norway's financial system and Kredittilsynet a positive review. At the same time the objectives and instruments of supervision need to be updated on a regular basis. In 2006 we are marking the twentieth anniversary of Kredittilsynet's establishment, and the agency will also be reviewing and revising its strategy. A broad-based paper on "Goals and Performance Measurement" has been prepared as a contribution to this process. We have invited supervised entities and authorities alike to voice points of view to be taken on board in formulating our strategy.

Oslo, 23 January 2006

Finn Hvistendahl
Chairman of the Board

Bjørn Skogstad Aamo
Director General

Functions and main objectives

Kredittilsynet's mission is to ensure that financial institutions and markets function securely and efficiently in the best interest of society and users of financial services, and that service providers are afforded an appropriate framework for their operations.

Kredittilsynet is an independent government agency that builds on laws and decisions emanating from Parliament (Storting), the Government and the Ministry of Finance and on international standards for financial supervision and regulation.

Through its supervision of enterprises and markets, Kredittilsynet strives to promote financial stability and orderly market conditions and to instil confidence that financial contracts will be honoured and services performed as intended. In addition to its preventative work, Kredittilsynet maintains a preparedness for dealing with concrete problems that may arise. Kredittilsynet's premise is that Norwegian enterprises must be afforded competitive conditions which all in all are in line with those enjoyed by institutions in other EEA countries.

Kredittilsynet's approach to attaining its overarching goals can be summarised as follows:

Institutions

Kredittilsynet's premise is that responsibility for business operations rests with the board and management of the institutions themselves. Kredittilsynet will work to promote satisfactory capital strength, risk awareness, management and control at institutions under its supervision. Through its administration and effective enforcement of the rules, Kredittilsynet will strive to ensure that institutions and other market actors comply with laws, rules and ethical norms. Institutions of major significance for financial stability and for users are given priority for supervision purposes.

Markets and market places

Kredittilsynet works for efficient and effective competition and price formation in securities markets, credit markets and other markets under its supervision. Settlement and payment systems and the financial infrastructure in general must function in an appropriate and satisfactory manner. Markets and market places need to be open and transparent, and market actors must exhibit good conduct.

Users of financial services

Kredittilsynet will in its dealings with institutions, markets and market places promote the interests of the users of financial services. Kredittilsynet will contribute to rules and arrangements that ensure that users receive correct information – in the first instance from the institutions themselves – about the institutions, their products and the associated risks.

Kredittilsynet's performance of its activity

Kredittilsynet intends to be an effective, flexible and independent body featuring high competence and good service. It will emphasise transparency and predictability in its activities, good communication with supervised institutions and the general public, and good collaboration with other authorities and industry organisations.

Important events in 2005

Structural changes and licensing

7

Three new commercial banks open for business

Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised yA Bank and Bank2 to start operations while Netfonds was authorised to provide banking services on a limited basis.

Commercial banks in new hands

Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised the following takeovers in the banking sector:

- The takeover of Romsdals Fellesbank by SpareBank 1 Midt-Norge
- The takeover of BNbank by Íslandsbanki
- The takeover of Bankia Bank ASA by Santander Consumer Finance S.A.
- The takeover of Privatbanken ASA by Skandinaviska Enskilda Banken AB

DnB NOR expands eastwards

- Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised DnB NOR Bank ASA to acquire 51 per cent of the shares of Bank DnB NORD AS. The bank will operate in Denmark, Finland, Poland and the Baltic states.
- Kredittilsynet advised the Ministry of Finance to authorise DnB NOR Bank ASA to acquire the Russian bank Monchebank in Murmansk.

Ministry of Finance awards licence to Silver Pensjonsforsikring AS, in line with Kredittilsynet's recommendation

Silver Pensjonsforsikring AS was authorised to engage in life insurance business. The company's main focus is on the market for paid-up policies.

Gjensidige Forsikring authorised to establish Gjensidige Pensjonsforsikring AS, as recommended by Kredittilsynet

The Gjensidige Forsikring Group applied in September 2005 for a licence to establish a life insurance company. The company will be a wholly owned subsidiary of Gjensidige Forsikring, offering life index-linked insurance and mediating and selling pure savings products with no investment element. As a condition for the licence the Ministry of Finance required Gjensidige Forsikring to set up an intermediate holding company.

Measures to promote competition in the pension products market

In response to an initiative by the Competition Authority, Kredittilsynet proposed in May 2005 an amendment to the product packaging regulations with a view to fostering competition in the market for pension products. The regulations have now been amended such that a life insurer that offers both retirement pension and disability and/or surviving dependant's insurance (risk cover) cannot omit to provide risk cover if it chooses to arrange retirement pensions through another provider.

Strong increase in new entrants to the estate agency market

The unprecedented growth witnessed in the real estate agency market in 2004 continued in 2005 which saw more than 100 new entrants to the market and a net increase of 70 estate agencies.

Regulatory framework

New capital adequacy rules

– For banks and investment firms

In June 2005 Kredittilsynet presented draft law amendments based on a directive proposal from the European Commission. In December 2005 the Ministry of Finance circulated for comment a proposal, based on the draft amendments, for implementing the new capital standard in Norwegian law. The proposal envisages transitional rules which will prevent minimum capital requirements from being set lower than 95 per cent of the current minimum requirement under Basel I in 2007. In 2008 and 2009 the corresponding floors will be 90 and 80 per cent respectively of the minimum requirement.

– For insurance companies

Against the background of the changed capital adequacy rules for banks and investment firms, Kredittilsynet drew up in autumn 2005 a consultative paper outlining alternative designs for provisional capital requirements to apply to insurance companies in the period 2007–2009 pending implementation of the Solvency II framework.

Prospectus Directive

Based on implementation of the Prospectus Directive in Norwegian law, new provisions were adopted concerning the design, contents, approval and publication of prospectuses. The new rules, which came into force on 1 January 2006, assign overarching responsibility to Kredittilsynet, while Oslo Børs is responsible for the operative control of prospectuses.



Nominee registration of Norwegian company shares

The Nominee Registration Committee, on which Kredittilsynet has one representative, delivered in June 2005 its report NOU 2005: 13 *Nominee registration of Norwegian company shares*. The committee unanimously recommended that domestic investors should not be permitted to register shares of Norwegian companies in the name of a nominee. They also recommended that foreign investors' right to do so should be retained. The proposal of the Nominee Registration Committee broadly continues the current arrangement.

Directive on Markets in Financial Instruments (MiFID)

This directive was proposed by the EU Commission on 21 April 2004. Based on postponements proposed thus far, the date of implementation could be 1 November 2007. The directive brings a wide-ranging revision and enlargement of the current regulation of investment firms' business and market places etc.

Changes to the Debt Collection Act

Amendments to the Debt Collection Act, imposing a fit and proper requirement on senior managers at debt collection agencies, went into force on 1 January 2006. From now on, not only the CEO, but also general managers, board members and owners of significant interests in debt collection agencies must be fit and proper to engage in debt collection in conformity with laws, regulations and good debt recovery practice.

Changes in estate agency rules

Several of the amendments to the Estate Agency Regulations that were adopted in 2004 came into force in 2005. All estate agency firms and lawyers engaged in estate agency were required to double the security put up for their estate agency business from NOK 10 million to NOK 20 million. Stricter requirements on the CEO's presence on the premises mean that as a rule one person cannot be effectively in charge of two or more agencies. In 2005 the Estate Agency Act Committee completed a general revision and updating of the Estate Agency Act. Its recommendation was delivered to the Ministry of Finance at year-end, and is expected to be circulated for comment in February 2006.

Kredittilsynet decides to lower the interest rate guarantee in life insurance

Kredittilsynet decided in November 2005 to lower the maximum guaranteed interest rate in life insurance from 3 per cent to 2.75 per cent for all life insurance contracts established after 1 January 2006. Should long interest rates not rise significantly, a maximum guaranteed rate of 2.75 per cent or lower should also apply to new accrual on established group contracts from 1 January 2007 onwards.

Guarantee scheme for non-life insurance companies

Following a consultative paper from Kredittilsynet and a Government Bill from the Ministry of Finance, Parliament (the Storting) adopted changes to the existing guarantee arrangements for insurers. The guarantee scheme, which is unfunded, will ensure that insurance customers' claims are met should a non-life insurer be unable to honour its obligations. Norwegian branches of any non-life insurer whose head office is in

another EEA state, and in the event other branches, will be mandatory members of the scheme. Kredittilsynet forwarded draft regulations to the Ministry of Finance in December 2005.

Regulations to new Insurance Act drafted

In autumn 2004 Parliament adopted amendments to the life insurance legislation. Subsequently editorial changes have also been made. Key aims of the Act are to draw a clearer distinction between the assets of the insured and those of the insurer, a clearer distribution of risk between customer and insurer and clearer pricing of life insurance products. Kredittilsynet sent draft regulations to the Ministry of Finance in October 2005.

New Act on Insurance Mediation

With a background in the EU Insurance Mediation Directive, and after a consultative paper from Kredittilsynet and a Bill from the Ministry of Finance, a new Insurance Mediation Act was passed. The Act and associated regulations came into force on 1 January 2006.

Compulsory occupational pension schemes adopted

As part of a compromise on future basic state pensions, Parliament imposed a mandatory pension scheme on all employers within the framework of the Defined Contribution Pensions Act or the Defined Benefit Pensions Act. The Act came into force on 1 January 2006.

New instruments proposed by Kredittilsynet to enhance supervision of compliance with securities market conduct rules

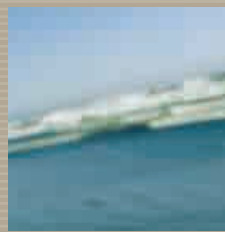
In October 2005 Kredittilsynet wrote to the Ministry of Finance recommending changes to the Securities Trading Act to enable Kredittilsynet to respond to less serious rule breaches by imposing administrative penalties, and not simply refer all violations to ØKOKRIM or another prosecuting authority. Provisions on administrative penalties will put the machinery for dealing with violations in this area on a more efficient footing.

Regulations on auditor independence

Based on amendments of 4 March 2005 to the Auditors Act, the Ministry of Finance adopted on 26 August 2005 amendments to the Regulations on Auditing and Auditors which had been drawn up by Kredittilsynet. The regulations require an auditor to pre-empt any risk of his auditing the result of his own consulting services or of performing functions that belong to the audited entity's decision-making process. He must also avoid putting himself in a situation in which, over time, his total income from non-audit services becomes substantial compared with the audit fee from the same client.

Regulations on external accountants

In September 2005 Kredittilsynet circulated draft amendments to the External Accountants Regulations for comment. The amendments address higher requirements on education, changes in the continuing education requirement and further regulation of the rule requiring authorisation of the person effectively in charge of an external accountancy firm. They also eliminate exemptions from the authorisation requirement in certain sectors.



Supervision and regulatory compliance

9

Supervision of the supervisor

The International Monetary Fund (IMF) assessed the Norwegian financial system's supervisory regime in 2005 as part of its Financial Sector Assessment Program (FSAP) for Norway. The assessment was largely positive. Norges Bank and Kredittilsynet followed up the IMF's call for better organised cooperation between the various authorities in a letter to the Ministry of Finance of 16 December 2005.

Kredittilsynet to control the financial reporting of listed companies

As from 2005 listed companies are required to apply international financial reporting standards (IFRS) when preparing consolidated accounts. In Norway Parliament has given Kredittilsynet responsibility for overseeing that this is done properly. At end-2005 about 280 Norwegian-registered issuers of shares, primary capital certificates and bonds were subject to Kredittilsynet's accounting controls.

Unlawful activity in the securities market

The on-site inspection effort in 2005 focused on firms engaged in unlawful business, especially internet brokers' use of intermediaries. As a result a number of firms and individuals had to cease business. The most serious cases were brought to light in the Kristiansand area where a number of clients had been defrauded.

Sundal Collier Fondsforvaltning ASA and Sundal Collier Institusjonell Forvaltning ASA

At an on-site inspection at Sundal Collier Fondsforvaltning ASA, selected portfolio overviews and securities fund transactions were scrutinised. Kredittilsynet uncovered violations of several provisions of the Securities Trading Act. The violations were serious enough to warrant withdrawal of the company's licence to carry on fund management, and the company and its CEO were reported to the police. Subsequent enquiries revealed that Sundal Collier Institusjonell Forvaltning ASA also violated provisions of the Securities Trading Act, again seriously enough to warrant withdrawal of the company's licence to engage in active management.

Investigation of nominee registered accounts at the Norwegian Central Securities Depository (VPS)

In September 2005 Kredittilsynet undertook an investigation of nominee registered accounts at VPS. The investigation is designed to identify the extent to which nominees can provide information on the real owners of underlying holdings of financial instruments. Results so far show that a number of nominees are unable to disclose this information. Several were warned in December 2005 that they risked losing their authorisations.

New products from Nord Pool and Imarex

Early in 2005 Nord Pool was authorised to quote CO2 quotas

and CO2 quota derivatives, and in autumn 2005 its licence was extended to include derivatives on green certificates. Nord Pool Clearing was concurrently authorised to act as clearing house for the above products.

Inspections at the debt collection companies Intrum Justitia and Bryn Creditservice

Kredittilsynet carried out extensive inspections at one of Norway's largest debt collection companies, Intrum Justitia AS and its subsidiary Bryn Creditservice AS. The controls revealed basic shortcomings in handling client assets, and highly deficient routines and preparedness in relation to the ICT regulations. At Bryn Creditservice AS, breaches of good debt recovery practice were serious enough to close down the company. Intrum Justitia AS was allowed to continue subject to board and management replacements and improved reporting routines.

Inspections at the real estate agencies Notar Eiendom Bergen AS and Notar Nybygg Bergen AS

Kredittilsynet withdrew Notar Eiendom Bergen AS' and Notar Nybygg Bergen AS' corporate licences at year-end after thorough checks at the two companies in 2005. Extensive trading for own account was brought to light in housing projects in which the companies had agency assignments, and in several cases they made a substantial profit on rapid resale of properties. Unsound settlement practices and highly deficient record keeping on the part of the companies were also revealed. The estate agency business was transferred to a new company – Notar Eiendom Bryggen AS – which was granted a licence after a close assessment of the fitness and propriety of the new owners and the new manager.

Supervisory collaboration with the Norwegian Association of Authorised Accountants (NARF)

Kredittilsynet has initiated collaboration with NARF on quality control. Under the guidelines for the collaboration Kredittilsynet will not as a rule carry out random on-site inspections of NARF members unless NARF's procedures bring to light circumstances that must be reported, or Kredittilsynet needs to perform its own controls on other grounds. The scope, frequency and organisation of NARF's controls of its members, along with access and information-exchange issues, are covered in the guidelines.

Kredittilsynet's scrutiny of KPMG – indictment and compensation claim against the company

In the wake of the Finance Credit affair, charges were brought against KPMG as a company and against the statutory auditor, while various creditors, including the involved banks, brought claims for compensation. In spring 2005, prompted by what had emerged, Kredittilsynet decided to scrutinise the audit company's organisation, routines and procedures in relation to audit assignments. Kredittilsynet had no significant comments on the way KPMG's business is presently organised.

Organisational set-up and resource use

10

Board of Directors

Kredittilsynet's Board of Directors has by law the overarching responsibility for the agency's activities and handles important matters in relation to regulations and licences, budgets and action plans. The Board has five members. Members and alternates are appointed by the King in Council for a four-year period.

Kredittilsynet's Board, appointed 1 March 2002, comprises the following:

Mr Finn Hvistendahl, chartered engineer, Chairman

Mr Endre Skjørestad, advocate, deputy chair

Ms Eli Aas, advocate, board member

Mr Erling Steigum, professor, board member

Ms Nina Mår, court of appeal judge, board member

Ms Marianne Berg, district court judge, first alternate

Mr Lasse Ekeberg, director at the Norwegian Competition Authority, second alternate

A letter from the Ministry of Finance dated 10 August 2005 granted **Nina Mår's** application to be released from her duties as board member. District court judge **Marianne Berg** was appointed as a new board member, and **Mette Bjørndal**, associate professor, was appointed as a new first alternate.

Mr Birger Vikøren, director at Norges Bank, attends as observer. **Mr Thorvald Grung Moe**, special adviser, is his alternate.

Two members elected by and from among the employees supplement the board when administrative matters are dealt with. Since February 2005 the employee representatives have been:

Ms Lisbeth Strand, senior adviser

Ms Angela Nygaard, senior adviser

Alternates: **Ms Nina Moss**, international coordinator, and **Ms Tone Aarland**, special adviser.

Eleven ordinary and two extraordinary board meetings were held in 2005. The board dealt with a total of 44 administrative matters and 62 supervisory matters requiring decisions. The board was also informed about 55 administrative matters and 127 supervisory matters.

The Board of Directors of Kredittilsynet

Back row from left to right:
Endre Skjørestad, Finn Hvistendahl, Eli Aas, Angela Nygaard, Thorvald Grung Moe (alternate to the observer from Norges Bank).

Front row from left to right:
Lisbeth Strand, Marianne Berg, Mette Bjørndal (Erling Steigum and Lasse Ekeberg were not present when the photograph was taken).



Photograph: Morten Brun

Priorities in 2005

Kredittilsynet's supervisory activities are based on statutory tasks, the Ministry of Finance's annual letter of allocation, based on the budget adopted by the Storting, and Kredittilsynet's strategy. Kredittilsynet's strategy was adopted by the Board in November 2002 and, together with signals given by the Ministry, guided Kredittilsynet's priorities in 2005. Against this background the Board of Directors of Kredittilsynet resolved that the following issues should have the highest priority in 2005:

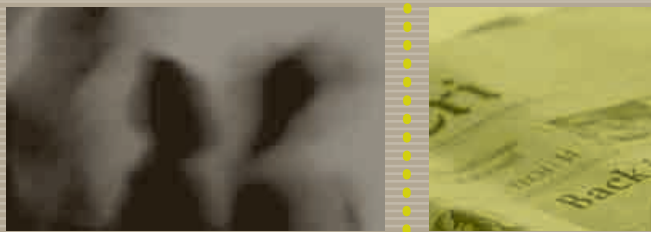
1. Ensure the efficient introduction and implementation of supervision of listed companies financial reporting
2. Adapt the capital adequacy framework to the requirements of Basel II / EU and facilitate risk-based supervision
3. Monitor structural and other changes in the Norwegian and international economy of significance to financial institutions and financial markets
4. Follow up the credit and liquidity risk of the banks and monitor developments in property markets and households
5. Follow the situation of life insurance companies with regard to solvency and buffer capital and profitability in light of interest rate levels and asset composition and assess possible measures
6. Efficiently enforce the rules of conduct in the securities market and the market for electricity derivatives
7. Work on rule simplification and measures to ensure efficient resource use
8. Initiate a preliminary project to prepare the strategy process in 2006

Kredittilsynet's management team

From left to right: Bjørn Skogstad Aamo, Gun Margareth Moy, Kjetil Karsrud, Sven-Henning Kjelsrud, Cecilie Ask, Anne Merethe Bellamy, Eirik Bunæs.



Photograph: Morten Brun



Goal achievement in 2005

Both general and more specific goals were satisfactorily achieved in 2005.

No banks experienced serious solvency or liquidity problems. Financial stability was enhanced with all categories of banks reporting very small losses, healthy earnings and satisfactory financial positions. Non-life insurance companies too recorded good profitability. Life insurance companies posted good returns. Nevertheless, had their buffer capital been higher, their chances of harvesting profits from the stock market would have been enhanced, since the low interest rate levels generated low returns on the fixed income market.

The report entitled *The Financial Market in Norway 2005: Risk Outlook* (available at www.kredittilsynet.no) takes a closer look at financial stability and other aspects of Norway's financial industry. Although corporate credit risk is less than in the past, the sharp increase in household debt is a cause for concern in the medium term. When credit is granted for corporate investments, account must be taken of possible lower economic growth and capacity utilisation at some point ahead.

During 2005 Kredittilsynet cooperated with ØKOKRIM and other police entities in bringing to light and pursuing a number of violations of the securities market legislation.

With the supervision of the financial reporting of listed companies Kredittilsynet's responsibility for ensuring that the markets function smoothly and efficiently has increased. The practical measures taken to this end are proceeding according to plan. Kredittilsynet is also on track in its preparations for new capital adequacy regulations.

A number of measures have been implemented aimed at increasing the efficiency of the work, including the use of the "Altinn portal" and other systems for electronic reporting and case processing. Kredittilsynet has essentially achieved its targets as regards case processing time (see Table 1).

Several projects have been initiated in preparation for a review of Kredittilsynet's strategy in 2006, including a report entitled "Goals and performance measurement – input to Kredittilsynet's next strategic plan".

Administration, staff and gender equality

Kredittilsynet's Director General is appointed by the King in Council for a six-year term. **Mr Bjørn Skogstad Aamo** was appointed for a new six-year term in February 2005 with effect from April 2005.

The Director General's salary at the end of 2005 totalled NOK 975,000, and the Chairman of the Board's fee was NOK 170,000.

Thirty-six vacancies were advertised in 2005, compared with 27 in 2004. Eight of the vacancies were internal, the same number as in 2004. Applicants totalled 782, compared with 431 in 2004. Two new heads of section were appointed as a consequence of the allocation of new tasks and additional responsibility to Kredittilsynet.

At the end of 2005 Kredittilsynet had 196 permanent staff, compared with 186 at the end of 2004. Fifty per cent of the

full time staff are women. Eighty-five per cent of the staff hold university degrees or the equivalent.

Women constituted 43 per cent of Kredittilsynet's management team in 2005. Thirty-six per cent of managers with personnel responsibility were women. While an effort is made to recruit women to senior positions, the success of this effort depends on existing positions becoming vacant or on new senior positions being established. Women's pay measured 89.8 per cent of men's pay in 2005, compared with 88.1 per cent in 2004. This development reflects the priority given to equal pay in Kredittilsynet's in-house pay policy. The gender equality effort is anchored in the work-environment and gender-equality committee. An elected representative for gender equality attends meetings of the committee on a regular basis. The committee routinely reviews pay statistics for each job category and for Kredittilsynet as a whole in order to keep abreast of equal pay development.

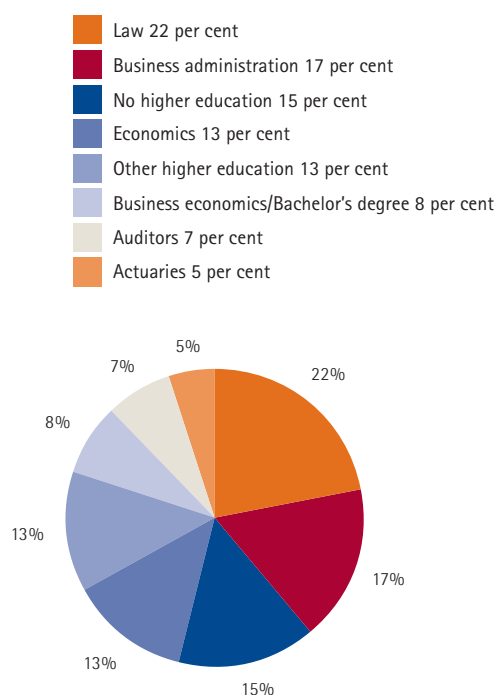
Kredittilsynet attaches much importance to building up and maintaining the expertise needed to perform effective supervision, and this is reflected in its pay and personnel policy. Whereas in 1995, 24 members of staff had substantial experience (generally more than five years) from industries under supervision, by the end of 2005 this figure had passed 50. Kredittilsynet is now more successful than just a few years ago at retaining staff who have gained long supervisory experience and staff who have developed a high level of expertise during their career with Kredittilsynet. Achieving this goal may necessitate a flexible pay policy. Kredittilsynet's staff turnover in 2005 was 7.5 per cent compared with 7 per cent in 2004.

With its espousal of the Government sponsored "IA Agreement" designed to promote inclusive employment, Kredittilsynet emphasises the importance of preventing sickness absence and maintaining the agency's low level of sickness absence, which was 2.7 per cent in 2005. The IA Agreement is also designed to prevent discrimination of physically and mentally challenged applicants who apply for jobs with the agency and to raise the de facto retirement age. Collaboration with the social security administration and corporate health service is given high priority under the IA Agreement.

Kredittilsynet's code of ethics and guidelines – which include guidelines for securities trading and use of supervised entities' services by Kredittilsynet's employees and officers – are working well. An amendment to the Financial Supervision Act in January 2005 (proposed by Kredittilsynet) permits the introduction of regulations prohibiting or otherwise restricting trading by Kredittilsynet's staff in quoted shares etc. (Trading

in shares etc. issued by supervised institutions is already prohibited.) Kredittilsynet has drafted regulations of this nature which are at present under review by the Ministry of Finance. The guidelines will be assessed and updated in light of regulations and general ethical guidelines applicable to public sector agencies.

Chart 1: Staff educational background as of 31.12.2005



Efficiency improvements

During 2005 Kredittilsynet worked on enhancing the efficiency of a number of functions. Using the Common Assessment Framework (CAF) model, Kredittilsynet analysed the scope for reprioritising and simplifying the activities of the agency. Other potential efficiency measures not encompassed by the CAF model were also considered. The results of the analysis will be followed up in the strategy process, the activity plan for 2006 and in reports to the Ministry of Finance. The results encompass the coordination of regulations and improved supervisory methods and administrative routines.

