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AUTHORITY OF NORWAY

Lessons learnt from the financial crisis

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The Norwegian experience

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Outline

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- The Norwegian banking system
- The economy and financial sector after the crisis
- The resilience to the crisis

Norwegian banking system

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- The financial market is dominated by financial groups/alliances
  - The 7 largest appr. 70 per cent of total assets.
  - The 3 largest 55 per cent

- The banking market is less concentrated than other Nordic markets, with market shares appr.:
  - 1/3 DnB NOR
  - 1/3 savings banks (130+) and a small number of commercial banks
  - 1/3 foreign foreign owned subsidiaries and branches (mostly Nordic)

- Only DnB NOR has foreign operations of some importance

- Housing loans are the dominating part of household loans, whereas loans to commercial real estate and shipping are the most important corporate loans.

The financial crisis and Norwegian banks

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The main impacts fall into four main categories

- Direct exposures
  - Low exposures to toxic products, low level of market risk and investment banking
  - Low levels of exposures to sovereign debt problems in GIIPS-countries
- Drying-up of funding markets
  - The main challenge for Norwegian banks
- Higher international capital requirement
  - No solvency issues
- Reduced economic activity
  - Entering the crisis from a strong cyclical position

The Norwegian economy and the financial sector has withstood the crisis well

The economy was entering the crisis from a very strong cyclical upturn, and the economy emerged early from a mild recession. Unemployment remained at a very low level (below 4 per cent).

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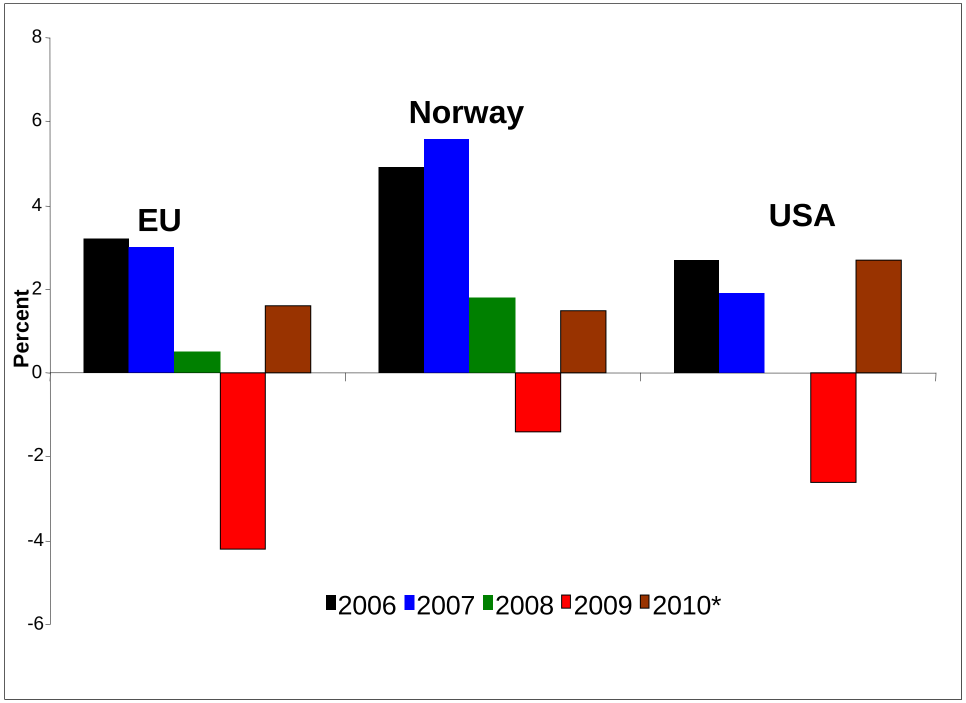
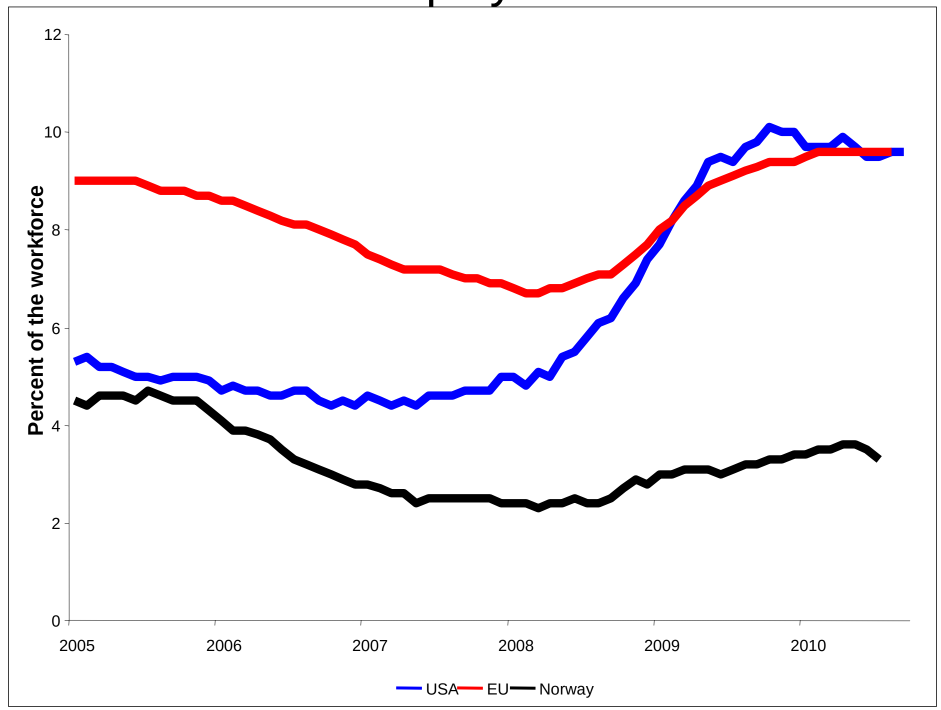
GDP Mainland



Forecasts for 2010

Sources: Consensus Forecasts and Statistics Norway

Unemployment



Sources: Reuters EcoWin and Statistics Norway

The main challenge during the autumn 2008 was the funding situation. The (dollar-based) interbank market had frozen, and refinancing of foreign market funding became difficult.

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