The work on enhancing efficiency includes increased use of electronic communication between Kredittilsynet and supervised institutions, including electronic reporting. Reporting by auditors and auditing firms via the "Altinn portal" commenced in 2005. In addition preparations were made for other groups

to commence equivalent reporting. Kredittilsynet has also developed a technical system designed to provide better support for general case processing and for the management. One feature of this system is that it provides continual updates of in-house registers from external data sources at the Brønnøysund Register Centre and the Tax Administration.

Kredittilsynet introduced electronic case processing in 2004. Development of the system continued in 2005, a process that provided better overview and easier access to case documents. Moreover, preparations were made for the transition to fully electronic archiving. This offers major efficiency gains for the supervisory departments, one benefit being that the management and case officers have far greater and documented scope for control and follow-up.

Case processing time

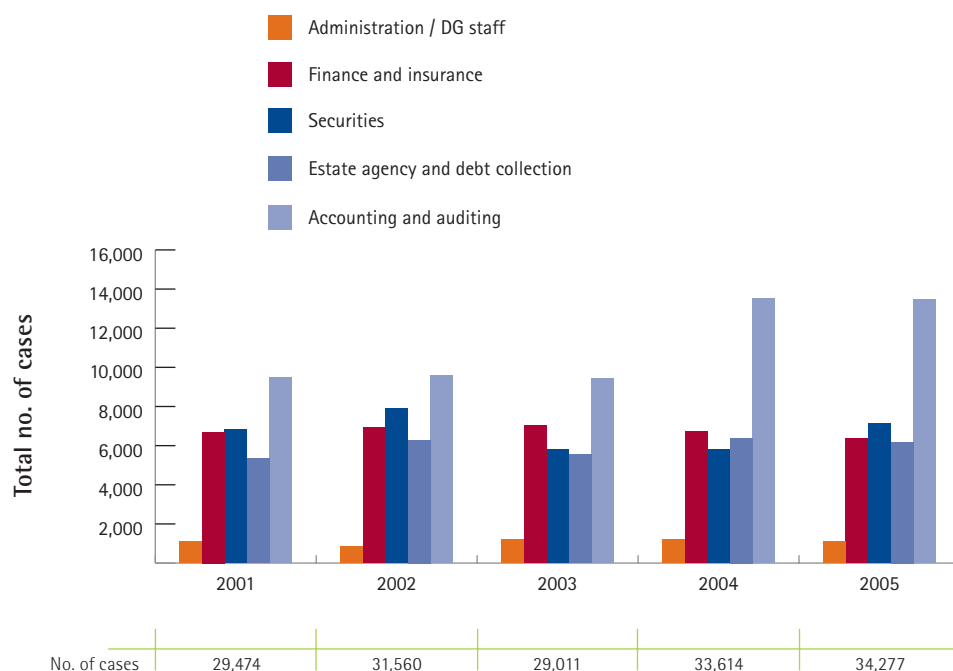
Since 2003, in keeping with Kredittilsynet's strategy, specific targets have been set for the time spent on a selection of administrative cases and for supervisory reports and resulting observations. The aim is to process 90 per cent of such cases

within 30 days. For some types of complex cases, a longer period is allowed. The deadline for supervisory reports and ensuing observations varies from one area of supervision to the next. Target achievement is reported on a quarterly basis, and detailed results are published at www.kredittilsynet.no.

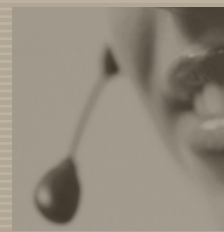
Table 1: Case processing time at Kredittilsynet in 2005

	No. of cases	Overall target achievement
Total no. of cases with processing-time target	1,718	78.6%
– Cases with 30-day deadline	1,201	90.8%
– Cases with longer deadline than 30 days	517	47.0%
Supervisory reports	184	74.5%
Supervisory comments	145	80.0%

Chart 2: Registered case documents – by sector*



*Cases in the finance and securities sector are significantly more complex than cases in other sectors.



Finances

15

Expenditure

Kredittilsynet's budget forms part of the government budget and is established by the Storting. The budget for 2005 totalled NOK 156.0 million. Including funds of NOK 3.86 million carried forward from 2004, the budget came to NOK 159.86 million. Kredittilsynet received an additional NOK 2.35 million in refunds of maternity and sickness benefits. The aggregate disposable budget accordingly came to NOK 162.21 million, while aggregate expenditure came to NOK 160.78 million, an increase of 10.2 per cent on 2004. Total salary expenditure rose by 14.4 per cent, while expenditure on goods and services increased by 1.2 per cent. Aggregate expenditure was just over NOK 1.4 million less than disposable revenues. Unutilised revenues will be carried forward to 2006.

As in the case of other government agencies included in the central government accounts, Kredittilsynet's accounts are prepared on a cash basis and, unlike in the case of private businesses, not an accruals basis. The accounts are prepared based on the central government chart of accounts which employs natural classification of revenues and expenses. Based on this chart, Kredittilsynet has classified expenditures by function. The main classification by function is shown in table 2.

The closing letter dated 24 June 2005 from the Office of the Auditor General on the subject of the accounts for 2004 had no adverse comments on the accounts or on Kredittilsynet's implementation of the budget.

Table 2: Kredittilsynet's accounts

	2003	2004	2005
Salaries bill	94,866	100,058	114,439
Of which:			
Salaries and social costs (all positions)	91,736	95,725	111,090
Stand-ins/substitutes	2,396	3,715	2,391
Other emoluments (directors, consultants / other fees)	734	618	958
Goods and services	39,939	45,805	46,344
Of which:			
Operating expenses	16,420	16,640	17,381
Information	3,033	3,246	3,679
Service travel and meetings, subscriptions	4,185	6,307	6,446
Inspections and other supervision	4,615	5,509	3,123
Organisational development, management and competence development	4,054	4,949	6,102
IT expenditure	7,632	9,154	9,613
Total expenditure	134,805	145,863	160,783

Figures in NOK 1000s
(Preliminary accounts for 2005)

Comments

Kredittilsynet's expenses have risen in recent years, the main reason being a wider scope of responsibility resulting from new tasks and from legislative changes placing new demands on Kredittilsynet. This is true not least of EU legislation, which Norway is obligated to implement. A pertinent example is the new capital adequacy framework and the development of risk-based supervision. In 2005 Kredittilsynet was allotted responsibility for oversight of listed companies' financial reporting. A new section was created to perform this function. This is a key reason for the significant increase in pay costs recorded by Kredittilsynet and for the rise in the employer's premium payable to the Public Service Pension Fund as a result of a change in the method of calculation. Normal expansion of the

securities market, of the financial industry and of the number of auditor and external accountant entities also requires an increased effort on Kredittilsynet's part if supervisory standards are to be maintained. Active use of tendering processes has helped to keep down operating expenses. Expenditure on inspection visits and other supervisory work fell between 2004 and 2005. This was the result of a reduction in the number of inspections because of extensive work on regulation drafting and because less outside expertise was hired in. The increased expenditure on organisational development, consultants and competence development can be attributed to an efficiency project and the use of external assistance to assess future office premises for Kredittilsynet.

Revenues

Under section 9 of the Financial Supervision Act, Kredittilsynet's expenses are covered by the institutions under its supervision at the start of the financial year. The Storting therefore adopts a revenue appropriation equal to the expenditure appropriation. The Act requires the expenses to be apportioned among the various institutional groups based on the extent of the supervision, and the expenses are therefore paid in arrears. With effect from the levy for 2004 contributions are also claimed from branches of companies from other EEA states.

The total amount levied for 2004 was NOK 143.9 million. The amount levied was smaller than actual expenses because a) the levy is based on the budget appropriation, b) any amount carried forward from the previous year is deducted and c) part of the expenses are covered by the National Insurance Fund through refunds of maternity and sickpay outlays. The levy proposed by Kredittilsynet for 2004 was approved by the Ministry of Finance on 7 July 2005 after prior consultation with the trade organisations concerned. Foreign branches had been informed of the proposal in advance. Supervised entities liable to pay the amount levied for 2004 number 10,372, of which 65 are foreign branches. The figure in 2003 was 9,792. The apportionment of the levy among the various categories of supervised entities is shown in chart 3. The foreign branches pay 2.8 per cent of the amount levied.

Chart 3: Total levy distributed by supervised groups

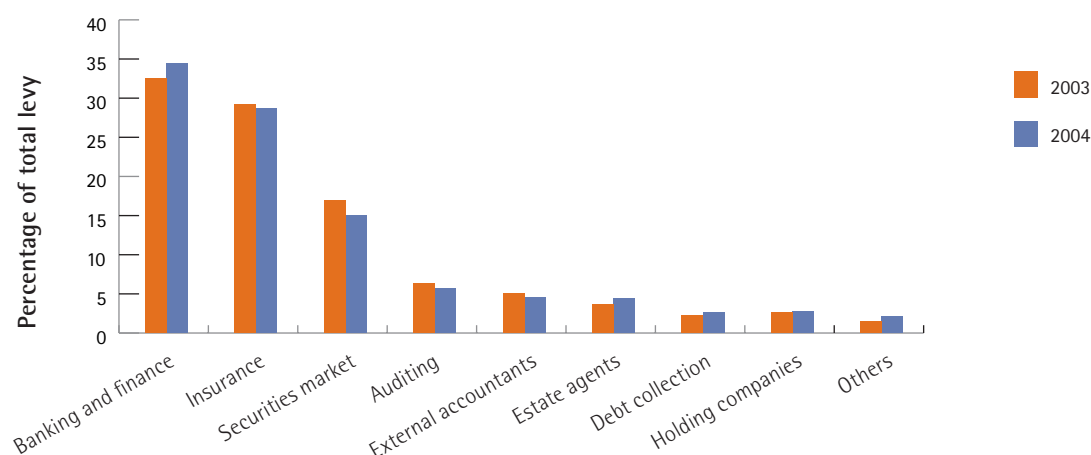


Table 3: Total levy as percentage of calculation base

Supervised groups	Calculation base	Percentage of calculation base		
		2002	2003	2004
Credit institutions	Total assets	0.0024	0.0023	0.0025
Insurance	Premium income	0.0404	0.0357	0.0345
Investment firms	Income from investment and ancillary services	0.2343	0.2335	0.1997
Management companies	Assets under management	0.0047	0.0037	0.0031
Estate agency	Commission income	0.1619	0.1315	0.1516
Debt collection	Debt collection proceeds	0.1896	0.1767	0.2122
Auditors	Turnover	0.1925	0.2410	0.2345

Table 3 shows the size of the levy as a percentage of the calculation base for various groups of supervised entities. External accountants are omitted from the table since they pay an identical annual levy irrespective of turnover. There is some variation between the groups in terms of the trend in

the percentage of the levy they pay, due in part to conditions in the respective industries. Although Kredittilsynet's expenditure rose by 18.0 per cent between 2002 and 2004, the levy burden borne by most groups has declined.

Resource input by institution

Table 4 shows an increase in resource input from 2004 to 2005 equivalent to about seven full-time positions. This was five fewer than planned. The reason is that some new positions are filled later than envisaged, that vacancies have increased, and

that long-term absence has risen slightly. The table shows a marked increase compared with 2004 in resource inputs to the securities area and to the new area of financial reporting oversight.

Table 4: Resource input by institution

	2003		2004		2005	
	FTEs	Per cent	FTEs	Per cent	FTEs	Per cent
Banks	34.3	19.7	37.0	20.8	38.5	20.8
Finance companies	2.9	1.7	2.9	1.6	2.6	1.4
Mortgage companies	1.7	1.0	1.9	1.0	1.8	1.0
Insurance companies	29.5	16.9	28.9	16.2	25.7	13.9
Holding companies	3.1	1.8	3.3	1.9	3.8	2.0
Pension funds	5.6	3.2	5.9	3.3	5.0	2.7
Securities market	29.4	16.9	28.8	16.2	32.0	17.3
Estate agents	5.4	3.1	6.6	3.7	6.1	3.3
Debt collection	3.4	2.0	3.6	2.1	2.5	1.3
Auditors	8.1	4.7	7.5	4.2	7.5	4.1
Accounts in general	2.3	1.3	2.0	1.1	0.3	0.2
Financial reporting					4.8	2.6
External accountants	6.6	3.8	6.0	3.3	8.2	4.4
Miscellaneous	0.6	0.4	0.8	0.5	1.5	0.8
Undistributed	41.1	23.6	42.8	24.0	44.5	24.1
Total	174.1	100	178.0	100	185.0	100

FTEs – Full-time equivalents

Information and communication

Kredittilsynet views information and communication as a strategic instrument of supervision, especially with a view to preventing breaches of rules and standards. The information effort is directed in the first instance at institutions and sectors under supervision, and is based on the principles guiding the central government information policy. The information and communication aspect is incorporated in Kredittilsynet's strategy, and is also elaborated on in a separate communication strategy.

Kredittilsynet attaches importance to contact with sectors under supervision, and holds regular meetings with trade organisations. Similar meetings are held with collaborating public authorities. Collaboration with the Consumer Council is formalised in a special agreement, and in 2005 Kredittilsynet collaborated with the Consumer Council and the Office of the Consumer Ombudsman on a joint project in which a working group considered various solutions for establishing an internet-based information portal aimed at improving the information available to private customers in the financial market (see account in the chapter *Other Issues*, page 66).

Kredittilsynet also participates widely in seminars for trade organisations and institutions under supervision, and numerous presentations are given on the agency's activities and tasks, as well as on rules and guidelines affecting supervised entities. Kredittilsynet organised a seminar on the consequences for Norwegian law of the EU Market Abuse Directive and on the transition by listed companies to IFRS in 2005. The target audience included issuers of listed securities. In addition, two

information seminars for investment firms were organised in collaboration with Oslo Børs. The topics covered included updates on ongoing processes within the European Union and current issues of general interest.

Twenty-one circulars were issued in 2005 compared with 19 in 2004, and 50 press releases compared with 38 in 2004. One press conference was held.

Kredittilsynet's website, a key channel for information from Kredittilsynet, was further developed in 2005. One new feature of the site was a provisional register in Norwegian and English of banks, finance and insurance businesses licensed by Kredittilsynet. The register is linked to the Register of Business Enterprises at Brønnøysund.

Kredittilsynet has an extensive network of contacts. Each year Kredittilsynet's management and other staff meet a large number of representatives of supervised institutions, trade organisations, collaborating authorities and international contacts. Kredittilsynet's officers meet many of these contacts in the field. Kredittilsynet received 1,970 visitors in 2005 compared with 1,932 in 2004. Eighty-three per cent of the visitors were from south-east Norway including Oslo.

According to user statistics the website had just over 97,000 unique visitors in 2005, accounting for a total of 320,000 page views. This represents an increase in unique visitors from 2004 when 92,000 unique visitors accounted for 270,000 page views.

Key figures and data on supervisory activities

Table 5: Figures for supervised entities as of 31 December

	2001	2002	2003	2004	2005
Banks and financial institutions					
Savings banks	129	129	129	127	126
Commercial banks	15	16	15	13	14
Foreign branches of commercial banks	10	10	9	10	10
Norwegian branches of foreign banks	8	8	8	8	9
Finance companies	35	33	29	28	30
Foreign branches of Norwegian finance companies	2	2	2	2	3
Norwegian branches of foreign finance companies	21	21	21	22	17
Mortgage companies	10	10	10	11	11
Norwegian branches of foreign mortgage companies	1	1	1	1	1
E-money institutions					
E-money institutions	–	–	4	5	5
Insurance					
Life insurance companies	8	7	7	6	6
Unit Linked companies	8	6	6	5	5
Non-life insurance companies	53	52	46	46	46
Local marine insurance associations	14	14	13	13	13
Local fire insurance associations	20	20	20	20	20
EEA branches and foreign companies' general agents	29	29	30	33	39
Insurance brokers	49	50	50	49	56
Private pension funds	122	120	107	95	93
Pension schemes	70	65	50	33	22
Municipal pension funds	29	29	30	30	29
Holding companies					
Holding companies	12	13	8	8	8
Securities markets					
Investment firms	93	92	87	78	75
Management companies for securities funds	28	24	23	21	21
Clearing houses	1	2	2	2	2
The Norwegian Central Securities Depository	1	1	1	1	1
Stock exchanges	1	2	2	2	2
Autorised market places	–	2	1	1	1
Auditors					
Auditors	4,824	5,006	5,154	5,358	5,495
Auditing firms	514	507	514	518	569
External accountants					
External accountants	5,856	6,201	6,598	6,724	7,179
External accounting firms	2,377	2,415	2,566	2,542	2,632
Estate agency					
Estate agencies	507	528	542	572	642
Lawyers' practices incl. estate agencies	1,016	1,018	1,094	1,178	1,213
Cooperative building associations	67	55	47	41	39
Debt collection					
Debt collection agencies	113	113	123	114	121
Debt purchase business	–	8	10	10	8

In addition Kredittilsynet supervises the financial reporting of approximately 280 listed companies.

The Banks' Payment and Central Clearing House (BBS) and EDB Business Partner ASA are not under the direct supervision of Kredittilsynet, but are relevant for Kredittilsynet's supervisory activity as providers of technical solutions to Norwegian financial institutions.

Table 6: Number of on-site inspections by type of institution (including IT inspections)

	2001	2002	2003	2004	2005
Banks/finance	51	55	53	57	49
Holding companies	2	2	–	4	2
Insurance	12	16	19	11	9
Insurance brokers	6	4	6	3	1
Pension funds	5	8	5	4	1
Investment firms	20	20	23	18	22
Other institutions in the securities market (incl. management companies for securities funds)	10	9	13	7	14
Auditors	73	32	19	65	52
External accountants	62	41	35	29	56
Estate agencies	60	71	12	19	22
Debt collection agencies	5	6	12	26	7
Data processing centres	1	2	2	2	5

Table 7: Number of IT inspections (on-site) by type of institution

	2002	2003	2004	2005
Banks/finance	4	6	4	9
Holding companies	2	–	2	1
Insurance	2	1	2	1
Insurance brokers	–	–	–	–
Pension funds	8	–	–	–
Investment firms	1	4	4	5
Other institutions in the securities market (incl. management companies for securities funds)	5	4	4	6
Auditors	–	–	–	–
External accountants	–	4	1	1
Estate agencies	–	–	1	1
Debt collection agencies	–	–	1	2
Data processing centres / IT providers	2	2	2	5
Other	–	–	1	–

IT inspections are often conducted in conjunction with ordinary inspections.
The number of IT inspections in Table 7 is also included in Table 6.

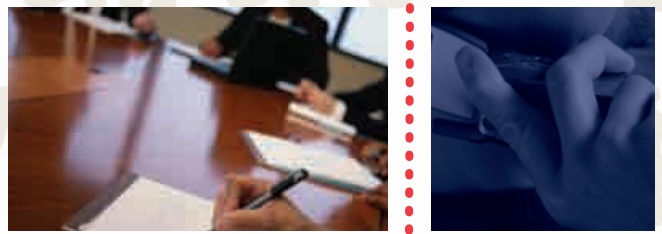
Table 8: Cases handled after delegation from the Ministry of Finance

	2001	2002	2003	2004	2005
Cases pursuant to Savings Bank Act (No. 1 of 24 May 1961)	28	50	46	69	71
Cases pursuant to Commercial Banks Act (No. 2 of 24 May 1961)	13	12	21	32	21
Cases pursuant to Financial Institutions Act (No. 40 of 10 June 1988)	64	59	53	130	131
Cases pursuant to Insurance Activity Act (No. 39 of 10 June 1988)	37	36	74	45	50
Cases pursuant to the Guarantee Schemes Act (No. 75 of 6 December 1996)	–	–	–	–	–

Banking and finance

Supervision of banking and finance is intended to ensure satisfactory financial strength, risk awareness, management and control of institutions and to promote financial stability and smoothly functioning markets. It comprises on-site supervision, off-site supervision, macroeconomic surveillance, administrative and consultative tasks as well as responsibility for drafting regulations.





Financial stability

In its macroeconomic surveillance Kredittilsynet monitors trends in the Norwegian and international economy that may affect financial stability. Economic and market developments are collated with conditions among banks and other financial institutions that are brought to light in analyses and inspections. Based on its findings, Kredittilsynet sends half-yearly reports to the Ministry of Finance and Norges Bank. It also sends quarterly reports to the Ministry of Finance on the situation among financial groups, banks, mortgage companies

(credit institutions) and finance companies. All the above reports are confidential. A further quarterly report is published on general trends among these institutions. Kredittilsynet's yearly report entitled *The Financial Market in Norway: Risk Outlook*, published in late February/early March, provides a synopsis of the state of the Norwegian financial industry based on economic, market and institutional developments. Kredittilsynet and Norges Bank collaborate on monitoring financial stability.

Analyses

In 2005, as in 2004, macroeconomic surveillance and analyses of financial institutions devoted much attention to the rapid growth in lending to households. In the past six years households' gross indebtedness has risen substantially, primarily among the lowest-income and youngest households, i.e. those most vulnerable to negative economic changes. Home mortgage loans have shown the strongest growth. Moreover, much of this borrowing has a high loan-to-value ratio and only a small portion carries a fixed interest rate. In the short term, however, banks' credit risk on exposures to the household sector is reduced by high activity levels in the Norwegian economy, low unemployment, low interest rates and rapidly rising house prices. In its analyses and presentations in 2005, Kredittilsynet emphasised that continued strong growth in debt and house prices ahead could heighten credit risk in the medium term, and that the surge in household indebtedness and in housing markets represents a substantial uncertain factor both for the financial markets and for the economy in general.

Regular analyses of financial institutions' profitability, financial soundness and risk exposure are carried out as well as ad hoc analyses of issues of current interest. Banks' results in 2005 were good, thanks mainly to very low loan losses and reduced costs. While banks' overall financial position is satisfactory, low interest rates have brought net interest margins under added pressure, and net interest revenues fell further in 2005.

Kredittilsynet's monitoring of banks' risk exposure to the household sector includes surveys of banks' credit practice. The results are published in an annual home mortgage loan survey. In 2005, as in 2004, Kredittilsynet examined banks' practice as regards loans secured on housing property. The survey covered about 30 banks, accounting for 85 per cent of the entire sector's home mortgage lending. The banks reported on the first 100 home mortgage loans granted after a given date, providing information on their routines for assessing borrowers' debt-servicing ability, data on collateral

furnished and data on households' loan-to-value ratios broken down by borrower age.

In 2005 Kredittilsynet conducted a survey to ascertain the degree to which borrowers received, and understood, information from banks on possible consequences of borrowing on their personal finances. After a similar survey in 2004, Kredittilsynet contacted the Norwegian Financial Services Association (FNH) and the Savings Banks Association with a view to ensuring that key information actually reaches and is understood by the borrower. The two trade organisations thereafter released a circular to their member banks stressing the need for customers to understand important aspects of their borrowing. The trade organisations concurrently instructed their joint documents committee to draft a new text for their standard loan documents, exemplifying consequences of higher interest rates. The documents committee's draft text was communicated to the banks in spring 2005.

In 2005 Kredittilsynet looked into banks' risk exposure to selected sectors including property management, construction, aquaculture and shipping. Banks' lending for the purchase of securities (secured on the same instruments) was also surveyed, as were loans to finance the purchase of interests/shares in real estate projects.

In order to throw light on households' sensitivity to interest rate increases, Kredittilsynet commissioned Statistics Norway, in 2005 as in 2004, to make a model projection of debt and interest burdens in the period to end-2006. The model, based on the wealth and income surveys, showed how an interest rate hike would affect households' interest burden.

Kredittilsynet regularly surveys finance companies whose main business is consumer finance. Thus far it appears that while these companies incur higher losses and defaults than other finance companies and banks, their risk pricing ensures sound profits.



In connection with the International Monetary Fund's (IMF's) review of the Norwegian financial system (Financial Sector Assessment Program – FSAP), the IMF conducted, in cooperation with Kredittilsynet and Norges Bank, stress tests of Norway's financial sector. The tests showed negligible vulnerability in the short term. In its report of June 2005 (Financial System Stability Assessment) the IMF none the less recommended the authorities to keep a close eye on the trend in household indebtedness and housing markets.

Analyses of economic, market and institutional developments form the background for Kredittilsynet's assessments of the general situation in the financial industry, and for the on-site inspections performed at institutions. The report entitled *The Financial Market in Norway 2005: Risk Outlook* provides further information on surveys, analyses and assessments.

Surveillance and analysis of the financial market is partly based on reporting by financial institutions. In conjunction with Statistics Norway and Norges Bank, Kredittilsynet devotes substantial resources to maintaining and refining systems

used by credit institutions and insurance companies to report data to the three authorities.

Oversight of compliance with statutory requirements

Off-site and on-site supervision entails overseeing financial institutions' compliance with statutory requirements – including those related to capital adequacy, liquidity and large exposures. Compliance with most of these statutory requirements can for the most part be monitored by checking the financial reports regularly submitted to Kredittilsynet.

Oversight of annual accounts

Reviews in 2005 of the annual reports of the largest financial institutions focused on financial statements' compliance with laws and regulations, and were confined to specific themes. This work prompted follow-up in the form of clarifications explained either in circulars or in letters directly to the institutions involved. Kredittilsynet's reviews did not bring to light significant deficiencies in the institutions' financial statements in the areas investigated.

Supervision of individual institutions in the banking and finance sector

The main aim of on-site inspections at banks is to ensure that they have the requisite financial strength and risk awareness, and that their management and control systems ensure satisfactory risk management. Forty-three inspections were carried out at commercial banks and savings banks in 2005.

In 2005 Kredittilsynet gave priority to preparing Overall Risk Assessments for the nine largest Norwegian banking groups. These assessments are used in the ongoing dialogue with the groups and form part of Kredittilsynet's preparations to meet the requirements of the new capital adequacy framework (Basel II), see the account on page 27. The assessments will form the basis for Kredittilsynet's own perception of the banks' risk profile and capital needs. Overall Risk Assessments will be prepared on an annual basis, and will be sent to the institutions' managements boards for comment.

The 2005 risk assessments were largely based on inspections of credit, liquidity and market risk, as well as scrutiny of banks' internal audit function. They were also based on internal analyses and reports, and on Norges Bank's bankruptcy prediction model. The assessments contain financial analyses, risk analyses, assessment of banks' risk management and capital allocation, and a concluding chapter on supervisory follow-up.

In 2005 risk analysis was in focus rather than banks' assessment of capital needs. Kredittilsynet intends to refine Overall Risk Assessment as a supervisory product. With this in mind, the

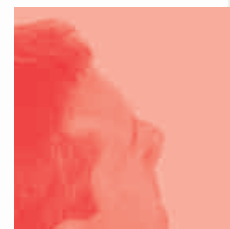
methodology underlying the assessments of credit, market and liquidity risk was published on Kredittilsynet's website in conjunction with the release of the 2005 analyses.

Credit risk

The largest banks' credit risk is assessed using a method developed by Kredittilsynet. Particular attention is given to institutions' concentration risk in relation to individual clients, industries, geographical areas etc., and portfolio quality is measured with the aid of Norges Bank's bankruptcy prediction model. According to the analyses, credit risk among most of the largest banks is low or moderate. In Kredittilsynet's assessment, however, some banks face somewhat higher risk. Kredittilsynet still sees room for improvement in banks' ability to price loans in relation to risk.

The largest banks' systems for management and control of credit risk are viewed as broadly satisfactory, although potential areas for improvement have been identified. Banks should for example do more to employ targets and limits in their management and control of credit risk, and early warning tools such as stress testing and industry analyses are absent at some banks.

Inspections at some fairly recently established smaller banks showed that it takes time for new banks to put in place a smoothly functioning system for management and control of credit risk.



Market risk

Market risk is assessed using a method developed by Kredittilsynet, in which stress testing of loss potentials related to share-price, interest-rate and currency risk are key elements. The calculations are done with a basis in exposure limits set by the banks' management boards. Risk diversification and market liquidity are also taken into account.

In 2005 market risk at the largest banks was to a large extent analysed off-site. In no case was market risk viewed as more than moderate. Based on on-site inspections carried out at some smaller banks, the conclusion was that share price risk was high due to excessively wide limits set by the management board. It was also pointed out that steps had not been taken to assure independent oversight of securities and currency trading.

Liquidity risk

Thematic inspections of liquidity risk were carried out at 14 large banks in 2005. Some smaller banks were also inspected due to presumed high liquidity risk. Kredittilsynet measures liquidity risk using two indicators of banks' long-term funding of illiquid assets. Importance is also attached to the stability of customer deposits, diversification of funding, liquidity of securities portfolios and volume of committed drawing rights. In the case of most banks, liquidity risk is considered to be low or moderate.

The 2005 thematic survey showed that all banks included in the 2002 survey had improved their management and control of liquidity risk in the intervening period. At some banks, however, attention was drawn to weaknesses in the limit system, to insufficient division of work and to a lack of independence between units and individuals performing different roles in banks' management and control systems.

Operational risk

Assessment of operational risk, including assessment of the internal control function, is a key aspect of on-site inspection. A new method of assessing operational risk, devised by Kredittilsynet in 2005, has been tested in one bank and will be revised in 2006.

During the risk assessment of some of the largest banks it was pointed out that strong expansion and a rapid pace of change may heighten operational risk. It was also pointed out that units responsible for risk management should be independent of business units, and that poorly defined roles and confusing organisation models might represent an operational risk. Recruiting and retaining specialist expertise may also involve operational risk.

Two of the largest banks have initiated complex integration projects in their IT units. The projects are closely monitored via IT inspections. In addition, the Terra banks carried out a very wide-ranging conversion project in 2005 entailing a switch both to a newly developed IT platform and to a new systems provider. Kredittilsynet has previously pointed to significant risk factors associated with this project which will be monitored by means of inspections.

Thematic inspections of the internal audit function

Kredittilsynet carried out thematic inspections of the internal audit function at ten of the largest banks in the first half of 2005. The background to the inspections was a requirement that financial institutions with total assets in excess of NOK 10 billion should establish an internal audit function as from 1 January 2004. While the inspections left an overall positive impression of standards and competence at the internal audit units investigated, the overall report and the observations made to individual institutions pointed to critical aspects at several institutions:

- In order to perform its role, the internal audit function must be assured genuine independence.
- The internal audit's role as the management board's "extended arm" is predicated on good dialogue between the internal audit and the management board.
- With a risk-based audit methodology, the internal audit function must base its audit plan on an independent risk assessment.
- Institutions should have clear-cut routines for acting on comments in the internal audit's reports.

Oversight of compliance with the Money Laundering Act at foreign branches

Kredittilsynet inspected three branches of foreign undertakings to check their compliance with the Money Laundering Act.

Nordic supervisory collaboration

The cooperation agreement in effect between the Nordic supervisory authorities on supervision of the Nordea Group requires regular exchange of information. The main priority in 2005 was to draw up an overall risk assessment and approval of Nordea's application to use internal rating models to compute capital charges. Kredittilsynet is also involved in the process of approving the Group's use of the standard method

for measuring operational risk. In addition, supervision of Nordea's outsourcing of IT operations continues.

Cooperation was established with the Icelandic Financial Supervisory Authority in 2005 on supervision of BNbank, Kredittbanken and Íslandsbanki.

Licensing and regulatory compliance

DnB NOR Bank ASA's branch opening in Shanghai, China

The Ministry of Finance authorised DnB NOR Bank ASA to set up a branch in Shanghai, China. The branch intends to service Norwegian and Nordic clients in China, with the main focus on banking services in the area of credits, guarantees and payments transmission.

DnB NOR ASA and Gjensidige Forsikring

After Gjensidige NOR ASA and Den norske Bank ASA merged in 2003 under the name DnB NOR, Gjensidige NOR Forsikring set up as a group in its own right and established a cooperation agreement with the new banking and financial services conglomerate. In February 2005 it changed its brand name to Gjensidige, and in May 2005 its corporate name was changed to Gjensidige Forsikring. The cooperation agreement between DnB NOR and Gjensidige NOR dating from 16 March 2003 was terminated on 7 September 2005. An accord has subsequently been negotiated to completely terminate the original agreement over a period of about five years. Soon the only remnant of the original agreement will be in the field of personal insurances, which DnB NOR will continue to distribute in the above five-year period.

DnB NOR Bank ASA's acquisition of a 51 per cent stake in Bank DnB NORD AS

DnB NOR Bank ASA and Norddeutsche Landesbank Girozentrale signed on 21 June 2005 an agreement of intent to establish a jointly owned Danish Bank, Bank DnB NORD AS, to engage in banking operations in Denmark, Finland, Estonia, Latvia, Lithuania and Poland. Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised DnB NOR Bank ASA on 16 December 2005 to acquire 51 per cent of the shares of Bank DnB NORD AS.

DnB NOR Bank ASA's acquisition of Monchebank

At the end of October 2005 DnB NOR signed an agreement to purchase Monchebank, a small regional Russian bank with its head office in Murmansk that is licensed to conduct banking

business throughout Russia. DnB NOR is to pay USD 21 million for 97.3 per cent of the shares of Monchebank. Kredittilsynet wrote to the Ministry of Finance on 19 December 2005 recommending that DnB NOR Bank ASA be authorised to go ahead with the acquisition.

yA Bank Holding ASA, yA Bank AS and yA Personforsikring AS

On 1 July 2005 the Ministry of Finance granted yA Holding ASA and its subsidiaries yA Bank AS and yA Personforsikring the licence needed to establish a commercial bank and non-life insurance company.

yA Bank AS will offer standard banking products targeted at the retail market such as loans, deposits, issuance of means of payment (including credit cards and traveller's cheques) etc. yA Personforsikring AS's offering will be confined to credit insurance provided through individual whole life insurance and individual disability coverage.

Bank2 ASA

On 1 July 2005 the Ministry of Finance granted Bank2 ASA a licence to establish a commercial bank. The bank will conduct ordinary banking business, and will offer traditional banking services such as loans, deposits and issuance of means of payment (including credit cards and traveller's cheques) etc. to the retail and corporate markets. The bank will also specialise in services sought by private individuals and firms in need of debt restructure and refinancing.

Íslandsbanki authorised to acquire Bolig- og Næringsbanken

Kredittilsynet recommended the Ministry of Finance to authorise Íslandsbanki hf to acquire all the shares of Bolig- og Næringsbanken ASA (BNbank). In its recommendation Kredittilsynet expressed the view that Íslandsbanki's risk profile was somewhat higher than that of comparable Norwegian banks, but had no material comments on the bank's financial strength. Authorisation was granted on 15 March 2005.



Skandinaviska Enskilda Banken authorised to acquire Privatbanken

Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised the Swedish bank, Skandinaviska Enskilda Banken AB (SEB), on 9 September 2005 to acquire all the shares of Privatbanken ASA.

Netfonds granted bank licence

Acting on Kredittilsynet's recommendation, the Ministry of Finance decided on 5 August 2005 to award the investment firm Net Fonds ASA a licence to engage in commercial banking operations. The licence confines Netfonds to accepting deposits from client accounts belonging to customers in the company's securities business. The Ministry of Finance did not act on Kredittilsynet's call for Net Fonds to make a secondary share offering as a condition for the licence. Net Fonds ASA has later changed its name to Netfonds Bank ASA.

Helgeland Sparebank and Sparebanken Rana – merger

On 31 March 2005 the Ministry of Finance authorised a merger between Helgeland Sparebank and Sparebanken Rana, with the former as the acquiring bank. A rationale for the merger is the increasing pressure on banks to achieve the critical size needed for funding purposes. The new bank will be more robust and attractive in the funding market. The merger makes for a stronger local entity with good branch coverage. Moreover, merger of local offices is expected to yield substantial synergy effects.

Sparebanken Midt-Norge and Romsdals Fellesbank ASA – merger

Romsdals Fellesbank ASA, one of the last small commercial banks in existence, was acquired by and merged into Sparebanken Midt-Norge after Sparebanken Møre withdrew its bid for the bank. The acquisition caused controversy among Romsdals Fellesbank's customers, its owners and in local communities. Once the majority needed for the takeover was assured the merger process proceeded as planned. Romsdals Fellesbank ASA was wound up on 6 September 2005.

Santander Consumer Finance S.A. – Santander Consumer Bank AS

On 20 April 2005 the Ministry of Finance authorised Santander Consumer Finance S.A. to wholly own Bankia Bank ASA. Permission to acquire 100 per cent of the shares of Elcon Finans AS had already been granted on 2 July 2004. Santander accordingly wholly owns both Bankia Bank ASA and Elcon Finans AS. On 15 December 2005 the Ministry of Finance gave its permission for a merger of these two companies, in keeping with Kredittilsynet's recommendation. The bank's new name will be Santander Consumer Bank AS.

FATF evaluation of Norway's regime for combating money laundering and the financing of terrorism

The FATF (Financial Action Task Force), an inter-governmental body established by the G7 countries, develops and promotes policies to combat money laundering and terrorist financing. In 2005 the FATF carried out an evaluation of Norwegian measures in this field. The report on Norway is published on the FATF website at www.fatf-gafi.org.

The basis for the evaluation is FATF standards and recommendations in the area. These cover matters such as regulatory systems, action by public and private actors and resource use.

The report on Norway points out that the Money Laundering Act and Money Laundering Regulations do not fully transpose the FATF's recommendations. In response the Ministry of Finance will appoint a law commission to consider measures to combat financial market crime. The law commission's mandate will be to implement the EU's third money laundering directive in Norwegian law and to take account of other international obligations and recommendations, including the FATF recommendations.

The FATF report calls for more tailored and sector-specific guidance for supervised entities on their obligations under the money laundering legislation. Kredittilsynet is collaborating closely with ØKOKRIM (the National Authority for Investigation and Prosecution of Economic and Environmental Crime) and relevant trade organisations on a guidance specifically for auditors and accountants. The FATF also calls for more specific guidelines in regard to individual cases, trends and examples of possible suspicious transactions. The FATF will follow up on Norway to ensure that appropriate measures are taken.



Supervision of ownership of financial institutions – individual cases

New rules on supervision of ownership of financial institutions in the Financial Institutions Act went into force on 1 January 2004. The new rules are detailed in Kredittilsynet's Annual Report for 2003, page 30. The following authorisations were granted in 2005:

- Kistefos Venture Capital AS's acquisition of a stake in Bankia Bank ASA – up to 24.99 per cent (decision made by the Ministry of Finance in November 2004 acting on Kredittilsynet's recommendation)
- The National Insurance Fund's acquisition of up to 15 per cent of Storebrand ASA*
- Íslandsbanki hf's acquisition of Kredittbanken ASA (decision made by the Ministry of Finance in November 2004 acting on Kredittilsynet's recommendation)
- SpareBank 1 Midt-Norge's acquisition of Romsdals Fellesbank ASA – initially up to 20 per cent, subsequently 100 per cent*
- Íslandsbanki hf's acquisition of Bolig- og Næringsbanken ASA*
- Santander Consumer Finance S.A.'s acquisition of Bankia Bank ASA*
- Olympia Holding AS' acquisition of Ontime finance AS
- Aker Kværner AS's acquisition of Aker Insurance AS
- Kredittbanken ASA's acquisition of between 66.67 and 100 per cent of Factoror AS
- MBF Holding AS's acquisition of 49 per cent of Møller Bilfinans AS*
- EnterCard Holding AB's acquisition of EnterCard AS
- Skandinaviska Enskilda Banken AB's acquisition of Privatbanken ASA*
- Telenor ASA's acquisition of Telenor Forsikring AS
- Ferd AS' and Storebrand Livsforsikring AS' acquisition of ForbrukerForsikring ASA – each up to 24.99 per cent
- Statkraft AS's acquisition of Statkraft Forsikring AS

* These decisions were made by the Ministry of Finance acting on Kredittilsynet's recommendation.

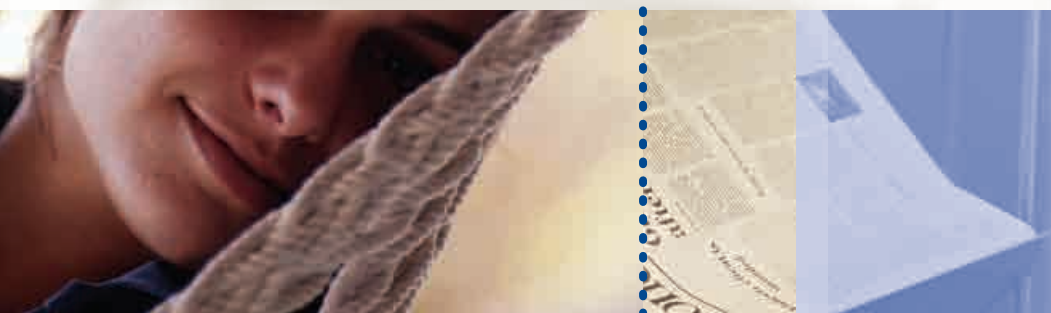
A test of fitness and propriety was applied by Kredittilsynet when processing some licence applications. This was true of applications for licences for:

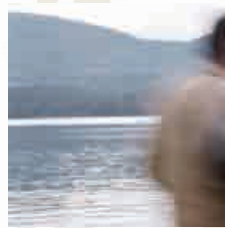
- the mortgage company Terra Boligkreditt AS, owned by Terra-Gruppen AS
- the finance company Caterpillar Financial Services Norway AS, owned by Caterpillar Financial Services Corporation
- the payments company Fexco Money Transfer Norway AS, owned by FEXCO**
- the life insurance company Silver Pensjonsforsikring AS, owned by Grieg International AS, Selvaag Invest AS, Hydro Pensjonskasse and Industriforsikring AS, et al.**
- the commercial bank Bank2 ASA, up to 25 per cent owned by BTWO Gruppen ASA**
- the commercial bank Netfonds Bank ASA (formerly Net Fonds ASA), owned by Netfonds Holding ASA, restricted licence granted by the Ministry of Finance acting on Kredittilsynet's recommendation
- the mortgage company DnB NOR Boligkreditt AS, owned by DnB NOR Bank ASA
- the life insurance company Gjensidige Pensjonsforsikring AS, owned by Gjensidige Forsikring**

** Authorisation granted by the Ministry of Finance acting on Kredittilsynet's recommendation.

One application for permission to make an acquisition was turned down. It concerned Siem Kapital AS's acquisition of up to 25 per cent of Privatbanken ASA. The decision was made by the Ministry of Finance acting on Kredittilsynet's recommendation.

An appeal was lodged, after which the ministry's decision was upheld by the King in Council.





Investigation of Norwegian card issuers' information to customers on the costs of card use abroad

In response to a request from the Ministry of Finance, Kredittilsynet polled a selection of Norwegian banks to ascertain what information they disclose to customers on charges, including currency mark-ups, levied on customers' use of payment cards abroad. The survey showed that all banks state in general terms in the payment card agreement that charges apply. Agreements normally refer to price lists showing both the size of charges and the currency mark-up. Information given after card use includes the charges applied and the transaction amount in foreign and Norwegian currency, although the currency mark-up is not stated.

Rule infringements

Kredittilsynet referred two breaches of the financial legislation to the police in 2005. One concerned a company registered with the Brønnøysund Register Centre for the purpose of "currency exchange and money transfers to and from Norway". The company is not licensed to conduct foreign exchange business, cf. the Financial Institutions Act chapter 4. The company did not respond when asked to explain its business, and the matter was therefore referred to the police.

The other breach referred to the police by Kredittilsynet, in November 2005, concerned a Norwegian firm suspected of carrying on business without authorisation and in contravention of the Financial Institutions Act and/or the legislation governing e-money institutions.

Regulatory amendments and consultations

New capital adequacy rules for banks

The Basel Committee on Banking Supervision adopted new guidelines for measuring banks' capital adequacy on 26 June 2004. Changes in the EU's existing capital adequacy Directives were adopted on 11 October 2005, and will become effective for credit institutions and investment firms on 1 January 2007. Some parts of the framework will take effect on 1 January 2008.

The new Directives on capital adequacy will impose substantial demands on institutions and require them to start preparations at an early stage. This will particularly apply to institutions intending to utilise the more advanced methods for computing minimum capital requirements. Draft regulations based on the new capital adequacy rules were published by Kredittilsynet in May and June 2005. This was done to elicit the views of the financial industry and other interested parties on Kredittilsynet's preliminary assessments of parts of the framework that are regarded as important in relation to institutional preparations. Kredittilsynet has opted to prioritise the rules governing institutions' use of an internal rating-based (IRB) approach, provision of security and operational risk for computing minimum capital charges.

The Ministry of Finance asked Kredittilsynet to draft law amendments implementing the new capital adequacy Directives. Draft legislation with an associated consultative document was duly forwarded to the Ministry of Finance on 23 June 2005. Kredittilsynet received comments on the draft from the Ministry of Finance by letter of 23 November, and responded to them by letter of 28 November. The ministry circulated its Bill for comment on 15 December. The Bill is expected to be introduced to the Storting in the spring of 2006.

The minimum capital requirement is expected to be lowered for IRB banks, mainly due to their substantial holdings of home mortgage loans and loans to small and medium-size firms. However, institutions will not be able to reduce their capital levels to the minimum requirement without further ado. According to the Directives institutions will at all times be required to maintain their capital above the minimum requirement, one reason being that the minimum requirement does not cover all risk present in institutional portfolios. Over time, however, banks can be expected to adjust to the new requirements by maintaining a somewhat lower share of regulatory capital than at present. Hence better risk management at the individual bank and closer supervision will be crucial to identifying and monitoring the risks assumed by banks.

Transitional arrangements have been established for the switch from the current framework (Basel I) to the new framework to avoid a precipitate reduction in the minimum capital requirement. In 2007 the minimum requirement for IRB banks cannot be lower than 95 per cent of the minimum requirement under the current framework. In 2008 and 2009 the corresponding limits will be 90 and 80 per cent of the minimum requirement.

A new Quantitative Impact Study (QIS5) has been initiated under the auspices of the Basel Committee and the European Commission to identify the impact of the new rules on capital charges. The results of this study will be evaluated by the two bodies in spring 2006 and may lead to changes in the formulas used to compute minimum requirements.

Kredittilsynet will continue the process of implementing the capital adequacy framework in Norway in 2006, including the groundwork for the requisite regulations. Kredittilsynet aims

to forward a complete set of draft regulations to the Ministry of Finance in spring 2006. Kredittilsynet will also work on introducing a new pan-European regime of capital adequacy reporting in Norway.

Applications to use internal rating-based (IRB) methods

The new capital adequacy framework requires institutions to apply to Kredittilsynet for permission to utilise an IRB approach to compute capital charges for credit risk. The new framework makes the statutory minimum requirement more risk sensitive in the sense that capital charges to a greater degree reflect the risk present in the underlying portfolios. Institutions wishing to use internal rating methods will need to meet wide-ranging requirements.

DnB NOR, SpareBank 1 SR-Bank, SpareBank 1 Midt-Norge, SpareBank 1 Nord-Norge and Sparebanken Vest have applied to Kredittilsynet for permission to use internal rating in respect of credit risk. Institutions that receive such permission will be entitled to base the statutory minimum capital requirement on their internal risk assessments as from 2007. Kredittilsynet intends to process the bulk of the applications by the autumn of 2006.

Regulations on EEA branches' membership of the Norwegian Banks' Guarantee Fund

On 6 July 2005 the Ministry of Finance issued regulations governing the right of branches of banks with their head office in another EEA country to join the Norwegian Banks' Guarantee Fund. The Fund will be in a position to make good any difference between the coverage provided by a new member's home state and the Norwegian ceiling of NOK 2 million per depositor. The regulations require satisfactory agreements between the Norwegian Banks' Guarantee Fund and the corresponding deposit insurance scheme in the bank's home state as well as a cooperation agreement between Kredittilsynet and the home state's supervisory authority.

Only one application for membership was received, from the Swedish bank Nordnet Securities Bank AB, between the regulations' entry into force and year-end.

Savings banks – more leeway in composition of supervisory boards

At the start of 2005 a law amendment took effect allowing greater flexibility in the composition of savings banks' supervisory board. Among other things it removes the requirement as regards a publicly appointed member. The supervisory board is intended to reflect the savings bank's customer structure and other interest groups as well as the bank's community role. Guideline articles of association for savings banks, and comments to the articles, have been published in Kredittilsynet's circular 21/2005. Kredittilsynet received and approved 24 applications in 2005 to amend articles of association in conformity with the above law amendment.

Move to amend the capital adequacy framework to accommodate new accounting standards

New international financial reporting standards (IFRS) prompted Kredittilsynet to forward on 21 June 2005 a consultative paper to the Ministry of Finance on the introduction of corrective provisions in the capital adequacy framework. The proposals implement guidelines from CEBS (Committee of European Banking Supervisors) and recommendations from CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) in this field.

The new international accounting standards give institutions greater freedom to recognise balance sheet items at fair value. Capital fluctuations related to balance sheet and income statement items will accordingly increase. An important rationale for introducing corrective provisions in the capital adequacy framework is the need to maintain the quality requirements applied to institutions' capital. Key to this thinking is the notion that capital must be available to absorb losses and that it must be sufficiently stable.

In its consultative paper on accommodation to IFRS, Kredittilsynet recommended a five-year transition period for full recognition, in the capital adequacy context, of negative amounts that are charged to equity when unamortised estimate deviations on pension obligations are set at zero.



Changes in accounting legislation

The Accounting Act was significantly amended on two occasions in 2005 – by amending act no. 81 of 10 December 2004 and by amending act no. 46 of 10 June 2005. The act now has a two-track system – the IFRS regulation's system and the ordinary Accounting Act system.

In 2005 Kredittilsynet drafted the need for specific regulation of banks, mortgage companies and finance companies by way of three separate amendments proposed in the Accounting Regulations. Acting on Kredittilsynet's recommendation, the Ministry of Finance decided to prohibit banks, mortgage companies and finance companies from utilising the IFRS regulation for accounting purposes. Kredittilsynet recommended that the prohibition should remain in effect until such time as the adjustments to the Accounting Regulations specifically and separately targeting banks, mortgage companies and finance companies were in place. The adjustments will be implemented in 2007 at the earliest.

A guidance on the regulations (contained in circular 10/2005) was issued by Kredittilsynet in March 2005.

Supervision of financial conglomerates

The amendments needed to implement the EU Directive on the supervision of financial conglomerates (2002/87/EC) were passed into law by Act no. 43 of 10 June 2005. The Directive is detailed in Kredittilsynet's annual report for 2004, page 30. The text of the Act diverged in several respects from the draft submitted by Kredittilsynet to the Ministry of Finance in the summer of 2004, and in the spring of 2005 Kredittilsynet was commissioned by the ministry to draft regulations to further implement the financial conglomerates directive.

New rules for banks' collateral for loans from Norges Bank

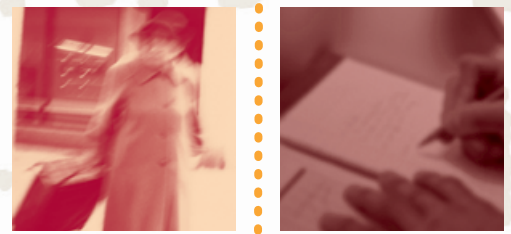
Norges Bank decided to amend the regulations on banks' access to loans and deposits in Norges Bank and the guidelines on banks' provision of collateral for loans from Norges Bank with effect from the fourth quarter of 2005. A number of comments to the proposed amendments made by Kredittilsynet at the consultative stage received little support. Norges Bank decided to introduce a transitional period whereby securities already pledged as collateral can continue to be used for that purpose until 1 November 2007. An amendment announced by the Ministry of Finance in regard to formal liquidity requirements will lessen the impact on the banks of changes in the guidelines on collateralisation.



Insurance

Supervision of the insurance sector aims to ensure satisfactory financial strength, risk awareness, management and control of institutions and to promote financial stability and smoothly functioning markets. It comprises on-site supervision, off-site supervision, macro-economic surveillance, administrative and consultative tasks and responsibility for drafting regulations.





Financial stability

31

Kredittilsynet's macroeconomic surveillance involves following developments in the Norwegian and international economy of significance for financial stability. Economic and market trends are collated with developments among institutions. There are several reasons why surveillance of financial stability should include insurance companies and pension funds. One of them is the prominence in the Norwegian financial market of mixed financial groups featuring insurance companies. Moreover, insurance companies are central participants in the Norwegian securities market and own substantial holdings in

the real estate markets. A satisfactory insurance industry is essential for long term saving and distribution of risk. Analyses of insurance companies and pension funds are included in the half-yearly macroeconomic surveillance reports and in the quarterly analyses and associated press releases on the situation at financial institutions. A yearly report entitled *The Financial Market in Norway: Risk Outlook* provides a synoptic assessment of the position of the Norwegian financial industry against the background of developments in the economy, markets and institutions.

Kredittilsynet / Annual report / 2005

Analyses

Insurance companies' results essentially reflect the trend in Norwegian and international securities markets. Recent years have seen major changes in the composition of life insurers' investments, featuring a substantial reduction from 2000/2001 to 2002/2003 in the proportion of total assets invested in shares accompanied by an increase in holdings of fixed income securities. Some increase in the share component was seen in 2004 and 2005. As in 2004, macroeconomic surveillance of the insurance industry focused on analyses of insurance companies' profitability and financial strength in light of their asset composition and continued low interest rates. Life insurers face major challenges in terms of persistent low interest rates. Relatively low share components mean that they and their customers benefit little from expanding equity markets. By investing such a large portion of their total assets in bonds held to maturity at a relatively high interest rate, they are none the less securing a continuing return for some years ahead. Low interest rates are making it difficult for insurers to accumulate sufficient capital buffers and at the same time to honour their guarantee obligations to their customers.

Forecasts are prepared for the trend in results and buffer capital over the next five years. Continued low interest rates will bring a substantial fall in insurers' adjusted result, at the same time as impaired results make it difficult for insurers to enlarge their buffers, and thereby their risk bearing capacity.

Analyses of insurance companies' profitability, financial strength and risk were prepared on a regular basis in 2005, along with ad hoc analyses of topics of current interest. Quarterly reports are published on life and non-life insurers, and pension funds' position is commented on at half-yearly intervals.

Although the share component of life insurers' balance sheets rose somewhat in 2005, and the foreign share portion edged down, the strong recovery on Oslo Børs had limited impact on

life insurers' results. At the same time low interest rates left weak returns on fixed income securities. Much emphasis was given to the use of stress tests to gauge insurers' vulnerability to changes in interest rates, share values and property values.

Several years' increase in non-life insurers' premium revenues accompanied by a stable trend in claims and expenses have improved this segment's technical results. Non-life insurers' results in 2005 were very good, due both to a stable trend in technical results and to high financial earnings. Part of the increase in financial earnings was of an extraordinary nature, however, and there were signs towards year-end of an increase in the volume of claims. Close analyses of the trend in profitability and risk among non-life insurers were carried out in 2005.

Pension funds posted good results in 2005 on the back of the share market upturn. This was particularly true of private pension funds whose balance-sheet equity exposure was higher than that of municipal pension funds, resulting in a more positive trend.

In connection with its review of Norway's financial system (Financial Sector Assessment Program – FSAP), the International Monetary Fund conducted, in cooperation with Kredittilsynet and Norges Bank, stress tests of the Norwegian financial sector, including the largest life and non-life insurers. The tests showed that a steep fall in share values would make heavy inroads into life insurers' solvency margin capital and buffer capital, whereas non-life insurers were most vulnerable to substantial changes in their technical provisions.

See also the report *The Financial Market in Norway 2005: Risk Outlook* for an overall presentation of the situation among insurance companies and pension funds against the background of developments in the economy, markets and results in 2005.

On-site supervision

A main aim of on-site supervision of insurance companies is to see to it that they have the requisite financial strength and risk awareness, and that their management and control systems ensure satisfactory risk management.

Non-life insurance companies

Four inspections were conducted at three non-life insurers in 2005, of which two were thematic inspections on the role of the internal audit and one was an IT inspection. See the account of thematic inspections of internal audit in the chapter *Banking and finance* on page 23.

Kredittilsynet worked on a new method of risk measurement for insurance companies in 2005. The new insurance module was tested at a company in autumn 2005 and thereafter modified. The module will from now on form the basis for on-site inspection of non-life insurers. Due to its development of new methodology and participation in the designing of new EU solvency rules, Kredittilsynet devoted fewer resources to on-site inspections than in previous years.

Life insurance companies

Inspections were conducted at four life insurers in 2005, of which one was a thematic inspection focusing on internal audit. Ordinary inspections at life insurers checked overarching management and control, asset management and insurance.

Should low interest rates persist, life insurers will be dependent on sound return on shares and property in order to honour the interest rate guarantee. Kredittilsynet's inspection reports emphasised the need for institutions – independently of current rules for profit calculation, asset weighting and solvency requirements – to develop risk models and risk measures that capture the risk arising from the long-term nature of their obligations.

Life insurers have experienced operational problems with their IT systems in a variety of areas. Kredittilsynet has accordingly drawn their attention to the systems-related challenges posed by compulsory occupational pensions and the introduction of new business rules for life insurers.

Nordic supervisory collaboration

Kredittilsynet has signed Memorandums of Understanding (MoUs) with other Nordic supervisory authorities regarding supervision of If and Sampo. The MoUs require regular information exchange among the Nordic authorities. Based on the MoUs the supervisory authorities prepared overall risk assessments for the If Group and the Sampo Group in 2005. This was the first analysis of its kind for the Sampo Group one of the reasons being the group's strong growth in home mortgage lending and ongoing preparations to meet the

requirements of Basel II. With regard to If, particular attention was given to their new risk management process, internal control, reserve setting, reinsurance and the trend in premiums.

Kredittilsynet also collaborates with its Nordic counterparts on supervision of the Tryg Vesta Group. An overall risk assessment is prepared annually for the Nordic group under the auspices of the Danish FSA.

Licensing and regulatory compliance

Storebrand's branch opening in Sweden

On 18 March 2005 Kredittilsynet reported Storbrand Livsforsikring AS's establishment of a branch in Sweden under the Regulations on Norwegian insurers' provision of insurance services and branch establishment in other non-EEA states. The branch is to market group and individual occupational pensions featuring disability and death benefits, as well as risk insurances, to the competitively exposed segment of the Swedish occupational pensions market.

Silver Pensjonsforsikring AS

Silver Pensjonsforsikring AS, licensed in 2005, represents a new offering to Norwegian consumers. The company's business idea is to manage paid-up policies deriving from group pension funds in such a way that the customer achieves better return on his/her capital, thereby providing a higher pension. The advent of Silver Pensjonsforsikring heightens competition in the Norwegian market for paid-up policies.



ForbrukerForsikring AS

Acting on Kredittilsynet's recommendation, the Ministry of Finance authorised ForbrukerForsikring to engage in non-life insurance business. The company is to offer legal expenses insurance to consumers who file complaints in regard to purchases of tradesman's services and dwellings, and in regard to purchases of capital goods costing more than NOK 2,000. At the company's extraordinary general meeting on 30 November 2005, shares worth a total of 57.5 million were subscribed – in keeping with the terms of the licence. The company started business in December 2005.

ForbrukerForsikring AS was granted an identical licence in 2002 which the Ministry of Finance withdrew when the company failed to put up sufficient capital.

Licence for Gjensidige Pensjonsforsikring AS

Gjensidige Forsikring applied in September 2005 for a licence to establish a life insurance company – Gjensidige Pensjonsforsikring AS. The company will offer index-linked life insurance as well as pure savings products with no insurance element. Kredittilsynet recommended the Ministry of Finance to award the requisite licence without requiring the creation of an intermediate holding company. The ministry none the less made it a licence condition that Gjensidige Forsikring should own Gjensidige Pensjonsforsikring AS via an intermediate holding company, and this was duly established under the name Gjensidige Pensjon og Sparing Holding AS.

Embezzlement of client assets at an insurance broker

An insurance broker's authorisation to carry on insurance broking was withdrawn after its general manager wrongfully removed funds from the broker's client account. It was pointed out that wrongful removal of client assets breaches central provisions of the insurance mediation regulations, and that withdrawing authorisation is an appropriate response to such a grave act. Wrongful removal of client assets could have substantial negative financial consequences for policyholders and/or insurers.

European Insurance Agency AS reported to the police

On 24 November 2005, in consultation with ØKOKRIM (the National Authority for Investigation and Prosecution of Economic and Environmental Crime), Kredittilsynet reported European Insurance Agency AS, c/o its general manager, to Asker og Bærum Police District for selling insurance devoid of cover.

Since Kredittilsynet did not oversee the activities of insurance agents at the time the firm was reported, the only way to stop it selling bogus insurance was to report it to the police.

Kredittilsynet was given responsibility for oversight of insurance agents as from 1 January 2006 under new insurance mediation legislation, which requires insurance agents to have applied for authorisation by 1 July 2006.

The EIA's general manager declared the firm bankrupt on 9 January 2006. Insurance brokers who have mediated insurance for EIA are now being monitored by Kredittilsynet to see if their routines and quality are up to standard and to consider what, if any, steps should be taken in that connection.

Interest rate guarantees in life insurance

Regulations on premiums and insurance funds in life insurance require Kredittilsynet to set a maximum guaranteed interest rate below 3 per cent in life insurance should 60 per cent of the effective yield on long-term government bonds fall below 3 per cent. Any such reduction of the maximum rate must be established by 1 December prior to the calendar year it is due to take effect.

After an overall assessment in November 2005, Kredittilsynet decided to reduce the current maximum guaranteed interest rate to 2.75 per cent for contracts written after 1 January 2006. The maximum guaranteed interest rate for new accrual on existing group pension insurance contracts was not concurrently reduced, but Kredittilsynet signalled that such a reduction would take place on 1 January 2007 should long interest rates not rise significantly in the course of 2006. Insurers are entirely at liberty to stipulate a lower rate than the maximum permitted. Within the limits laid down by relevant legislation, insurers have an independent responsibility to assess the level of guaranteed interest rates.

Kredittilsynet wrote to all insurance companies and pension funds on 14 December 2005, urging them to consider steps to bolster their solvency levels when closing the books for 2005.

Preliminary assessment of a new product – "bank pension"

Kredittilsynet concluded on 4 July 2005 that, providing specific conditions are met, the "bank pension" product to be offered by Sparebanken Bien will not conflict with the Insurance Activity Act. This product makes credit available to homeowners against security in their dwelling, while giving the owner a life-long right to occupy the dwelling. The product is designed to mitigate the bank's life expectancy risk. Mortgage loans, including interest, will not be called in until either the house is sold or the occupant (surviving spouse) dies or moves permanently to a nursing home. Upon sale of the house, the bank recoups the drawn amount with interest. The bank has no claim on the borrower beyond the value of the house. Should the house value be below the value of the loan upon redemption, the bank will incur a loss. The product is intended to give the customer assurance that he/she and in the event spouse can live in their own home as long as desired, irrespective of house price and interest rate trends or longevity.

Banks' opportunity to offer defined contribution pensions

At the request of the Savings Banks Association, Kredittilsynet has looked into the question of whether banks, as providers of index-linked occupational pension schemes, should be registered as owning the mutual fund units in a scheme, or whether the policyholder/insured can be registered as owner. Kredittilsynet took it that neither the Defined Contribution Pensions Act nor the rules restricting the business activities of banks set limits to the management regimes a bank can offer. Where a bank offers a pension scheme under sections 3-2a and 3-3 of the Defined Contribution Pensions Act that contains mutual fund units, the bank is required to utilise a securities fund management company as its sub-provider. Kredittilsynet concluded, however, that registering mutual fund units in the employer's/member's name in the register of unit holders is not counter to the above Act.

Fixed income securities quoted on the Alternative Bond Market

In June 2005 Oslo Børs established an Alternative Bond Market (ABM). This market largely resembles the existing bond market in as much as central trading and admission rules will apply. The establishment of ABM raises specific issues in regard to bonds in insurance companies' held-to-maturity portfolios, since any loans moved from Oslo Børs to ABM will become subject to different, more restrictive, investment limits. In view of the fact that bonds in a held-to-maturity portfolio cannot be sold without this having consequences for other bonds in the portfolio, Kredittilsynet sent identically worded letters to insurance companies and pension funds granting dispensation from the investment restriction rules of the asset management regulations to enable insurers to retain bonds that were present in held-to-maturity portfolios at end-2005 until the investments in question mature, even if this should entail overstepping the investment restriction rules.

Paid-up policies

There was a greater focus on life insurers' treatment of paid-up policies in 2005. Paid-up policies are insurance contracts on which premiums are no longer paid, and are generally established upon leaving a group pension scheme due to cessation of employment or termination of contract. Profits

allocated to paid-up policies in the form of higher pension benefits have been fairly modest in recent years. This is due to low financial return and to the build-up of insurance funds through supplementary provisions along with strengthened disability and administrative reserves, partly in response to demands from Kredittilsynet. In addition, paid-up policies enjoy an underlying interest guarantee, normally about 4 per cent.

Occupational injury insurance and the sectoral account

Financial reports for 2004, received in 2005, show that the negative trend for occupational injury insurance seen in 2003 continued in 2004, although the gross technical account shows a smaller deficit than the previous year. Occupational accident insurances and occupational disease insurances both brought a deficit in 2004. The claims level is particularly uncertain in the case of occupational disease insurances.

Premium growth in this sector from 2003 to 2004 was relatively moderate. Any stagnation in the premium level will be a matter for concern in view of the uncertainty still surrounding the claims level.

Individual account schemes and other self-sustaining insurance arrangements

Kredittilsynet will bring its study of individual account schemes and other self-sustaining insurance arrangements to a close in 2006. The survey is intended to determine whether this type of business is sufficiently regulated by the insurance legislation and whether insurers are entitled to engage in it.

An individual account scheme is a form of self-insurance arrangement agreed between an insurer and a customer/policyholder whereby the customer's or policyholder's risk is covered by the policyholder him/herself. The customer does not in Kredittilsynet's view contribute to building up the company's capital on a par with policyholders participating in an insurer's risk equalisation mechanism. The customer or policyholder is neither contributing to nor benefiting from the risk equalisation effect achieved by being part of an insurance community together with the insurer's ordinary policyholders. The insurer's income is confined to an administration charge.





Regulatory changes and submissions

35

Regulations to the Insurance Act, chapters 7, 8 and 9

The Act on insurance companies, pension funds and pension companies and their activities (Insurance Act) was passed on 10 June 2005. Kredittilsynet sent draft regulations to chapter 7 to 9 of the act – dealing with pension funds, pension companies and life insurance companies – to the Ministry of Finance in October 2005. Once chapter 9 of the Insurance Act and new, unified regulations come into force, nine current regulations will be revoked.

The new Insurance Act provides a clearer distinction between the assets of the insured and those of the company, a clearer distribution of risk between customer and company and clearer pricing of life insurance products. The draft regulations contain rules on pension funds' business activity as well as on pricing and on profit models in life insurance. Kredittilsynet's model for long-term pension saving is aligned with the new rules. Kredittilsynet considers that contractual obligations not requiring regular premium payments should continue to be assigned to a system where the guaranteed return is paid by sharing profits between company and policyholder (a modified profit model). Kredittilsynet also recommends that individual life and pension insurances written before the Act's entry into force should be subject to profit sharing rules, but with a transitional period of ten years to deal with any administrative deficit.

The new Insurance Act introduces an entirely new pricing system. Since the extensive changes require sound preparations by insurers, Kredittilsynet recommends that the Act's rules on pricing and profit models should not become effective until 1 January 2008, the remainder becoming effective on 1 January 2006. In keeping with the Act's aim of clearer pricing of life insurance products, and in the interest of comparability of accounts, Kredittilsynet recommends that all insurers switch to the new rules on the same date.

The draft regulations, currently under review by the ministry, are expected to be circulated for comment in March 2006.

Regulations to the Insurance Mediation Act

On 19 September 2005 Kredittilsynet delivered a consultative paper to the Ministry of Finance containing draft provisions to the Insurance Mediation Act which had been passed on 10 June 2005. The provisions concern the size of liability insurance, the insurance mediator's disclosure obligation to the customer, keeping of registers (insurance agents), complaints arrangements and transitional rules. Following a consultation ending on 15 November 2005, the regulations were adopted by the Ministry of Finance on 9 December 2005 and entered into force on 1 January 2006.

Kredittilsynet has also adopted regulations easing the Act's qualification requirements, including competence and experience, for ancillary insurance agency businesses. The regulations are expected to come into force in February 2006.

The internal control regulations were given effect for insurance intermediaries in January 2006.

Kredittilsynet held information meetings on the insurance mediation rules on 16 January 2006.

Future solvency framework for insurance companies (Solvency II)

The EU/EEA countries' work on a new solvency framework in insurance (Solvency II), designed to reflect the various types of risk met by insurers, was further intensified in 2005. The work involved quantitative solvency requirements (Pillar 1), supervisory oversight (Pillar 2) and market discipline (Pillar 3).

The first round of impact assessments of draft new rules started in autumn 2005, focusing on technical provisions. A large number of European insurers are expected to take part in this process (on a voluntary basis). A new round of impact assessments, also focusing on the proposal for a standard method of calculating the new solvency capital requirement, will start in spring 2006.

Work on Solvency II has taken longer than originally envisaged by the EU Commission. The normal deadlines for implementing a new EU-based body of rules suggest that the Solvency II requirements will become effective in 2010 at the earliest, very possibly not until 2011.

Provisional capital requirements for insurance companies in the period 2007–2009

Norwegian banks and insurance companies are both subject to the 1988 Basel Accord (8% minimum capital requirement). The new, risk-sensitive Basel II framework will be in force for banks and other credit institutions from 2007 onwards. As mentioned above, it is doubtful whether risk-based capital requirements for insurers will be implemented before 2010 or 2011. Hence an obvious issue is whether the original regulations on minimum capital requirements will remain in effect for insurers, or whether it would be best to replace them with an alternative, risk-based requirement taking into account the stage reached in the Solvency II process.

Against the above background, Kredittilsynet prepared in autumn 2005 a report outlining alternative designs for provisional capital requirements applying to insurers in the period 2007–2009 pending implementation of the Solvency II framework.



In Kredittilsynet's view work should continue on an alternative in which the supplementary capital requirement is based on stress testing. This option comes across as the most flexible, which may be an advantage given that it will be utilised in a transitional period until the Solvency II framework is in place. It has, moreover, been opted for in Denmark and Sweden, and, although these countries have applied somewhat differing solutions, Norway can benefit from their experiences and preparatory studies.

The report on provisional capital requirements was forwarded to the Ministry of Finance on 9 December 2005 to provide the ministry with a basis for a round of consultation with the insurance industry and other affected parties on the policy choices discussed in the report.

Regulations on non-life insurers' claim assessment services

At the request of the Ministry of Finance, Kredittilsynet drafted regulations to promote independence between non-life insurers and claims appraisers. Kredittilsynet proposed that policyholders should have a statutory right, on given terms, to request independent appraisal. Such appraisal should in general be paid for by the insurer, and the right to request it should be clear from the insurance certificate. Kredittilsynet also proposed rules to improve the quality of initial claim assessment in situations where the compensation is likely to reach NOK 300,000 or more.

Changes in the accounting legislation

The Accounting Act was significantly amended on two occasions in 2005 – by amending act no. 81 of 10 December 2004 and by amending act no. 46 of 10 June 2005. The act now has a two-track system – the IFRS regulation's system and the ordinary Accounting Act system. In 2005 Kredittilsynet drafted the need for specific regulation of insurance companies by way of three separate amendments proposed in the Accounting Regulations. Acting on Kredittilsynet's recommendation, the Ministry of Finance decided to prohibit insurance companies from utilising the IFRS regulation for accounting purposes.

Kredittilsynet also recommended adapting the accounting regulations for insurance companies to IFRS, but that not all the options available under IFRS should be carried over. Kredittilsynet recommended that modified accounting regulations should apply from 2007 at the earliest.

Regulations of 21 December 2004 on accounting for loans and guarantees came into force on 1 January 2005. A guidance on the regulations (contained in circular 10/2005) was issued by Kredittilsynet in March 2005.

Permanent establishment requirement lifted for agreements under the Defined Benefit Pensions Act and the Defined Contribution Pensions Act

In a letter of 8 December 2004 the Ministry of Finance asked Kredittilsynet to consider whether removing the permanent establishment requirement necessitates the introduction of rules to assure the supervision of tax-favoured pension schemes provided by institutions in other EEA states. The ministry states in Proposition No. 1 (2004–2005) to the Odelsting that an overview of foreign pension funds that offer pension schemes can best be obtained by introducing a reporting obligation. The ministry will consider imposing a regular and somewhat detailed disclosure requirement that will provide Kredittilsynet with for example an annual updating on products offered by foreign insurers in Norway. The issue of what type of control regime is appropriate in terms of effective tax control and also implementability was raised with the Ministry of Finance in 2005. The ministry has asked Kredittilsynet to draw up a proposal for control arrangements, and to draft possible legislative amendments/regulations by 1 March 2006.

Pension scheme membership for persons who are not members of the National Insurance Scheme

Both the Defined Benefit Pensions Act and the Defined Contribution Pensions Act contain clauses enabling compulsory membership of the National Insurance Scheme to be waived by regulations issued by the Ministry of Finance. The ministry has delegated authority to draft and issue such regulations to Kredittilsynet. A number of conglomerates/companies have employees who for a shorter or longer period are not mandatory members of the National Insurance Scheme while stationed abroad, but whose links with the company make it desirable to maintain their membership of the company's pension scheme. Kredittilsynet circulated draft joint regulations to the above pensions acts for comment on 22 December 2004 with a deadline for reply set at 1 April 2005. Kredittilsynet will adopt the regulations early in 2006. The regulations establish that members of pension schemes established under the pensions legislation who are working temporarily abroad and are not mandatory members of the National Insurance Scheme can retain their membership on certain conditions.

Mandatory Occupational Pensions Act (OTP Act)

Prompted by the Pensions White Paper, the Storting decided on 26 May 2005 that legislation on compulsory occupational pension schemes should come into force on 1 January 2006. The Bank Law Commission was mandated to draft requisite rules. The commission's draft was circulated for comment on 1 July 2005 with the deadline for replies set at 8 August 2005. Kredittilsynet sent its comments to the Ministry of Finance on 8 August 2005. The Government Bill, which largely followed the Bank Law Commission's proposals, was enacted by the Storting in December 2005, sanctioned by the King in Council

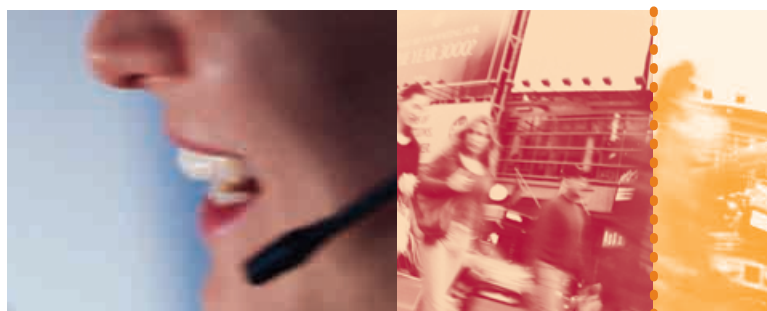
on 21 December 2005 and came into force on 1 January 2006. Kredittilsynet will decide in cases of doubt whether a company comes under the OTP Act or not, and in the event whether the company's pension scheme meets the requirements of the Act. Kredittilsynet will also, in continuation of its existing functions, be empowered to order any company failing to maintain a pension scheme in conformity with the Act's requirements to rectify the unlawful circumstance by a specific deadline, and will be empowered to impose a cumulative fine on the company to that end. There is no obligation on Kredittilsynet to visit companies to check their compliance, but it can step in if it receives information indicating that a company is not in compliance with its statutory obligations. The ministry recommends that Kredittilsynet's expenses on enforcing the OTP Act should be distributed on institutions that are entitled to offer pension schemes under the Defined Benefit Pensions Act and the Defined Contribution Pensions Act.

After examining the marketing of OTP products, Kredittilsynet issued a press release on 16 December 2005 drawing institutions' attention to certain detrimental aspects of their marketing. Based on the press release, identically worded letters were sent to the Financial Services Association, the Savings Banks Association and the Mutual Fund Association on 21 December 2005.

New guarantee scheme rules

June 2005 saw the adoption of new rules on the guarantee scheme for non-life insurers, based on the proposal sent by Kredittilsynet to the Ministry of Finance in 1997. The amendments confine the cover provided by the guarantee scheme to insured risk in Norway. Compulsory membership is established, also for branches of companies whose head office is in another EEA state. The guarantee scheme's ability to provide support to a company whose financial position is under threat and for the transfer of its portfolio to another company is removed. The provision on the size of insurers' contributions is amended such that members can only be instructed to pay in proportion to premium income in Norway directly related to the insurances covered by the guarantee scheme.

In December 2005 Kredittilsynet forwarded to the Ministry of Finance a draft consultative paper proposing supplementary regulations. The draft further limits the cover provided by the guarantee scheme to, broadly speaking, insurances contracted by consumers and small-scale business operators.

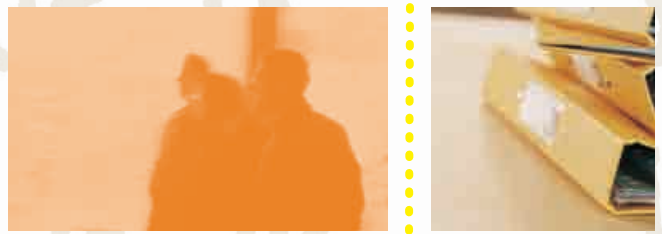


Securities market

The overarching aim of regulation and supervision is to ensure that the securities market functions properly as a source of capital for business and industry and for investors. In addition to licensed institutions, supervision covers compliance with general rules of market conduct.

Supervision encompasses companies authorised to carry on business under the Securities Trading Act, the Securities Funds Act, the Securities Register Act and the Stock Exchange Act. Important areas of supervision are market players' financial position and operations and compliance with the regulations governing their activities.

Kredittilsynet is also assigned legislative and administrative tasks as well as information tasks.



Investment firms

39

Supervision

The upward trend in the prices and turnover of shares quoted on Oslo Børs laid the basis for increased earnings by investment firms in 2005. There was also strong growth in issue volumes among companies listed on Oslo Børs.

Seventy-five investment firms held licences at the end of 2005. Five licences were awarded in the course of the year, one of which for banking operations. One firm lost its licence. Kredittilsynet conducted 17 inspections at investment firms in 2005. An additional five inspections focused on investment firms' ICT systems.

The firms vary widely in terms of size, organisational set-up and the investment services provided. Risk-based criteria are used to select firms for on-site inspection. The criteria include liquidity, capital adequacy, changes in revenues, earnings, customer complaints and suspected breaches of good business practice. Firms' periodic reporting to Kredittilsynet and information gained in dealing with administrative tasks provide a valuable basis for selecting firms for inspection. Priority is also given to large firms, firms that have recently received a licence, firms that have undergone substantial changes and firms that have not been inspected for some time.

Kredittilsynet opted for a general supervisory programme for investment firms in 2005, which however included a focus on firms engaged in unlawful business. Inspections brought to light several breaches of laws and regulations, and, in the case of some firms, significant deficiencies and flaws in their oversight of compliance with codes of conduct.

An inspection was conducted at Sundal Collier Institusjonell Forvaltning ASA as a follow-up to a prior inspection at the sister firm Sundal Collier Fondsforvaltning ASA. Sundal Collier Institusjonell Forvaltning ASA was found to have grossly and systematically acted in contravention of the Securities Trading Act. Kredittilsynet viewed the violations, in aggregate, as sufficiently serious to warrant withdrawal of the firm's authorisation to carry on active management. Kredittilsynet accordingly withdrew this authorisation.

At an inspection carried out at Acta ASA, Kredittilsynet looked into the information provided to purchasers of financial instruments and made it clear that customers must be informed of all types of remuneration charged by the firm and the adviser, as well as of the type and size of the remuneration charged in each case.

Acta Asset Management ASA was shown to have distributed shares in real estate projects to the firm's clients without preparing a prospectus as required by the Securities Trading Act.

Kredittilsynet noted the firm's compliance with Kredittilsynet's conclusion regarding the prospectus requirement for all increases of capital.

In its effort to expose and put a stop to unlawful securities trading, Kredittilsynet focused on internet brokers' use of intermediaries. This resulted in a number of firms and individuals being ordered to terminate their business activity. The most serious instances were brought to light in the Kristiansand district, where clients had been defrauded.

In 2005 it was brought to the attention of Kredittilsynet that several entities/firms (Robinson Reed Inc., Continental Advisory Services, Coats, Zante and Partners SL, The Kaikatsu Group, HYIP Norway, Extraordinary Economy, Hitra Pensjon og Finans and Dollar Invest), which had not been duly licensed by Kredittilsynet, were engaged in misleading marketing practices and unlawful sale of financial instruments. Using market alerts and press releases, Kredittilsynet warned consumers not to deal with the above undertakings. Orders to cease business were issued to four entities/firms operating out of Norway.

The extent and structure of own account trading at investment firms was looked into in the spring of 2005. The survey showed wide individual differences in own account trading among investment firms, with the largest relative share at 58 per cent and the smallest at 8 per cent. A study of transactions carried out in December 2004 indicates that most own account trading at Oslo Børs is in highly liquid securities. Firms appear to earn little on own account trading as such, the purpose being to show a high turnover on Oslo Børs.

A study of the spread of warehousing and its use in investment firms was initiated in the spring of 2005. Warehousing involves temporary retention of equities prior to their release to the customer. The survey showed that firms employ warehousing in line with in-house rules, and that all firms have written control routines for warehousing.

The Securities Trading Act section 7-1 third paragraph waives the licensing requirement where the investment service is confined to mediating orders for securities to investment firms and management companies for securities funds. In view of the apparent increase in the number of intermediaries operating under the derogation, and by agreement with investment firms, a circular was issued clarifying the firms' responsibilities in connection with order mediation (circular 7/2005).

Table 9: Investment firms

	2003	2004	2005
Firms with licence	87	78	75
– Firms licensed only to market financial instruments	10	10	8
– Firms licensed only for active asset management	10	9	9
New firms with licence	6	5	5
Firms with licence handed in	11	14	7
Firms with licence revoked	0	0	1

Legislation and administration

The Markets in Financial Instruments Directive – MiFID, which replaces the previous Investment Services Directive, was adopted on 21 April 2004. The deadline for implementing the Directive is 30 April 2006. In view of postponements called for, the deadline for national adoption could be 31 January 2007, and the deadline for entry into force could be 1 November 2007. The Directive heralds a comprehensive revision and enlargement of the current regulation of investment firms' activity, marketplaces etc. The Committee of European Securities Regulators (CESR) has been asked by the European Commission to draft technical implementing measures to a number of articles in the Directive. Kredittilsynet is represented in three expert groups charged with drawing up such provisions on issues such as business conduct, organisation requirements, market transparency and information exchange between public authorities. A body (the Securities Markets Law Commission) has been set up to implement the MiFID Directive together with the Takeover Directive and the Transparency Directive. Kredittilsynet has one representative on the Commission. The Commission delivered an interim recommendation to the Ministry of Finance on 25 August 2005 on takeovers and voluntary offers in connection with corporate acquisitions. Two further reports are to be delivered by the Commission by 20 February 2006.

The Nominee Registration Commission, in which Kredittilsynet has been a member, delivered on 16 June 2005 its report in NOU 2005: *Nominee registration of shares of Norwegian companies*. A unanimous commission recommends that foreign investors should not be allowed to nominee register their shareholdings in Norwegian companies. It also recommends foreign persons' right to do this should not be restricted. Apart from some clarifications and minor adjustments to the legislation, the Nominee Registration Commission's proposals broadly uphold the present regime. The Commission considers that the information value of the register of shareholders can be improved by requiring nominee undertakings to deliver updated particulars on the owners of nominee registered shareholdings at regular intervals, and recommends establishing a legal basis for further rules to this end.

The Securities Trading Act's provision requiring security to be furnished for investment firms was amended by Act no. 11 of 4 March 2005. The amendment establishes the Investment Firms' Guarantee Fund, and will enter into force on 1 July 2006. The amendment builds on the Ministry of Finance's proposal in Proposition no. 12 (2004-2005) to the Odelsting which is based on a consultative paper prepared by Kredittilsynet. The background to the amendment is the conclusion of the EFTA Surveillance Authority that the Norwegian arrangement of individual guarantee agreements, which up to 1 January 2004 allowed an upward cap to be placed on the guarantee, was counter to EU Directive 97/9/EC. The guarantee fund will be a collective guarantee scheme in which investment firms – including credit institutions licensed to offer investment services and management companies licensed to engage in active asset management – will be mandatory members. The objective of the guarantee fund will be to guarantee a minimum coverage for clients of investment firms in cases where such firms no longer have the financial ability to honour of their obligations in relation to client assets. It is assumed that the fund will be financed by its members. Kredittilsynet has drawn up a consultative paper containing further rules to be included in new regulations. These regulations were adopted by the Ministry of Finance on 22 December 2005, and will enter into force at the same time as the law amendment on 1 July 2006.

As a result of the implementation of the Prospectus Directive in Norwegian law, new rules setting requirements for the design, content, approval and publication of prospectuses were established in June 2005. Under the rules, effective as from 1 January 2006, Kredittilsynet will be the paramount prospectus authority, while Oslo Børs will exercise prospectus control.

In 2005, as previously, Kredittilsynet arranged two information seminars for investment firms in cooperation with Oslo Børs. Participants were updated on pertinent EU processes and topical issues of general interest.

Management companies for securities funds

Supervision

Share prices rose on a broad international front early in 2005, with the Norwegian equity market performing particularly well. Norwegian equity funds achieved steady growth in total assets in 2005 thanks to rising share values and net new subscriptions. Management companies also saw improved earnings.

At the end of 2005 21 management companies were licensed to manage securities funds. Nine of these were also licensed to carry on business described in the Securities Trading Act section 1-2 first paragraph no. 3: *active management of investors' portfolios of financial instruments on a client-by-client basis and in accordance with investors' mandates*. One new management company received a licence, one had its licence expanded and one lost its licence. The number of securities funds managed by the companies rose by six in 2005 to reach a total of 436.

Five ordinary on-site inspections were conducted at management companies in 2005. A further four on-site IT inspections were also carried out. Risk-based criteria are used to select companies for on-site inspection. The criteria include return and portfolio risk, size, client complaints or suspected breaches of good business practice. Companies' periodic reporting to Kredittilsynet also provides a basis for selecting companies for inspection. In 2005 a study was made of securities funds' use of derivatives and their compliance with the investment restrictions set forth in the Securities Funds Act sections 4-8 and 4-11.

At its inspection of ABG Sundal Collier Fondsforvaltning ASA, Kredittilsynet routinely examined a selection of portfolio overviews and transactions in the firm's securities funds. This revealed gross, systematic violations of several provisions of the Securities Funds Act. Some were serious enough to warrant withdrawal of the company's licence to carry on fund management, and Kredittilsynet duly issued an order to this

effect. The company and its CEO were reported to ØKOKRIM (Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime). Since ØKOKRIM were unable to give the matter priority, Kredittilsynet referred it to the Oslo Police District. Due to various circumstances the matter is now in the hands of Romerike Police District.

Monitoring the valuation of fund units for subscription and redemption purposes is a standard aspect of the ongoing supervision of management companies, and follows up recommendations made in connection with CESR's investigation, in which Norway participated, of irregularities in the European insurance industry. In March 2005 a circular was issued detailing deadlines set in regard to subscription and redemption of units in securities funds (circular 9/2005).

Legislation and administration

Amendments to the UCITS Directive require management companies to prepare a simplified prospectus for each securities fund. On 4 April 2005 Kredittilsynet sent a consultative draft to the Ministry of Finance proposing changes to the Regulations on prospectuses for securities funds (no. 750 of 28 July 1994) and Regulations on management companies' periodic reporting (no. 1045 of 13 August 2003). The amendments were prompted by the European Commission's Recommendation no. 384 of 27 April 2004. The Ministry of Finance circulated the proposal for comment, setting the deadline for replies at 20 June 2005. Amendments to the regulations have yet to be laid down.

The legislative amendments called for by the implementation of the UCITS Directive led to the introduction in spring 2004 of new standardised articles of association for securities funds. As a result much effort was put into affirming new articles of association and approving changes in articles. Kredittilsynet approved the articles of several funds that were subsequently admitted to stock exchange listing (Exchange Traded Funds).





Reporting by investment firms and asset management companies

Off-site supervision of management companies and securities funds is on a quarterly basis. In order to enable regular follow-up of compliance with all capital requirements, Kredittilsynet now requires investment firms' and management companies' quarterly reports to explain how the previous year's fixed expenses have been calculated. A statutory requirement is that regulatory capital cannot be lower than 25 per cent of the previous year's fixed expenses. For many investment firms and management companies the capital charge derived from the size of fixed expenses will exceed other minimum capital requirements.

In 2005 quarterly reporting was also introduced for Norwegian branches of foreign undertakings, which have previously reported on an ad hoc basis. The branches report the same items as Norwegian credit institutions that provide investment services.

As regards reporting on whether or not investments have been in keeping with law, regulations and articles of association, only a small number of breaches were noted in 2005, although management companies were asked to explain the breaches in a number of cases. See also the comments on Sundal Collier Fondsforvaltning.

Market infrastructure

Kredittilsynet oversees the Norwegian Central Securities Depository (VPS), Oslo Børs ASA, NOS Clearing ASA, Nord Pool ASA, Nord Pool Clearing ASA and the International Maritime Exchange ASA (Imarex).

Acting on Kredittilsynet's recommendation, the Ministry of Finance granted DnB NOR dispensation until further notice from the ownership restriction rules of the Stock Exchange Act and the Securities Register Act, thereby enabling DnB NOR ASA to own existing shareholdings in Oslo Børs Holding and Verdipapirsentralen Holding. Also acting on Kredittilsynet's recommendation, the Ministry of Finance extended, subject to further conditions, Statsnett SF's and Affärsverket Svenska Kraftnät's dispensation to own 50 per cent each of the shares of Nord Pool. The dispensation was time limited to three years. Nord Pool's dispensation to own all the shares of Nord Pool Clearing was similarly extended by three years.

The increase in traded and cleared volumes in the freight derivatives market slowed somewhat in 2005, but substantial market price fluctuations indicate that Kredittilsynet will need to pay close attention to this market in the period ahead. Imarex has established a subsidiary in Singapore, and received in 2005 authorisation from the Ministry of Finance to engage in business in the subsidiary under the Stock Exchange Act. Imarex was admitted to listing on Oslo Børs in spring 2005.

Imarex offers clearing and settlement of freight derivatives at NOS Clearing. NOS Clearing is also a central clearing counter-

party in the derivatives market on Oslo Børs. In contrast to most of Europe, Norway and the other Nordic countries have no corresponding clearing arrangement for shares.

In 2005, among other measures, NOS Clearing has taken out credit insurance, which substantially mitigates the clearing house's risks. In the first quarter of 2005 NOS Clearing expanded its capital base to enable it to meet any future loss not covered by the new insurance or other risk-mitigating measures.

The Stockholm, Helsinki, Copenhagen and Baltic stock exchanges have merged to form a single entity. The Finnish central securities depository has also initiated cooperation with its Swedish counterpart. These innovations have repercussions for the organisation of the infrastructure of the Nordic securities market. Oslo Børs collaborates closely with the other Nordic bourses through the NOREX alliance.

At the start of 2005 Nord Pool obtained authorisation to quote CO2 quotas and CO2 quota derivatives. In the autumn of 2005 Nord Pool had its licence further extended enabling it to quote derivatives on green certificates. Nord Pool Clearing was concurrently authorised to act as clearing house for all these products.

High prices appear to have become a lasting feature of the electricity derivatives market, and price uncertainty appears to have increased. One reason is the establishment of the European CO2 quota market, in which European electricity producers in particular have to factor the cost of CO2 quota purchases into their electricity prices. The short- and long-term impacts on the electricity market and the electricity derivatives market are uncertain. Kredittilsynet will therefore need to keep a close watch on developments in both the CO2 quota and the electricity derivatives market ahead. Kredittilsynet collaborates with the Competition Authority and the Norwegian Water Resources and Energy Directorate (NVE) on supervising the electricity market. The collaboration forum meets on a quarterly basis and addresses current supervisory issues.

As part of its FSAP (Financial Sector Assessment Program) in Norway in 2004 and 2005, the International Monetary Fund prepared a technical paper entitled *An Analysis of Possible Financial Risk in the Clearing and Settlement of Securities in Norway*. Kredittilsynet and the Central Securities Depository (VPS) considered the IMF's comments, and the VPS has started work on possible steps to improve conditions regarded as relevant.

In 2005 Kredittilsynet conducted on-site inspections at Oslo Børs, Imarex and Nord Pool. IT inspections were also carried out at Oslo Børs and Imarex.

Supervision of compliance with the general rules of conduct of the Securities Trading Act

Through its supervision in this field Kredittilsynet plays an important role in the effort to ensure orderly conditions in the securities market. The overarching aim is to reduce the risk compensation required by investors and thereby reduce issuers' capital costs.

The rules on unlawful insider trading, market manipulation and appropriate handling of information are at centre-stage. Kredittilsynet also oversees compliance with the rules on the drawing up of insider lists, the obligation to investigate, the prohibition against giving advice, the prohibition against unreasonable business methods, notification rules and rules requiring disclosure of sizeable share acquisitions. Hence a wide circle of supervised entities is involved: investors, advisers, issuers and their partners, including investment firms. The object is to bring to light and prosecute unlawful conduct in the securities market and, insofar as the conduct provisions are applicable, in the markets for freight and electricity derivatives. Kredittilsynet aims to show potential lawbreakers that any violation risks detection, and it will also apply other measures to discourage criminal acts.

Supervisory tasks

Many of the large number of cases investigated by Kredittilsynet in 2005 were referred to it by Oslo Børs. Under an agreement between Oslo Børs and Kredittilsynet only a low level of suspicion is required to justify referral to Kredittilsynet. Kredittilsynet also initiated a number of investigations based on its own observations in the market.

Several of the insider cases handled by Kredittilsynet were time-consuming, especially where the investigations involved other countries. Kredittilsynet availed itself on several occasions in 2005 of cooperation agreements with foreign supervisory authorities when conducting investigations. Kredittilsynet similarly assisted foreign supervisory authorities in a number of investigations, primarily by providing information in cases where a transaction related to Norway.

Kredittilsynet investigated several cases of suspected market manipulation and breach of provisions concerning unreasonable business methods in 2005. Suspected breaches of notification rules and rules requiring disclosure of sizeable share acquisitions also prompted investigations.

Five cases of suspected unlawful insider trading and/or breaches of confidentiality were reported to the prosecuting authority in 2005, in addition to one case of price manipulation, two cases of unreasonable business methods, one failure to disclose a sizeable share acquisition and four breaches of the notification rules. Kredittilsynet also issued warnings after minor breaches in the two last-mentioned areas.

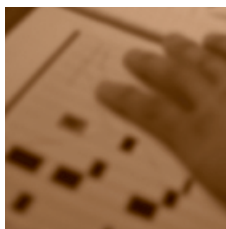
Kredittilsynet helped the prosecuting authority to follow up reported cases to a far greater degree in 2005 than previously. Particular mention may be made of the assistance given to Kristiansand Police District in connection with investigation of two suspected breaches of the provision prohibiting dishonest business methods. Kredittilsynet's assistance to ØKOKRIM in 2005 referred to suspected breaches of the market conduct rules.

Two convictions were handed down for unlawful insider trading in 2005, one of which is unappealable. One fine in lieu of prosecution was imposed in 2005 for breach of issuing undertakings' obligation to draw up a list of insiders. In addition, one fine in lieu of prosecution was imposed for breach of the rules governing notifiable securities trading.

Kredittilsynet ordered the relinquishing of unlawful gain in one case of unlawful insider trading. A relinquishment order was considered an appropriate sanction in this case, despite the objective gravity and degree of culpability of the violation.

In September 2005 Kredittilsynet started an investigation of nominees authorised by Kredittilsynet to appear in the Central Securities Depository's books. The main aim is to check whether nominees are in a position to disclose the identity of the underlying investors to Kredittilsynet. The results so far have shown that a number of nominees have difficulty delivering such information. In December 2005 several were given a preliminary warning that their authorisations would be revoked.

In 2005, as previously, the collaboration between Kredittilsynet, Oslo Børs and ØKOKRIM was further developed through joint seminars for staff from the three institutions. The collaboration between Kredittilsynet and the prosecuting authority was also strengthened through work done on individual cases in 2005. Kredittilsynet also collaborates fruitfully with Nord Pool. The aim of the collaboration between the institutions is to enhance overall market surveillance. Themes discussed included routines, priorities and legal issues.



Legislative tasks

In March 2004 Kredittilsynet sent to the Ministry of Finance a draft consultative document recommending how the Market Abuse Directive (2003/6/EC) might be implemented into Norwegian law. After consultation, the ministry proposed, in Proposition no. 12 (2004-2005) to the Odelsting, amendments to the Securities Trading Act. The proposal, based largely on Kredittilsynet's submission, was adopted in March 2005. As a step in the further implementation, Kredittilsynet drafted amendments to the Stock Exchange Regulations and Regulations to the Securities Trading Act. The drafts were sent to the Ministry of Finance in January and February 2005. Amendments to the Securities Trading Act and appurtenant regulations came into force on 1 September 2005.

As a result of the law revision, Kredittilsynet issued circular 14/2005 replacing circular 22/2001. The circular contains comments on some provisions of the Securities Trading Act "Chapter 2 General trading rules, duty of confidentiality etc.," and "Chapter 3 Notification requirements".

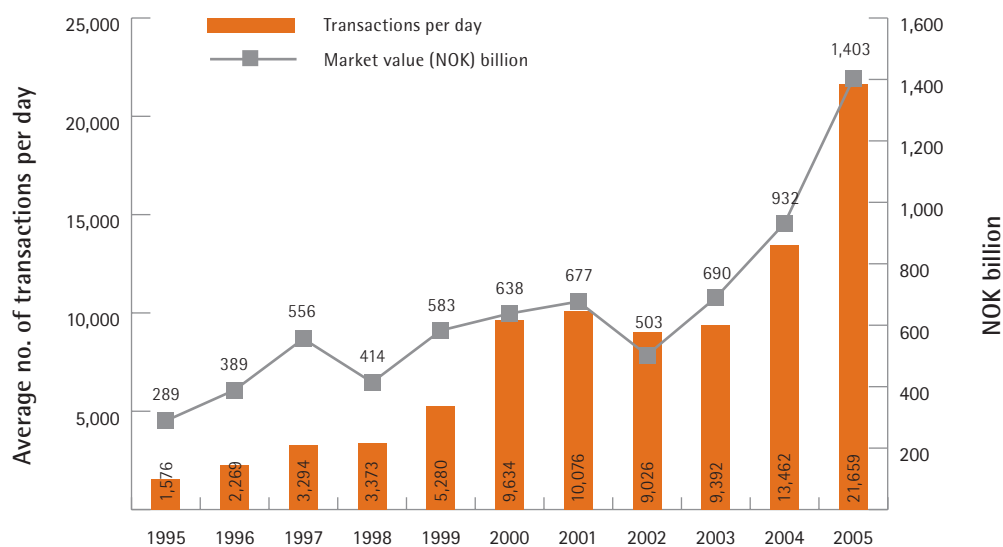
In view of somewhat vague practice on the part of investment firms, Kredittilsynet issued in February 2005 a circular on information handling in connection with book-building (circular 8/2005). The circular addressed an issue on which investment firms desired further guidance.

In a letter of 31 October 2005 to the Ministry of Finance, Kredittilsynet recommended amendments to the Securities Trading Act that would provide better scope for applying administrative penalties in the event of rule violations. The recommendation was prompted by the fact that not all rule violations automatically lend themselves to ordinary criminal prosecution.

Information

Kredittilsynet held several seminars and presentations in 2005 for investment firms, issuer undertakings, investment banks, law firms and Oslo Police District focusing on the amendments to the Securities Trading Act and appurtenant regulations.

Chart 4: Turnover and number of trades at Oslo Børs



Source: Oslo Børs



Financial reporting supervision

As from 2005 listed companies are required to apply International Financial Reporting Standards (IFRS) when preparing and presenting consolidated accounts. Kredittilsynet has been tasked with ensuring that companies comply with this requirement. The oversight encompasses all Norwegian registered enterprises that are listed on a stock exchange, authorised marketplaces in Norway or on regulated markets in other EEA states. Kredittilsynet's oversight does not extend to foreign enterprises listed on Oslo Børs. The oversight applies to periodic reporting such as annual accounts at group and company level, directors' reports and interim accounts.





Oversight of listed companies' financial reporting

47

An important aim of the EU's financial services action plan for a smoothly functioning market for investment and capital services in the European Economic Area is to protect investors' interests and thereby promote deep and liquid capital markets in Europe. The international financial reporting standards (IFRS) regulation forms part of this plan, requiring all listed companies to apply international financial reporting standards to their consolidated accounts from 2005 onwards.

National enforcement bodies have been established to oversee companies' application of IFRS's accounting rules and thereby underpin confidence in company accounts. In Norway, the responsibility for overseeing financial reporting has been assigned to Kredittilsynet. Control of financial reporting is to be carried out based on the same standards across the entire EEA. The Committee of European Securities Regulators (CESR) has been tasked by the EU Commission with preparing standards in this field. Kredittilsynet will base itself on the standards prepared by CESR.

Kredittilsynet / Annual report / 2005

Scope of the oversight

The oversight includes all Norwegian issuers, i.e. companies which are Norwegian-registered, listed on a stock exchange or authorised marketplace in Norway or on a regulated market in another EEA country. Listed issuers as well as issuers that have applied for listing are included. Foreign companies listed on Oslo Børs are subject to the oversight of the regulatory authorities in their respective home countries. Issuers listed on Oslo Børs but not registered in the EEA will not be subject to the oversight arrangement. Central government agencies, municipalities and county municipalities are not encompassed by the oversight, neither are municipal and inter-municipal enterprises/companies. State owned enterprises will, however, be included.

Oversight will in principal focus on companies' periodic reporting, irrespective of the accounting standards applied, i.e. annual accounts (at both group and company level), the directors' report and interim reports.

In determining which enterprises are to be selected for controls, a combination of techniques will need to be applied. A three-pronged model is planned whereby some companies will be selected based on submitted reports and others based on risk analysis. The risk-based analysis will be conducted on the basis of incoming reports received via the Altinn Internet portal. To ensure that the financial reporting of all enterprises is followed up, a rotation system will be followed under which all enterprises will be checked over a specified period.

Information to and communication with the market

Information to and communication with the market and important user groups is of major importance, not least from the perspective of confidence in the capital market. Kredittilsynet will provide information through a combination of its website, circulars, press releases, seminars on specific themes and oral presentations, as well as annual reporting. It will also be in direct contact with all listed companies.

At the outset of the oversight arrangement, Kredittilsynet sent out a circular to all listed companies containing information on the new system (circular 3/2005). All listed companies are

allotted a specific contact person. Moreover, identically worded letters were sent when the regulations on accounting controls were adopted, containing information on filing with Kredittilsynet.

In October 2005 Kredittilsynet held a half-day seminar for all issuers, which focused on new rules relating to insider trading and the system for and experience with accounting controls. In January 2006 a circular was distributed outlining Kredittilsynet's experience and findings with regard to its scrutiny of financial reporting in 2005 (circular 5/2006).

Supervision of financial reporting

Kredittilsynet has assigned responsibility for accounting controls to a recently established Section for Financial Reporting Supervision at the Accounting and Auditing Supervision Department. An important complement to Kredittilsynet's resources is the IFRS expert committee provided for by the Standing Committee on Finance and Economic Affairs in Recommendation No. 17 (2004-2005) to the Odelsting. Kredittilsynet functions as secretariat to the expert committee. The committee was appointed by the Ministry of Finance on 13 October 2005 and held its first meeting in November.

The expert committee

Frøystein Gjesdal (chair)
Aase Aa. Lundgaard (deputy chair)
Stig Enevoldsen
Erik Mamelund
Björgunn Havstein
Elisabeth Sulen (alternate)
Karina V. Hestås (alternate)
Jørgen Ringdal (alternate)

Regulations governing Kredittilsynet's activities in this area were adopted by the Ministry of Finance pursuant to the Securities Trading Act. The regulations also encompass financial reporting by issuers as well as reporting via the Altinn Internet portal, which forms the basis for Kredittilsynet's risk-based selection.

At year-end 2005 about 280 companies (Norwegian-registered share, primary capital certificate and bond issuers) were subject to Kredittilsynet's oversight of financial reporting. During 2005 several new companies were admitted to listing on Oslo Børs, primarily share issuers. Kredittilsynet reviewed all or parts of the financial reporting of 126 companies. Particular attention was focused on issuers of equity instruments such as shares and primary capital certificates.

Kredittilsynet's Section for Financial Reporting Supervision was fully operational from the summer of 2005 onwards and reviewed documents relating to financial reporting.

Table 10: Documents – financial reporting

Document	Number
Annual accounts 2004	126
IFRS transitional document	110
Interim accounts 2005	175

As a result of this review, 12 cases were followed up more closely. No information was received from the companies, their elected representatives, senior employees or auditor to indicate that the financial reporting of the issuers did not provide a fair presentation under the provisions of the Securities Trading Act.

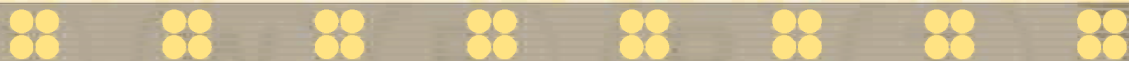
Legislative changes

During the course of 2005 extensive amendments were made to the Accounting Act on two occasions – by amending act No. 81 of 10 December 2004 and amending act No. 46 of 10 June 2005. With the enactment of these amendments the Act now incorporates a two-track system comprising the IFRS regulation's system and the ordinary Accounting Act system. Companies preparing and filing their accounts under the IFRS Regulation's system have a right and a duty to prepare their accounts in accordance with all EU approved financial reporting standards implemented in Norwegian law. During 2005 Kredittilsynet assessed the need for changes to the regulations on annual accounts for companies under its supervision in the following documents:

1. Letter of 2 March 2005 to the Ministry of Finance proposing amendments to regulations as a consequence of the amending act of 10 December 2004.

2. A consultative document dated 21 June 2005 proposing that financial institutions be precluded from using IFRS in their company accounts, but proposing that investment firms should not be precluded from doing so.
3. A consultative document dated 31 October 2005 proposing amendments to the annual reporting regulations for banks and finance companies and mortgage companies and for insurance companies as a consequence of the amending act of 10 June 2005. The consultative document also contained proposed regulatory amendments as a consequence of the regulations of 21 December 2004 on accounting treatment of loans and guarantees, and amendments to insurance legislation. An equivalent consultative document concerning pension funds was forwarded to the Ministry of Finance on 15 November 2005.

In addition, Kredittilsynet drafted a guidance on the regulations of 21 December 2004 on accounting treatment of loans and guarantees, ref. circular 10/2005.



Auditing

Kredittilsynet's tasks in relation to auditors comprise approval or licensing of individuals and firms in accordance with the legal requirements applying to this profession, as well as registration and supervision. Supervision includes checking that auditors maintain their independence, and that they discharge their assignments in a satisfactory manner and in compliance with law, regulations and good auditing practice.

The auditing profession features a bipartite structure: a small number of international audit firms that audit the majority of listed companies and other entities of public interest, and a large number of smaller audit firms that mainly audit small and medium-sized clients.





Administrative activity in 2005

The Auditors Act contains provisions on the statutory audit obligation, authorisation of auditors, the duties of the auditor and requirements on the performance of the audit. Kredittilsynet authorises auditors as either registered or state authorised auditors. Requirements are imposed as to training, practice and good repute. State authorised auditors are subject to higher requirements as to education than registered auditors. Additional requirements apply to auditors who conduct statutory audits or file certifications with public authorities. These include requirements for continuing education and the furnishing of security of NOK 5 million for any liability they incur in their practice.

Audit firms retained to audit the annual accounts of clients must also be authorised by Kredittilsynet. In the case of these firms, approved auditors or audit firms must hold more than 50 per cent of the share capital or the subscribed capital and votes in the firm. Transitional rule E of the Tax Reform resulted in a number of firms opting to set up ownership through holding companies rather than in the form of personal ownership. This in turn has resulted in a number of applications for authorisation of audit firms whose exclusive purpose is to hold ownership stakes in an audit firm.

Table 11: Number of authorised auditors and audit firms

	31.12.2003	31.12.2004	31.12.2005	Approved in 2005
State authorised auditors	2,177	2,325	2,469	168
Registered auditors	2,977	3,033	3,026	108
Audit firms	514	518	569	89

On 26 August 2005 the Ministry of Finance adopted amendments to the Regulations on Auditing and Auditors. Kredittilsynet initiated the changes to the regulations as a consequence of the negative findings of a thematic inspection conducted in 2003 of the advisory services offered by the major audit firms. Under the new provisions an auditor is required to ensure that he/she does not act in such a way that there is a risk that the auditor will audit the result of his or her own advisory services etc. or that the auditor performs functions that are part of the client's decision-making process. Moreover, the auditor must not put him or herself in a situation in which total revenues from advisory services over time are significant compared with the auditing fee received from the same client. The amendments to the regulations came into force on 1 October 2005. At the same time changes were introduced to the provisions governing the continuing education in that the mandatory hours must now include "ethical principles governing the professional duties and tasks of the auditor". This amendment was proposed by the Norwegian Institute of Public Accountants (DnR) and enters into force on 1 January 2007.

On 17 November 2005 Kredittilsynet adopted amendments to Section 5 first paragraph of the Regulations on the practical examination for auditors. This provision regulates the composition of the examination board. The background to this change was notification that the professional committee for auditor education had been dissolved and was therefore unable to nominate a member of the examination board. As a result of the change to the regulations, Kredittilsynet nominates a member of the examination board based on a proposal by educational institutions offering approved auditor education. The practical examination, as a precondition for authorisation as an auditor, was held for the first time in autumn 2005. The examination is prepared by the examination board. Under an agreement with Kredittilsynet, Agder University College is responsible for organising the examination.

In 2004, at the request of the Ministry of Finance, Kredittilsynet reviewed a proposal from ØKOKRIM recommending the introduction of an obligation for auditors to report suspicions of specific serious criminal offences to the police. The ministry did not follow this up with substantive measures in 2005. Kredittilsynet assumes that the proposal will be considered by the Law Commission that the Ministry of Finance has given notice will be appointed to consider measures to counter financial crime on the financial market.

Norwegian audit firms retained to audit companies or subsidiaries of companies listed on US stock exchanges are required to register with and are subject to the supervision of the Public Company Accounting Oversight Board (PCAOB). The PCAOB reports to the Securities and Exchange Commission (SEC). PCAOB was established to oversee the auditors of public companies in the USA. However, the PCAOB may wholly or partially base its oversight on the supervision conducted by the supervisory authority in the home country. The five largest audit firms in Norway requested that Kredittilsynet consider supervisory cooperation with the PCAOB. Kredittilsynet has established contact with PCAOB.

Since 1996 the Commission of the European Union has been working on improving and harmonising the quality of audit work in Europe through a new audit directive. No major changes appear to be required to the existing regulations governing auditors and auditing, with the exception of the requirement that audit assignments be conducted in accordance with "International Standards of Auditing" (ISA). The somewhat detailed and extensive standards may become regulations and will far and away replace existing legislative requirements on "good auditing practice" within the areas covered by the standards. This could pose a challenge to the audit profession, its clients and to Kredittilsynet in terms of enforcement.

Supervisory activity in 2005

Since 2002 Kredittilsynet has coordinated its supervisory activity with the quality control procedures that the Norwegian Institute of Public Accountants (DnR) conducts in respect of its members. Under the arrangement all members with audit responsibility are checked by DnR during the course of a five-year period. If DnR's quality control procedures bring to light circumstances that may entail the withdrawal of an auditor's licence, the matter is referred to Kredittilsynet for further action. This collaboration with DnR functions well. Under the existing guidelines DnR publishes a report on its control procedures. The report for 2005 can be found on page 53 of Kredittilsynet's annual report.

Kredittilsynet conducts its supervisory activities on the basis of reports received – primarily from the tax authorities, liqui-

dators and audit clients – and signals emerging, for example in the media. The Directorate of Taxes and Kredittilsynet liaise with a view to considering which reporting procedures should apply, including the content of reports and how reporting should proceed. Matters that come to light in other entities supervised by Kredittilsynet may also lead to closer assessment of the work of an auditor. A pertinent example is the follow-up of Sundal Collier Fondsforvaltning ASA. Moreover, the checks conducted by Kredittilsynet of the accounts filed by listed enterprises may bring to light circumstances that will necessitate a closer examination of the work of an auditor.

206 cases were handled in 2005, of which 52 were on the basis of on-site inspections. Kredittilsynet received 95 reports on auditors in 2005, compared with 84 in 2004.

Table 12: Revocation of auditors' licences

	31.12.2002	31.12.2003	31.12.2004	31.12.2005
State authorised auditors	1	0	0	2
Registered auditors	5	3	4	2
Audit firms	8	1	0	0

All auditors are subject to off-site supervision every second year, most recently in autumn 2005 when 5,495 auditors and 569 audit firms were involved. The Altinn Internet portal was used for reporting. It is thought that in the longer term this approach will considerably simplify the process of reporting to Kredittilsynet. The aim of off-site supervision is to gain an overview of auditors' commercial ties, their business activities and the scope of such activities. Compliance with requirements as to continuing education and provision of security is also checked. The responses are used to compile statistics and also provide the basis for analysis of trends in the audit industry. Processing of the information received will be completed during the course of 2006.

With effect from 1 January 2002, the State took over all hospitals previously operated by the county municipalities. In the autumn of 2004 Kredittilsynet conducted on-site inspections of the audits of the regional health enterprises. The inspection was completed in the spring of 2005. Kredittilsynet did not find serious faults in the audits or in the basis for the audit reports issued.

In light of developments in the Finance Credit affair, Kredittilsynet conducted a review in spring 2005 of audit firm KPMG's existing organisation, routines and procedures for audit

assignments. Kredittilsynet's inspectors reviewed and assessed a large quantity of documents submitted by KPMG, supplemented by discussions and interviews with managers and key personnel. Kredittilsynet had no substantial comments of note.

In the autumn of 2005 work started on an overview of control procedures in place in IT units at a selection of banks. The process aims to identify what audit documentation is available for the planning phase, implementation phase and concluding phase and to assess the adequacy of this documentation. The question of whether external auditors adequately test the work of the internal auditor will also be looked into. A report and conclusions are expected to be finalised in spring 2006.

Kredittilsynet performed on-site inspections at the five largest audit firms' offices in Bergen, Stavanger, Trondheim and Tromsø in autumn 2005. This process excluded branch offices at which DnR had performed quality control checks in 2005. The primary objective of the inspections was to assess the responsible auditor's documentation of examination of key aspects of selected assignments, and the offices' routines for and documentation of quality control checks performed on the conducted audit. At offices with banks as audit clients, the audit of the banks' IT units was assessed. The process did not bring to light significant flaws.

DnR Quality Control – Annual Report 2005

With reference to the guidelines for collaboration between Kredittilsynet and the Norwegian Institute of Public Accountants regarding quality control of statutory auditors, the Executive Board of the Norwegian Institute of Public Accountants hereby presents an overview of the results of the quality control conducted in 2005.

Organisation of quality control in 2005

The control set-up is described in "Details of the quality control set-up 2005" as posted at www.revisornett.no. It is designed with a view to checking compliance with good auditing practice, including audit standards, and focuses on the provisions of the Auditors Act concerning auditors' finances, independence, provision of security and continuing education.

The controller team comprised 36 state authorised and registered auditors, all with a broad professional background.

Selection of auditors for quality control

The quality control scheme in 2005 encompassed 1,460 statutory auditors. 300 statutory auditors were selected for ordinary control measures. A further 21 statutory auditors were subject to follow-up control.

Result of the quality control process

In our assessment Norwegian auditors conduct their duties to a high professional standard and their work is of high quality. Nevertheless, DnR wishes to reduce the number of cases in which follow-up measures are required. We will seek to achieve this through the provision of technical information and guidance to our members.

The facsimile of the original letter is from Den norske Revisorforening (DnR). It includes the organization's logo and contact information in both Norwegian and English. The letter is dated Oslo, 30. januar 2006, with reference number HS/kr. The main body of the letter is in Norwegian and discusses the 2005 quality control report, the organization's objectives, and the results of the control process. A small table summarizes the control results, showing 321 total controls conducted with a 100.0% success rate. The letter is signed by Henning Strøm, Chairman of the Board.

	Antall	%
Godkjent	273	85,0
Mangler – handlingsplan og ny kontroll	40	12,5
Oversendes Kredittilsynet for videre oppfølging	8	2,5
Sum utførte kontroller	321	100,0

(facsimile of original letter)

	Number	%
Approved	273	85.0
Deficiencies noted – action plan and new control	40	12.5
Referrals to Kredittilsynet for further action	8	2.5
Total controls conducted	321	100.0

Yours sincerely
(sign)

Henning Strøm
Chairman
Norwegian Institute of Public Accountants

External accounting services

Kredittilsynet's tasks in relation to external accounting services comprise authorisation of individuals and firms in accordance with the legal requirements applying to this profession as well as registration and supervision. Supervision includes checking that the activities of providers of external accounting services comply with laws and regulations and are conducted in an appropriate and satisfactory manner.





Administrative activity in 2005

55

The Authorisation of External Accountants Act contains provisions regulating when the authorisation requirement applies, the preconditions for granting and renewing authorisations and rules on the loss and revocation of authorisations. The Act also contains provisions on the performance of external accounting assignments etc. After the decision in June 2004 that Kredittilsynet should retain responsibility for authorisation, the authorisation scheme was fully integrated in Kredittilsynet's organisation. The administration of the authorisation of the External Accountants Act and the supervision of external accountants follow the same principles as Kredittilsynet's other supervisory work.

Kredittilsynet has recommended amendments to acts and regulations aimed at bringing greater clarity to the legal basis for authorisation and the way in which external accounting assignments are to be performed. An educational reform was initiated effective from the 2002/2003 academic year involving a transition to a new degree structure (three-year bachelor's degree and five-year master's degree). Kredittilsynet has proposed that the authorisation requirement should be linked to this degree system. Moreover, Kredittilsynet's experience with supervisory work has revealed a general need to improve the quality of accounting services conducted

under the External Accountants Act. Kredittilsynet has for this reason suggested raising the educational requirement from two years of financial training to a three-year bachelor's degree in economics and management. Kredittilsynet has also proposed removing the existing scheme under which authorisations are renewed every five years. Continuing professional training will be checked through off-site supervision, on-site inspections and, where applicable, by other means. The Authorisation of External Accountants Act also permits the authorisation of accounting firms. In the case of such firms there is a requirement that the chief executive officer must be a licensed external accountant. Kredittilsynet has proposed that this requirement should continue to apply, but that an amendment be made to the regulations exempting large accounting firms. Apart from this exemption the practice in regard to dispensation will be restrictive. Kredittilsynet's proposal also entails certain other changes. The proposed amendment to the Authorisation of External Accountants Act was circulated for comment by the Ministry of Finance on 19 December 2004. Kredittilsynet's proposal for amendments to the regulations on the authorisation of external accounts was circulated for comment by Kredittilsynet on 30 September 2005, the closing date for comments being 31 December 2005.

Table 13: Number of authorised external accountants and external accountancy firms

	31.12.2003	31.12.2004	31.12.2005	Authorised in 2005
Individuals	6,598	6,724	7,179	545
Firms	2,566	2,542	2,632	226

Unlawful external accounting activity

In addition to administrative and supervisory activities Kredittilsynet investigates entities within the industry that undertake accounting assignments for third parties without holding the required licence. These investigations are conducted on

the basis of written reports and other signals received by Kredittilsynet and by means of checks of registrations in the Register of Business Enterprises etc. The written reports are generally received from the tax authorities, but also from clients, liquidators etc.

In 2005, 29 reports of unlawful accounting activities were received, and 12 orders were issued requiring business to be terminated. Three persons reported to the police by Kredittilsynet were convicted of unlawful external accounting activities in 2005. One case resulted in a fine.



Supervisory activity in 2005

The primary aim of supervision is to ensure that providers of external accounting services observe the requirements laid down in law and regulations. In its on-site inspections Kredittilsynet also focuses on the way in which licensed external accountants conduct their business, see Kredittilsynet's guidelines on inspection (circular 12/2000). Kredittilsynet's general impression is that the quality of external accountants' operating setups varies considerably. It is important to note that Kredittilsynet's checks are not based on a random sample but rather on complaints and reports received from sources such as the Tax Administration, liquidators of bankruptcy estates, clients of accountants and the like.

Contact has been established between the Directorate of Taxes and Kredittilsynet with a view to closer assessment of the routines applicable to reports filed with Kredittilsynet, including factors that need to be reported and how reporting should take place.

Kredittilsynet processed a total of 112 supervisory cases involving authorised external accountants in 2005, 56 of which took the form of on-site inspections. As in previous years much of this work involved following-up external accountants in cases where Kredittilsynet had brought to light breaches of professional conduct or where Kredittilsynet had received reports from the tax authorities or other public agencies. Forty-five reports were received regarding external accountants.

Table 14: Revocation of authorised external accountants' licences

	31.12.2002	31.12.2003	31.12.2004	31.12.2005
Licence revoked – individuals	10	3	4	18
Warning issued	7	2	2	2
Licence revoked – firms	1	–	–	–

Of the above revocations 14 were due to failure to reply or respond to off-site supervision. Warnings are given if there are grounds for revoking a licence but where special circumstances indicate that the sanction should be limited to a warning.

In 2005, guidelines were drawn up regulating the collaboration between Kredittilsynet and the Norwegian Association of Authorised Accountants (NARF) on conducting quality control checks of licensed external accountants. Because of the large number of entities that are supervised, carrying out quality control checks on licensed external accountants and external accounting firms is resource-intensive. The arrangement is based on NARF's quality control work on its members and largely coincides with the collaboration between Kredittilsynet and the Norwegian Institute of Public Accountants (DnR). The guidelines came into force on 1 January 2006.

In the autumn of 2004 Kredittilsynet conducted an off-site supervisory process targeting the external accountancy profession. The findings of the survey included the following:

- There has been considerable expansion in the external accountancy profession in terms of turnover, number of assignments performed and person-years worked. Since the last survey in 2000, turnover had increased from approximately NOK 3.4 billion to NOK 5.9 billion, and the number of assignments had risen from some 207,000 to 260,000.
- There are a large number of small firms, a handful of large enterprises, as well as various chains and groupings.
- Earnings are low. For example, average turnover per full-time position in the industry in the 2003 financial year was approximately NOK 390,000.
- There has been a significant rise in the level of the professional qualifications held by external accountants since 2000.
- The contracting-out of accountancy services by business and industry is increasing.





Estate agency

Supervision of estate agents encompasses the activities of firms licensed to practise estate agency and lawyers who have put up security for estate agency, as well as housing cooperatives licensed to provide estate agency services and ordinary housing cooperatives' brokerage of cooperative flats. Firms, lawyers and housing cooperatives are checked for compliance with the requirements of law and regulations, including observance of good estate agency practice. Kredittilsynet is also assigned administrative and consultative tasks. Revising the Estate Agency Act was a resource-demanding task for Kredittilsynet in 2005.





2005 – a year of expansion for the estate agency industry

59

Kredittilsynet / Annual report / 2005

2004 saw the highest level of activity in the estate agency industry ever, with 125,000 properties sold, total property sales of NOK 214 billion and no less than NOK 4 billion generated in estate agency fees. This growth continued into 2005 with a first half that well outstripped the first six months of 2004 in terms of all three of the aforementioned values. Thus the number of property sales increased by 5,000 or 17 per cent on the first half 2004. Property sales values in the first half year 2005 were up by NOK 25 billion, or 26 per cent, on the first half of 2004, while the increase in estate agency fees totalled NOK 300 million, or 17 per cent.

However, it is becoming increasingly clear that the industry is becoming oversaturated. Both the net rise in the number of new estate agency businesses in 2005 – 70 – and the total number of new licences issued during the course of the year, no less than 106, are higher than in any other single year. Estate agents are increasingly finding that price conscious customers are shopping around for offers from several estate

agencies and negotiating before taking on an agent. The downward pressure on commissions is reflected in the bottom lines of estate agencies' accounts as in the form of operating losses, and a number of businesses have lost their equity capital and are unable to continue their estate agency activities without injections of fresh capital. In the first six months of 2005 approximately one quarter of the businesses reported operating losses. However, bankruptcies are the exception rather than the rule in the industry; businesses not capable of trading at a profit are generally wound up through ordinary company closure procedures.

At year-end 2005, 642 licensed estate agencies were trading, 39 ordinary housing cooperatives provided estate agency services and 1,213 lawyers had furnished security to engage in estate agency. The estate agency activities of lawyers in private practice are of limited scope, however. In 2004 less than 5 per cent of property sales were arranged by lawyers, and approximately 40 lawyers accounted for these sales.

Commercial property brokers

Commercial property broking differs significantly from residential estate agency, as do the skills required of its practitioners. The chief differences lie in the way in which the initial process of selling properties is conducted and the nature and scope of the information that needs to be provided. Moreover, it is frequently the case on the professional commercial property market – particularly in the case of major transactions – that the parties will also retain professional assistance from lawyers, auditors, engineers etc. Financial settlement in major property sales is often between the bankers of the vendor and purchaser, as a result of which the broker is not involved in this stage. It is probably true to say that the nature of commercial property broking is more akin to the role of an intermediary, with the primary function of the intermediary being to find a contract counterparty for the property to which the assignment relates.

There is no doubt that estate agency businesses have tightened their grip on the commercial property segment. When the present Estate Agency Act came into force in 1990, there were very few specialist commercial property broking businesses, and by and large the market was serviced by various types of consultants drawn from a variety of backgrounds. The number of businesses that exclusively, or predominantly, specialise in broking commercial properties has increased steadily. In fact reports filed with Kredittilsynet for the first half of 2005 revealed that no less than 51 businesses were exclusively involved in commercial broking, and that 66 businesses reported that over 80 per cent of their business comprised broking commercial properties. The last five-year period has seen a steady growth in the housing market, whereas the commercial market has shown greater fluctuations with a relatively healthy market in 2000 and 2004 with reported sales values in the two latter years of NOK 27 and NOK 38 billion, respectively, whereas the value of sales in the three intervening years ranged from NOK 16 to 20 billion. Property sale values for commercial properties in the first six months of 2005 totalled NOK 22 billion, representing an increase of NOK 12 billion on the NOK 10 billion recorded in the first half of 2004.

Kredittilsynet registers very few negative reports on the activities of commercial property brokers. Nor does this part of the industry appear to have come under the same critical spotlight as housing brokers. The reason for this is probably that these are professional operators and that disputes involving brokers are resolved through lawyers and the courts.





Increased stringency in the requirements applicable to the presence of the estate agent in charge

The changes introduced with the amendments to the Estate Agency Regulations in 2004 included provisions imposing relatively strict requirements aimed at ensuring that the estate agent in charge of an estate agency business spends sufficient time on the business' premises to ensure that he or she can keep the agency's brokers under continuous control and is available to the public.

The provision came into force on 1 June 2005 and the discretionary assessments required have resulted in numerous approaches to Kredittilsynet in regard to the way in which the provision is practised. Apart from giving general guidelines in this area, Kredittilsynet does not provide advance approval of plans governing the presence of the estate agent in charge. Assessing the extent to which the estate agent in charge should be present on the premises is the responsibility of the estate agency business and the estate agent in charge.

Nevertheless, if negligent estate agency practice comes to light and this is thought to be related to insufficient time spent on the premises, Kredittilsynet may order the estate agent in charge to spend more time on the premises.

Moreover, the change to the regulations entailed that it is generally no longer permissible for a single estate agent to be in charge of two or more estate agency businesses. The amendment prompted Kredittilsynet to write to 60 businesses ordering them to cease this practice.

Kredittilsynet's impression is that the industry as a whole is following up the new provisions in this area by reassessing whether the partial presence of the estate agent in charge – where this is the case – is in compliance with the regulations. In a number of cases reassessment has resulted in the estate agent in charge spending more time on the premises.

Revision of the Estate Agency Act

The law commission appointed by the Ministry of Finance in 2004 to update and revise the Estate Agency Act was originally expected to publish its report by May 2005. However, in light of the amount of work involved the Ministry of Finance extended this deadline until 31 December 2005. The Law Commission's recommendation presents a number of proposals aimed at creating a better organised, more orderly and transparent market. The proposals include a new licensing system with requirements as to the fitness of all key management personnel in a company, competence requirements applicable to all personnel of the estate agency business involved in estate agency services, requirements as to the independence of brokers and stricter rules governing trading for own account and conducting other business activities. There are also proposals requiring more information to be compiled and presented about properties.

In May 2005 the Commission published an interim report entitled "Safer bidding – bidding through an estate agent", which assessed the need for measures to counteract the high speed at which bidding rounds are conducted. The Commission proposes the inclusion in the Estate Agency Regulations of a new provision regulating the duties of the broker during the bidding process. However, the Commission was divided on the question of whether a specific minimum time for acceptance should be laid down, with the majority opposing the introduction of a rule of this nature, while the minority proposed that in consumer transactions estate agent should not pass on bids with a shorter time for acceptance than two hours from the time at which the bid reaches the broker. This interim report has been circulated for comment.

On-site inspection

Kredittilsynet conducted 21 inspections of estate agency firms and lawyers in 2005. In view of the heavy expansion of the industry a greater number of inspections might have been preferable. However, regulatory drafting, including Kredittilsynet's participation on the law commission revising the Estate Agency Act, claimed substantial resources. In Kredittilsynet's view, measures with a view to regulations that are more up-to-date and better suited to their purpose

represent a necessary investment in achieving a more modern approach to regulating the industry.

Of the inspections conducted in 2005 some were targeted checks in response to indications of possible cases of trading for own account, which it is important to follow up since the Estate Agency Act contains strict provisions prohibiting trading for own account and other business activities.

In connection with brokers' personal purchases and sales of real property through estate agencies, some supervisory cases brought to light breaches of good estate agency practice and of the Act's prohibition against trading for own account.

The most serious cases concerned two firms based in Bergen: Notar Eiendom Bergen AS and Notar Nybygg Bergen AS. At the end of 2005, following extensive investigations, Kredittilsynet revoked the firms' licences. Brokers employed by these firms and other persons undertaking paid assignments for the firms as well as acquaintances of such persons had bought up flats on a relatively large scale in projects that the firms had been retained to sell, and speedily resold the flats, generally at

a considerable profit. Investigations also brought to light unsatisfactory settlement practices in connection with brokers' payment to first-time buyers of capital gains on the resale of flats. Moreover, the records kept by the firms were found to be very unsatisfactory.

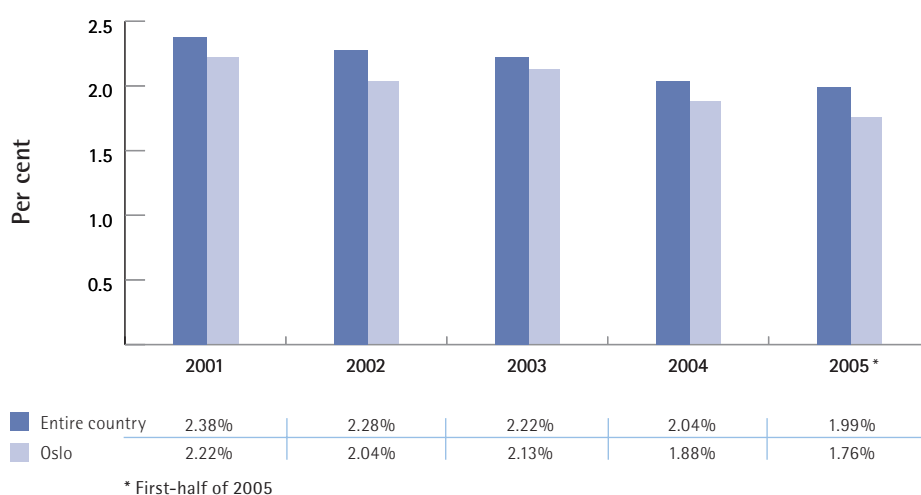
The estate agency businesses of these two firms were continued in a new enterprise – Notar Eiendom Bryggen AS – which was granted a licence following a detailed assessment in which the Act's requirements as to the fitness and propriety of the new owners and of the new estate agent in charge were found to have been satisfied.

Estate agents' duty of investigation and disclosure

Some cases reviewed by Kredittilsynet in 2005, and cases presented in the media, highlighted the importance of estate agents conducting thorough investigations, including into issues relating to public zoning plans. Estate agents are required to investigate and disclose any public authority interventions in the form of roads, developments etc., affecting the properties to which their assignment relates. In light of the extensive

zonings and re-zonings taking place in certain areas of the country, it is essential that estate agents diligently investigate such matters and disclose the information in a clear and unambiguous way in the sales documents. The estate agent's duty to conduct independent investigations cannot as a rule be replaced by quoting information provided by the vendor, since the vendor may not always be interested in shedding light on such matters.

Chart 5: Sales assignments, residential properties – average fee as a percentage of sale price



Debt collection

Supervision of the debt collection industry encompasses agencies' financial position and their treatment of client funds. It encompasses agencies that collect overdue debt on behalf of other businesses and organisations as well as agencies that purchase overdue debt and collect it themselves. Collection of own claims and lawyers' debt collection activities lie outside the scope of Kredittilsynet's supervision. At on-site inspections Kredittilsynet checks in particular that recovered funds are properly handled and that the business is conducted in accordance with generally accepted debt collection standards.





The market for debt collection services

At the end of 2005, 121 ordinary debt collection agencies were registered, seven more than the 114 agencies registered at the start of the year. The number of cases referred for recovery continues to increase, although this increase is relatively moderate. In the first half of 2005, debt collection agencies received 1,987,761 new cases for action, an increase of approximately 160,000, or 8.7 per cent, on the first half 2004. At the end of the first half year 2005 these companies had just under 2.6 million ongoing cases in their portfolios, an increase of 128,000 or 5.2 per cent on the end of the first half year 2004. The number of pending cases at the end of the first half year 2005 accounted for NOK 40.2 billion, including collection fees and other expenses.

It is by no means certain that the increase in debt collection is a function of an increase in defaults, since another pertinent

explanation could be that more creditors who formerly recovered their own outstanding debts are now outsourcing recovery to debt collection agencies.

Ordinary debt collection agencies recorded a total turnover in 2004 of approximately NOK 1.6 billion. About 20 per cent of all the agencies fail to operate at a profit and file reports with Kredittilsynet showing negative operating results and/or negative equity. Some enterprises in this category, particularly smaller businesses, cease operations before reaching the liquidation stage. It has long been the case that a handful of large debt collection companies with well developed collection systems and a sound financial base win out in the competition for attractive collection portfolios. Many of the smaller enterprises must make do with more niche-based activities.

Reduction in the number of debt purchase and collection companies

Since the purchase of overdue debts and collection of these debts were brought within the scope of the Debt Collection Act on 1 January 2002 and became subject to a special licensing requirement, only a small number of firms have applied for and been granted licences to conduct business of this nature. One reason for this is that enterprises with a licence to conduct financing activities under the Financial Institutions Act do not need a separate licence to recover purchased debt.

During 2005 the number of licensed agencies which purchased overdue debt fell from ten to eight after two companies owned by Aktiv Kapital were wound up and their collection portfolios were transferred to Aktiv Kapital's subsidiary licensed to

conduct financing activities in Sweden – Aktiv Kapital Nordic AB. Claims on Norwegian debtors are now recovered through Aktiv Kapital Nordic, the Norwegian branch of Aktiv Kapital Nordic AB. Business conducted in Norway by a Norwegian branch of a foreign enterprise is to some extent subject to Kredittilsynet's control. However, debt recovery by an enterprise of this nature does not fall within the remit of the Debt Collection Services Complaints Board since the enterprise does not hold a separate collection licence.

The six agencies licensed to purchase and collect debt at end-2005 held claims for recovery totalling NOK 1 billion and approximately 11,000 cases for recovery.

Changes to the Debt Collection Act – fitness and propriety etc.

Effective from 1 January 2006, certain changes were introduced to the Debt Collection Act. Of particular importance is a new fitness and propriety requirement applicable to all key personnel in a collection agency. In addition to the existing requirements applicable to the de facto manager, general managers, directors and owners with a significant stake in a collection agency – i.e. more than 10 per cent – must be fit to operate a collection business in accordance with the law, regulations and generally accepted collection practice. As part of Kredittilsynet's assessment of fitness and propriety,

directors and the general managers must submit a police certificate.

To achieve compliance with the EEA Agreement, a change has also been made to the requirements that need to be met in order for a collection licence to be granted. This entails that a debt collection agency with a permanent place of business within the EEA may conduct collection business in Norway, provided that it holds a Norwegian debt collection licence and is registered in the Register of Business Enterprises in Brønnøysund.

On-site inspections

Whereas in 2004, 25 on-site inspections were conducted of collection agencies, with a particular focus on smaller and recently started enterprises, in 2005 resources were above all devoted to inspections at certain major collection agencies and a number of other agencies where there were clear indications of unsatisfactory handling of client funds. Five inspections were conducted in 2005.

A widespread problem in the industry is that collection agencies make withdrawals on account from client accounts to their own operating accounts. This entails that when the collector wishes to transfer to its own account funds owed to it by clients in the form of collection fees, disbursements etc., round sums are transferred to the operating account without the amounts being specified or related to the case in question in the subsidiary ledger. Kredittilsynet regards this as a serious breach of the rules on the handling of client funds since it entails a real danger that the enterprise will transfer greater amounts than it is in fact owed by clients, with the result that the client account is overdrawn.

All inspections conducted in 2005 revealed flawed procedures and breaches of the rules governing how client funds are to be handled, one example being the widespread practice of withdrawals on account. In four of these cases it was not possible to prove any shortfall in the client account. One enterprise was unable to document that the collector had sufficient funds in the client account to cover the underlying liability towards the client. This agency's debt collection licence was revoked.

Ensuring that client funds are handled properly is one of the most important functions of the de facto manager of a collection agency. A collection agency must have at least one de facto manager. If considered appropriate, for example due to the scope of the business, the enterprise may have several

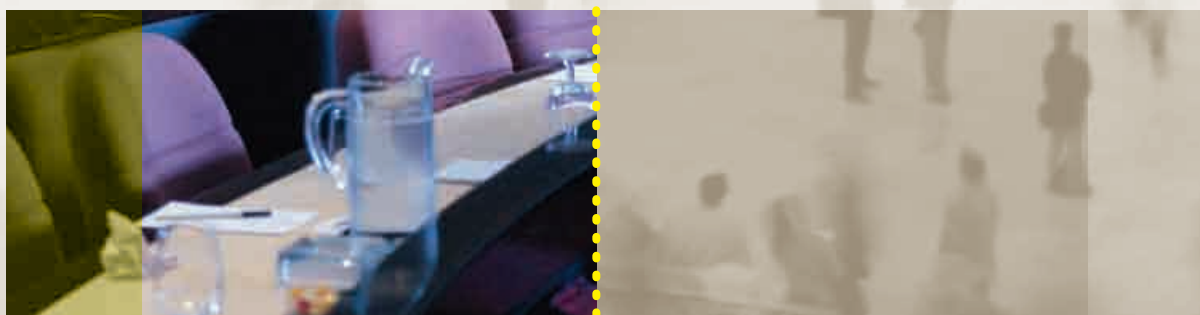
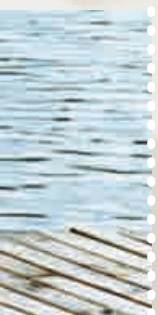
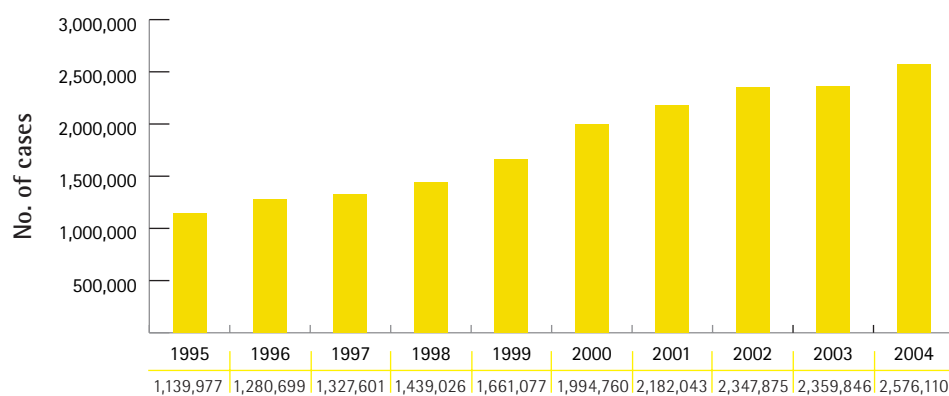
de facto managers with agreed areas of responsibility. If the enterprise has several de facto managers, responsibility for, for example, the handling of client funds must be assigned to one or more of these de facto managers. If breaches of the regulations governing client funds come to light, it will also be necessary to assess whether the de facto manager of the collection agency is fit to continue to hold a personal collection licence. Kredittilsynet has found in some instances that certain de facto managers do not appear to be sufficiently aware of the responsibility they bear for ensuring that client funds are handled in a lawful manner.

Four personal collection licences were revoked after unlawful handling of client funds was revealed during Kredittilsynet's inspections in 2005.

Kredittilsynet's inspections at one of the biggest operators in the debt collection industry, Intrum Justitia AS and its subsidiary Bryn Creditservice AS, brought to light serious rule violations resulting in heavy censure of the two collection businesses. At both companies, withdrawals on account from client accounts had taken place as described above. At Bryn Creditservice AS, the handling of objections received from debtors was so poor that this in itself would be sufficient for the enterprise's collection licence to be withdrawn. However, Intrum Justitia itself decided to close down Bryn Creditservice's collection business. Moreover, major breaches of the ICT regulations by Intrum Justitia AS were confirmed. In Kredittilsynet's assessment, Intrum Justitia AS had not carried on debt collection in an appropriate and satisfactory manner, as a result of which the question withdrawing the firm's licence was considered. Nevertheless, in light of the steps taken by the board of the company to remedy the situation, Kredittilsynet concluded that it would be appropriate to permit Intrum Justitia AS to continue its collection business.



Chart 6: Debt for recovery



Other issues





IMF assessment of the financial sector

The International Monetary Fund (IMF) monitors the economic policies of its member countries and promotes dialogue between them on the national and international consequences of their economic policies. Exchange rate policy, monetary policy and fiscal policy have long been at centre-stage in the IMF's surveillance effort. In recent years this has been accompanied by an increased focus on financial stability in member countries' financial sectors. In 1999 the IMF established a so-called Financial Sector Assessment Program (FSAP). Most member countries have been assessed by the IMF – among them Iceland, Finland and Sweden.

The objective of an FSAP is to weigh up the weaknesses and strengths in the financial sector of the member country concerned and to assess the challenges facing its financial system. The FSAP review of Norway extended from summer 2004 to spring 2005. Meetings were held with Norwegian government authorities, financial institutions and trade organisations. A central aspect of the review was to assess Norway's observance of international standards for supervision and regulation of various facets of the financial sector. In Norway's case the review focused on supervision and regulation of banks, insurers and the payments system. It was accompanied in January 2005 by a Financial Action Task Force (FATF) assessment of Norway's compliance with international recommendations on measures against money laundering and terrorist financing.

The review of Norway was in general positive, concluding that "Norway's financial system appears sound, well managed, and competitive, and shorter-term vulnerabilities appear low overall." The IMF recommended measures aimed at strengthening

the financial system. The IMF's assessments were published in June 2005. More information on the FSAP review can be found in the report *The Financial Market in Norway 2005: Risk Outlook*.

After the FSAP review, the Ministry of Finance asked Norges Bank and Kredittilsynet for an updated report on cooperation and work-sharing between the two institutions in relation to financial stability and preparedness for possible crises in the financial industry. On 16 December 2005 the two institutions wrote to the Ministry of Finance calling on the ministry to establish necessary national structures with a view to closer tripartite collaboration between Norges Bank, the Ministry of Finance and Kredittilsynet. In the letter Norges Bank and Kredittilsynet recommend that the ministry's annual "Credit Report", should brief the Storting on how responsibility for financial stability and crisis management is shared between the ministry, Norges Bank and Kredittilsynet, taking up the same matters as are included in a formal agreement (MoU) between corresponding authorities in other EEA states.

Norges Bank and Kredittilsynet advise the establishment in Norway, as elsewhere, of a regime of regular tripartite meetings between the Ministry of Finance, Norges Bank and Kredittilsynet. The ministry should preside over the meetings which should be held at least twice a year. They should be in addition to the bilateral meetings already held between departments of the three institutions, and should be of an overarching nature. The meetings should address the outlook for financial stability, coordination of crisis preparedness and important issues in regard to the financial sector's regulatory framework.

Safeguards and preparedness

Maintaining a preparedness to deal with problems that may arise in the financial sector is defined as one of Kredittilsynet's main objectives. The aim is to respond to possible crises in enterprises, infrastructure and markets with measures that limit harmful impacts and consequences for users, enterprises

and owners to the greatest possible extent. This includes monitoring compliance with relevant statutory requirements. Priority is given to crisis preparedness focusing on activities and areas of significance for financial stability. Preparedness plans have been drawn up in all such areas.

Kredittilsynet's focus is on safeguards and preparedness, in keeping with requirements of society. A risk and vulnerability analysis has been prepared for supervised entities and their use of information technology.

In response to the IMF evaluation of the Norwegian financial market, Norges Bank and Kredittilsynet have also taken a closer look at collaboration between the two institutions in relation to possible crises in the financial sector.

In December 2005 Kredittilsynet conducted an exercise involving a crisis at a savings bank. The exercise was designed to test preparedness at Kredittilsynet and at the Banks' Guarantee Fund with an eye to possible alternative solutions for a bank that is unable to honour its commitments. Norges Bank also



took part. Among other things, the exercise scenario enabled the Banks' Guarantee Fund to review conditions which must be met in order for the fund to provide support to, or issue a guarantee in favour of, one of its members.



Where its own organisation is concerned, Kredittilsynet has reviewed and updated contingency planning and safety routines in terms of physical and technological safety. Moreover, new security measures have been introduced at Kredittilsynet's office premises, and a controller function has been established whose remit includes security and terror preparedness.

IT supervision

Kredittilsynet conducted more than 31 IT inspections in 2005 at banks, insurers, finance companies, securities institutions, debt collection agencies, real estate agencies and external accountants. IT inspections were also carried out at IT service providers and data processing centres under the ICT Regulations section 12 on the outsourcing of ICT operations. The IT inspections were conducted in conjunction with the department responsible for the supervision of that sector.

The inspections showed there was still room for improvement in a number of areas in terms of institutions' use of information technology. Problems relate to change management, project implementation, adequate testing of catastrophe response plans and implementation of risk and vulnerability analyses.

The results of the risk and vulnerability analysis of IT use in the financial services sector were published in 2005, as previously. Based on analyses from Kredittilsynet and the data sources available, the following risk and vulnerability areas were identified as particularly important with a view to putting risk-mitigating measures in place:

- change management
- project management – major change projects
- organised crime – especially in relation to online banking and credit card use
- organisation of security measures against viruses and other malicious codes

New control questions were prepared for self-evaluation purposes in the area of IT supervision. New modules were devised for IT providers, IT projects, money laundering, internet banking, catastrophe preparedness, virus protection, firewalls and payments services. The IT inspection regime is now coordinated with risk-based supervision and the introduction of a new capital adequacy framework (see separate account on page 27 in the chapter *Banking and finance*).

The reporting obligation on payments services has not had the desired effect. An increase was noted in the number of undertakings failing to comply with the reporting obligation, prompting follow-up by Kredittilsynet in this area in 2006.

Follow-up work on, and supervision of compliance with, the ICT Regulations continued, and improved guidance on the regulations will be drawn up. Extending the regulations' scope to include external accountants and insurance intermediaries was also considered, but will not be implemented for the time being.

Kredittilsynet's IT supervision unit played an active part in a number of forums in 2005, and collaborates with other authorities in Norway and elsewhere on topical issues with a view to better coordination of the supervisory effort. They included the Coordinating Committee for Information Security, the Contingency Committee for Financial Infrastructure (BFI) and the Critical Information Infrastructure Protection Project (BAS5). Kredittilsynet also submitted consultative statements to the OECD, the European Network and Information Security Agency (ENISA) and other bodies.



Better information to retail customers in the financial market

In 2004 Kredittilsynet carried through a strategic project to examine the information disclosed to end-users in the financial market. A working group drawing participants from the Consumer Council, the Office of the Consumer Ombudsman and Kredittilsynet recommended ways to improve information disclosure to retail customers in the financial market. The working group's report specifically proposed measures to facilitate comparison of prices of loans and credit, savings and investment mediums and non-life insurance. One of its key recommendations was to set up an internet-based information database/portal for the financial sector providing a better product overview.

In 2005 the recommendations were followed up by the three institutions behind the report. Headed by the Consumer Council, they continued work on the issue of whether – and in the event how – an information portal for the financial services sector might be established. This study will be completed early in 2006 and thereafter circulated for comment.

Kredittilsynet also continued its work to improve the information provided on composite products, including index-linked bonds and deposits. This included a survey of what action institutions have taken to meet the information requirements set for such products in Kredittilsynet's circular 4/2004. The survey findings will provide Kredittilsynet with a basis on which to monitor compliance with the information requirements.

Kredittilsynet also worked together with the Office of the Consumer Ombudsman on a proposal requiring disclosure of the effective interest rate in all marketing of loans and credit. The issues raised by the report in regard to financial advice will be considered in conjunction with the implementation of the EU Directive on Markets in Financial Instruments (MiFID). Responsibility for the initial work in this connection will rest with the Securities Market Law Commission which is due to present its recommendation at the end of February 2006. Other measures are still in preparation.

Appeals handling – Register of Company Accounts in Brønnøysund

Kredittilsynet is the appeals body in respect of decisions by the Register of Company Accounts to refuse applications to waive penalties imposed for late filing of accounts, annual reports and audit reports with the above Register. In 2005 472 appeals were received compared with 562 in 2004. Kredittilsynet waived the penalty in full in 112 cases and in part in 56 cases. In other words, the penalty was waived in full or in part in about 35 per cent of cases compared with 43 per cent in 2004.

As a result of the amendment of section 8-3 of the Accounting Act, the maximum penalty period is now 26 weeks. Solidary debtors' liability is limited to the penalty accruing up to the date a solidary debtor retires from his post, and board members can now apply for exemption from solidary liability on an individual basis.

The filing obligation vis-à-vis the Register of Company Accounts is extended to all enterprises required to prepare accounts. This is expected to lead to an increase in the number of appeals.



International activities

Participating in international forums, where international supervisory standards and international rules are developed, is a matter of strategic importance for Norway and Kreditilsynet. Norway is committed to abiding by international standards and EU rules, and good international rules and standards can contribute significantly to financial stability and smoothly functioning financial and securities markets. That is why it is important for Kreditilsynet to play its part in their evolution and to exploit the opportunities available to that end.



Global collaboration

Annual meeting of integrated supervisors

The integrated supervision model – entailing joint supervision of banks, insurance companies and in general the securities sector – is gaining ever more ground in the international arena. Since 1999 a number of supervisory authorities with an integrated approach to supervision have met informally each year to discuss administrative and technical matters of common interest. In 2005 the Integrated Financial Supervisors Conference was hosted by Germany's Federal Financial Supervisory Authority (BaFin) which established integrated financial supervision in 2002. The meeting was attended by supervisory authorities from 16 countries.¹ Topics discussed included supervisory powers, conflicts of objectives, accountability and performance measurement. The extent to which supervisors heighten consumers' understanding and knowledge of financial products was also discussed.

Securities market

Kredittilsynet is a member of the International Organization of Securities Commissions (IOSCO), which held its annual conference in Colombo, Sri Lanka, in April 2005 (see www.iosco.org). Themes addressed at the conference's open panel sessions included supervision of rating agencies, challenges to rapidly evolving economies, supervision of financial analysts, and the increasing activity of hedge funds. Kredittilsynet also attends the semi-annual meetings of IOSCO's European Regional Committee, and participates in a working group under the technical committee which deals with enforcement of IOSCO resolutions and collaborates on issues related to surveillance, enquiries, investigation and prosecution of criminal offences. IOSCO has drawn up a multilateral Memorandum of Understanding (MoU) on cross-border information exchange. Supervisors must apply to become a signatory to the IOSCO MoU by completing a comprehensive questionnaire. So far 27 countries have become signatories. Kredittilsynet applied to become a signatory in 2005 with a view to signing in 2006.

Kredittilsynet is also a member of the Enlarged Contact Group on the Supervision of Collective Investment Funds (ECG) which meets once a year. This is an informal group of collective investment fund oversight bodies from about 20 countries which meets once a year.

Insurance

Kredittilsynet participates in the development of international principles for supervision of insurance business by virtue of its membership of the International Association of Insurance Supervisors (IAIS). The IAIS held its twelfth annual conference in Vienna in October 2005 in conjunction with the anniversary of 125 years of insurance supervision in Austria (see



www.iaisweb.org). Themes presented at the conference proper included global solvency rules, valuation of insurance liabilities, effective supervision in emerging markets, promoting policyholders' interests, outsourcing, private pensions, accounting standards, insurance cover against natural disasters and other catastrophes. Several reports and standards were adopted by the General Meeting of the IAIS, among them a paper outlining a common structure for assessing insurance companies' solvency, guidance on finite reinsurance, a standard for disclosure requirements for insurers and reinsurers, and a guidance paper on combating the misuse of insurers for illicit purposes. In addition a revised standard on fit and proper requirements for insurers was adopted.

Kredittilsynet is represented on several IAIS subcommittees in addition to the technical committee, which has overarching responsibility for standard setting.

Occupational pensions

In 2004 the OECD initiated the setting up of a new international body, the International Organisation of Pension Supervisors (IOPS), which Kredittilsynet has joined. The organisation gained about 24 members upon its foundation. The OECD secretariat acts as secretariat to the IOPS.

Banks and financial institutions

No true global forum on a par with IOSCO and IAIS exists for banking supervision. The Basel Committee on Banking Supervision under the Bank for International Settlements (BIS) coordinates global cooperation on banking supervision.² Kredittilsynet receives relevant documents from the Committee and is invited to comment on them, and to take part in some of the Committee's activities. In 2004 the Basel Committee adopted new international rules for calculating banks' capital adequacy which are currently being implemented in Europe (see page 27 in the chapter *Banking and finance*). Every year the Basel Committee invites supervisory heads from countries outside G10 to an annual contact meeting in Basel under the auspices of BIS and FSI (Financial Stability Institute). Every second year the Basel Committee organises the International Conference of Banking Supervisors (ICBS). The next conference will be held in Mexico in 2006.

Cooperation on financial stability and macro-economic surveillance

Developments in financial markets have led to closer international collaboration on financial stability and macroeconomic surveillance. Kredittilsynet and Norges Bank attend semi-annual contact meetings with the European Central Bank (ECB). Kredittilsynet has also attended meetings of a working group

¹ The group now comprises the supervisory authorities of Australia, Austria, Belgium, Canada, Denmark, Germany, Hungary, Iceland, Ireland, Japan, Korea, the Netherlands, Norway, Singapore, Sweden and the United Kingdom. The Netherlands formally established integrated supervision, under the central bank, on 1 January 2005. Liechtenstein, Latvia, Malta and Estonia also have integrated supervisory authorities.

² The Basel Committee comprises representatives from the banking supervision authorities and central banks in the following countries: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.



under ECB auspices focusing on crisis management. Furthermore, Kredittilsynet sends a representative to meetings of the UN-coordinated Project Link, a macroeconomic analysis centre. Kredittilsynet is not a member of the Financial Stability Forum or Joint Forum, but keeps abreast of the work done under the auspices of these forums, particularly through its participation in the European supervisory committees.

Attendance at OECD meetings

Kredittilsynet also attends meetings of the OECD Insurance Committee and the OECD Capital Markets Committee on a regular basis, in addition to a number of other meetings under OECD auspices.

Money laundering and terrorist financing

Kredittilsynet plays a part in developing national and international measures against money laundering and terrorist financing, and attends the meetings of the Financial Action

Task Force (FATF). FATF develops international standards against money laundering and has also in recent years worked on international guidelines to combat terrorist financing. Kredittilsynet participates in the FATF Terrorist Financing Working Group and collaborates with the United Nations in this field. FATF evaluated Norway's measures against money laundering and terrorist financing in 2005, see page 25 in the chapter *Banking and finance*. Its report was presented at the FATF meeting in Singapore in summer 2005, and is available at the FATF website, www.fatf-gafi.org.

In 2005 Kredittilsynet coordinated a visit by a Bulgarian delegation as a step in developing measures against money laundering and terrorist financing in Bulgaria. Kredittilsynet also plays an active part in other international meetings and seminars on measures against money laundering and terrorist financing, and was involved in the evaluation of Ukraine under Council of Europe auspices.

Cooperation within the EU/EEA

The EEA Agreement sets crucial premises for Norwegian laws and regulations and hence for developments in the areas to which the Agreement applies. In the financial sector Norway is obliged to transpose all adopted EU legislative acts into Norwegian law. While EU Directives give some leeway for interpretation, relevant legislation has to be transposed into Norwegian law with little scope allowed for national adjustments (subsidiarity). Once a Directive proposal is submitted to the Council of Ministers and the European Parliament, Norway has little opportunity to influence the discussions and the decisions made under the co-decision procedure, since only EU members have access to the Council's and Parliament's decision-making processes. Hence it is all the more important for Norway to attend meetings under the European Commission, and Kredittilsynet prioritises participation in the supervisory committees and the Commission working groups since this is where it has the greatest opportunity to influence the EU's legislative process.

New EU committee structure and cross-sectoral collaboration

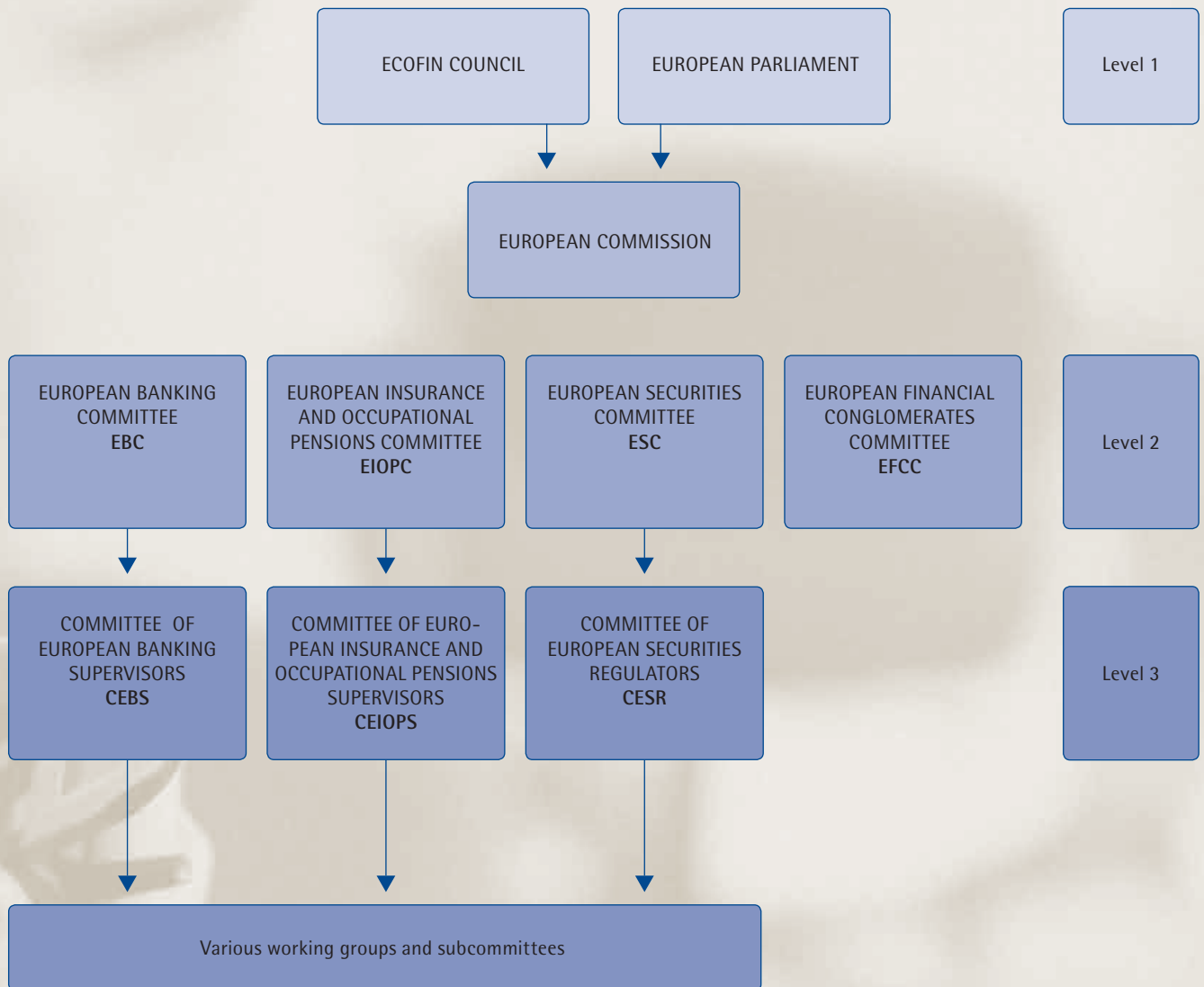
The new structure for developing regulations in the financial sector was finally put in place in April 2005. This was when the Lamfalussy committee structure, which was initially used for regulating the securities sector, was finally extended to banking, insurance and collective investment funds (see Chart 7).

The Ministry of Finance attends meetings of the Level 2 bodies – European Securities Committee (ESC), European Banking Committee (EBC) and European Insurance and Occupational Pensions Committee (EIOPC) – as an observer. Kredittilsynet attended most EBC and EIOPC meetings as adviser to the Ministry of Finance.

Collaboration between the three supervisory committees was emphasised in 2005 in order to prevent work duplication and to coordinate matters of common interest, including supervision of financial conglomerates operating in several countries. To mark this intention the Chairmen of the three supervisory committees signed a cooperation agreement in November 2005 in connection with the first joint conference of the three committees. All three committees stress the importance of transparency in their work, and documents that are circulated for comment are published on their websites. Consultation panels have also been established. Financial stability and crisis management are important topics within the EU, and finance ministries, central banks and supervisory authorities have signed a joint MoU on crisis management.

Chart 7: EU committee structure

EU financial architecture – Bodies and committees





Securities market

Kredittilsynet attends meetings of the Committee of European Securities Regulators (CESR). CESR acts as an advisory committee to the ESC and the European Commission, and works for consistent implementation of community law in member countries. Kredittilsynet plays an active part in CESR working groups. Several legislative acts were adopted by the Commission under the Lamfalussy procedures in 2005. In the course of the year CESR advised the Commission on related technical implementing measures to the Prospectus Directive and Transparency Directive, and also provided advice on the Directive on Markets in Financial Instruments (MiFID).

In March 2005, for the first time since the establishment of CESR, Kredittilsynet hosted a two-day meeting of CESR chairmen. Kredittilsynet also hosted a meeting of a CESR working group dealing with standard setting related to control of financial reporting. See also the chapter *Financial reporting supervision* on page 46. For more information about CESR, visit www.cesr-eu.org.

Banks and financial institutions

Kredittilsynet attended all meetings of the Committee of European Banking Supervisors (CEBS) in 2005. CEBS has set up several working groups focusing on, among other issues, accounting and auditing and on the implementation of the new capital adequacy framework. One such group is looking into the merits of coordinating supervisors' procedures and routines for publishing information related to capital adequacy. Kredittilsynet attends meetings of Groupe de Contact (the main working group under CEBS) and of a number of other CEBS subgroups. Within this forum, banking supervisors exchange information on a number of supervisory issues and gain an overview of supervisory methods in member countries. Groupe de Contact has also set up further working groups, and delivered several reports to CEBS in 2005 with particular emphasis on the supervisory processes to be applied to follow up on the new capital adequacy regime. In 2005 CEBS delivered advice to the European Commission on changes to the rules governing deposit guarantee schemes, on application of the e-money directive's provisions, and on cross-border mergers and acquisitions (revision of Article 16 of the Banking Directive, 2000/12/EC). See also the CEBS website at www.c-ebs.org.

Insurance and pensions

Kredittilsynet attended all meetings of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in 2005, and also participates in CEIOPS working groups and committees. Kredittilsynet has for several years chaired a subcommittee coordinating the supervision of insurance groups engaged in cross-border activities, based on a multilateral MoU. In 2005 this subcommittee presented a proposal for changes to the Insurance Groups Directive. In 2005 CEIOPS also adopted recommendations on supervisory

follow-up of international accounting standards (IFRS) in the insurance sector. The bulk of CEIOPS' work consists in preparing advice to the European Commission on the reform of EU solvency rules (the Solvency II project), CEIOPS and gave advice to the Commission on several issues in 2005. See CEIOPS' website at www.ceiops.org.

Accounting and auditing

Kredittilsynet and the Ministry of Finance attend the meetings of the Accounting Regulatory Committee (ARC) which is responsible for assessing the new financial reporting standards and for preparing for their implementation across the EU. Kredittilsynet participates in the EU's elaboration of financial reporting rules and standards for auditors within the EEA, and attends meetings of the EU Accounting Contact Committee and the EU Committee on Auditing.

In June 2005 Kredittilsynet hosted a meeting of a CESR working group dealing with standard setting in regard to control of financial reporting.

EFTA cooperation

Kredittilsynet participates in EFTA's Working Group on Financial Services and EFTA's Working Group on Company Law. The remit of these working groups – which operate under EFTA's Subcommittee II in the EFTA pillar within the EEA structure – is to coordinate viewpoints and to incorporate legislative acts in the financial sector, capital movements and company law areas (including accounting and auditing) into the EEA agreement. The working groups meet three or four times each year, and are also useful forums for obtaining updates on legislative developments in the EU. EU Commission representatives are invited to each meeting to give presentations on a variety of measures and to give updates on the decision-making process in the European Council and the European Parliament.

Nordic cooperation

Nordic cooperation remains a priority despite the increasing cooperation both within the EU and EEA framework and on the global level. In addition to joint annual meetings of Nordic financial supervisors at director general level and department level, Kredittilsynet's representatives attended several meetings with their Nordic counterparts focusing on supervision of Nordic financial conglomerates. Moreover, in 2005 comparative studies were undertaken of resource use, resource distribution and case-handling times in the respective Nordic supervisory authorities.

No collaboration has previously existed between the Nordic auditor supervisors. In autumn 2005 Kredittilsynet took the initiative for a meeting in Oslo between the auditor supervisors of Sweden, Denmark, Finland and Norway. The meeting showed that closer contact and collaboration is also useful in the audit



field, not least in order to discuss the transposition of changes to the Eighth Company Law Directive into national law. Kredittilsynet also hosted a Nordic accounting meeting in 2005.

Kredittilsynet signed a Memorandum of Understanding with the Icelandic financial supervisory authority on supervision of BNbank, Kredittbanken and Íslandsbanki. See also page 24 in the chapter *Banking and finance*.

Bilateral cooperation and visits from abroad

Bilateral MoUs on supervision of the banking sector have been established with a number of supervisors, and Kredittilsynet is currently establishing an MoU with the Russian banking supervisor.

Good bilateral contacts are useful with a view to drawing on other countries' experiences, for example when developing new supervisory methods, strategic plans and priorities etc. As part of its preparations for a new strategy, Kredittilsynet visited the Dutch supervisory authority and finance ministry to benefit from their work on identifying goals for and measuring results of the supervisor's activity.

Together with the Consumer Council and the Consumer Ombudsman, Kredittilsynet has established a working group to determine if, and in the event how, an internet-based information portal for financial services can be established in Norway. To this end the working group visited public and private sector enterprises in Sweden, Denmark and the UK that have established such portals.

In September 2005 Kredittilsynet also visited its counterparts in Ireland and the UK to learn more about their organisational set-up and their consumer information and consumer protection regime.

Each year Kredittilsynet receives representatives of other supervisory authorities, among them the Federal Reserve Bank of Chicago, the US banking supervisor responsible for Norwegian banks in the USA. Kredittilsynet also hosted a number of Nordic and European meetings in 2005.

Chart 8: International meetings attended by Kredittilsynet

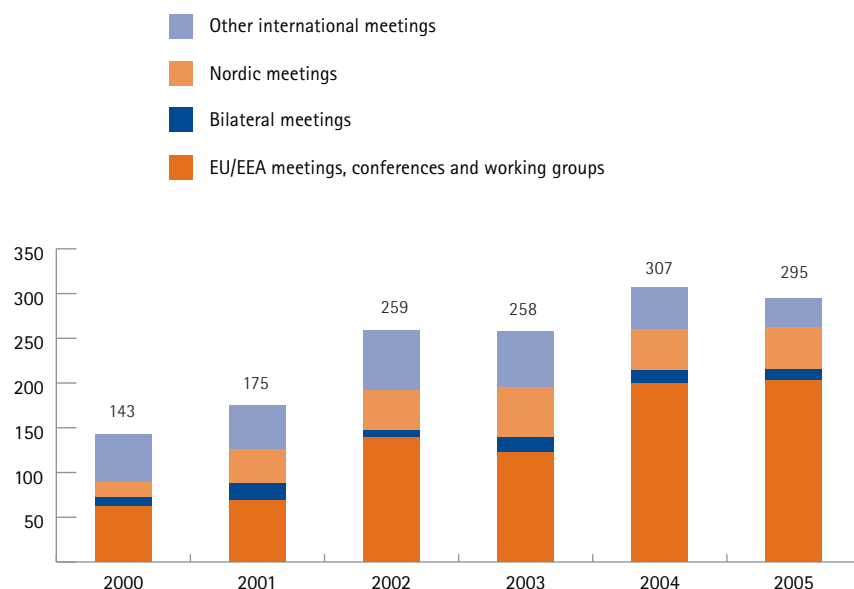


Table 15: International organisations and EU/EEA related committees in which Kredittilsynet participates as a member or observer

See also the overview of EU's committee structure on page 73.

Meetings common to several sectors

- Integrated Financial Supervisors Conference

Banking/Finance

- International Conference of Banking Supervisors
- OECD's Financial Markets Committee
- EBC (European Banking Committee)
- CEBS (Committee of European Banking Supervisors) – www.c-ebs.org
- Groupe de Contact
- Nordic supervisory meetings

Insurance

- IAIS (International Association of Insurance Supervisors) – www.iaisweb.org
- IOPS (International Organisation of Pension Supervisors)
- OECD's Insurance Committee
- EIOPC (European Insurance and Occupational Pensions Committee)
- CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) – www.ceiops.org
- Conference of European Insurance Supervisory Services
- Nordic supervisory meetings
- Nordic-Baltic supervisory meetings

Securities

- IOSCO (International Organization of Securities Commissions) – www.iosco.org
- ECG (Enlarged Contact Group on Supervision of Collective Investment Funds)
- ESC (European Securities Committee)
- CESR (Committee of European Securities Regulators) and CESR working groups – www.cesr-eu.org
- Nordic meetings

Accounting and auditing

- ARC (Accounting Regulatory Committee)
- Accounting Contact Committee
- Audit Regulatory Committee (AuRC)
- EGAOB (European Group of Auditor Oversight Bodies)
- Nordic meetings

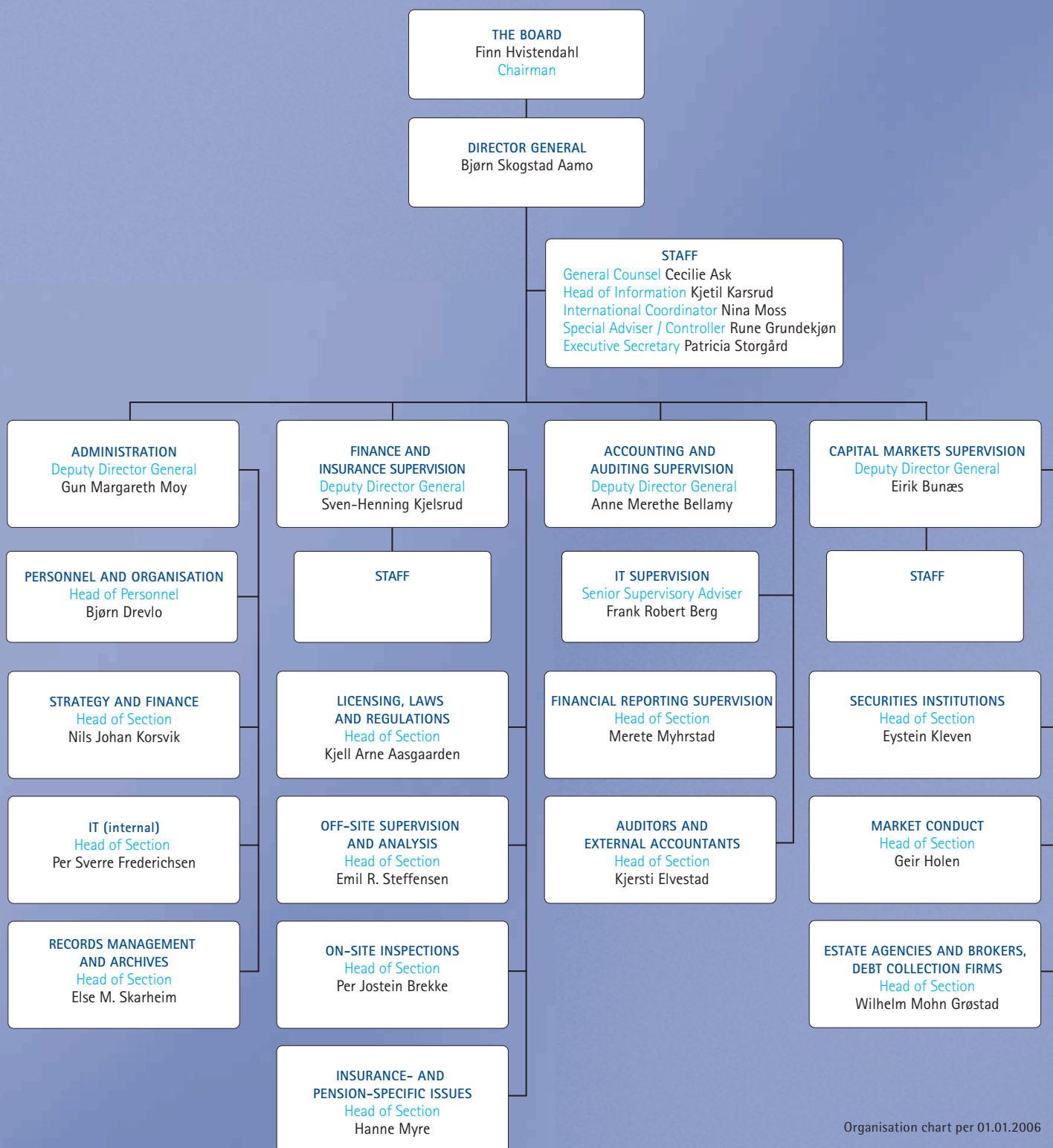
Money laundering

- FATF (Financial Action Task Force) – www.fatf-gafi.org
- EU's Contact Committee on Money Laundering
- Nordic meetings

EFTA

- EFTA Working Group on Financial Services
- EFTA Working Group on Company Law

Kredittilsynet's organisation



Organisation chart per 01.01.2006

The Financial Market in Norway 2005

Since 1994 Kredittilsynet has systematically analysed and assessed potential stability problems in the Norwegian financial market against the background of developments in the Norwegian and international economy. This is a necessary supplement to Kredittilsynet's ongoing supervision of individual institutions. Much of the assessment of individual institutions' profitability and financial strength needs to be carried out in light of the general state of the financial market. As from 2003 Kredittilsynet has given its view of the state of the financial market in a separate report. The report summarises financial institutions' results for the previous year in the light of general developments in the international and Norwegian economy, and assesses risks facing banks and other institutions in the financial market.

This year's report is available on paper from Kredittilsynet, and in electronic form at:
www.kredittilsynet.no.

KREDITILSYNET

The Financial Supervisory Authority of Norway

Kredittilsynet
Østensjøveien 43
Postboks 100 Bryn
N-0611 Oslo
Norway

Tel. +47 22 93 98 00
Fax +47 22 63 02 26

post@kredittilsynet.no
www.kredittilsynet.no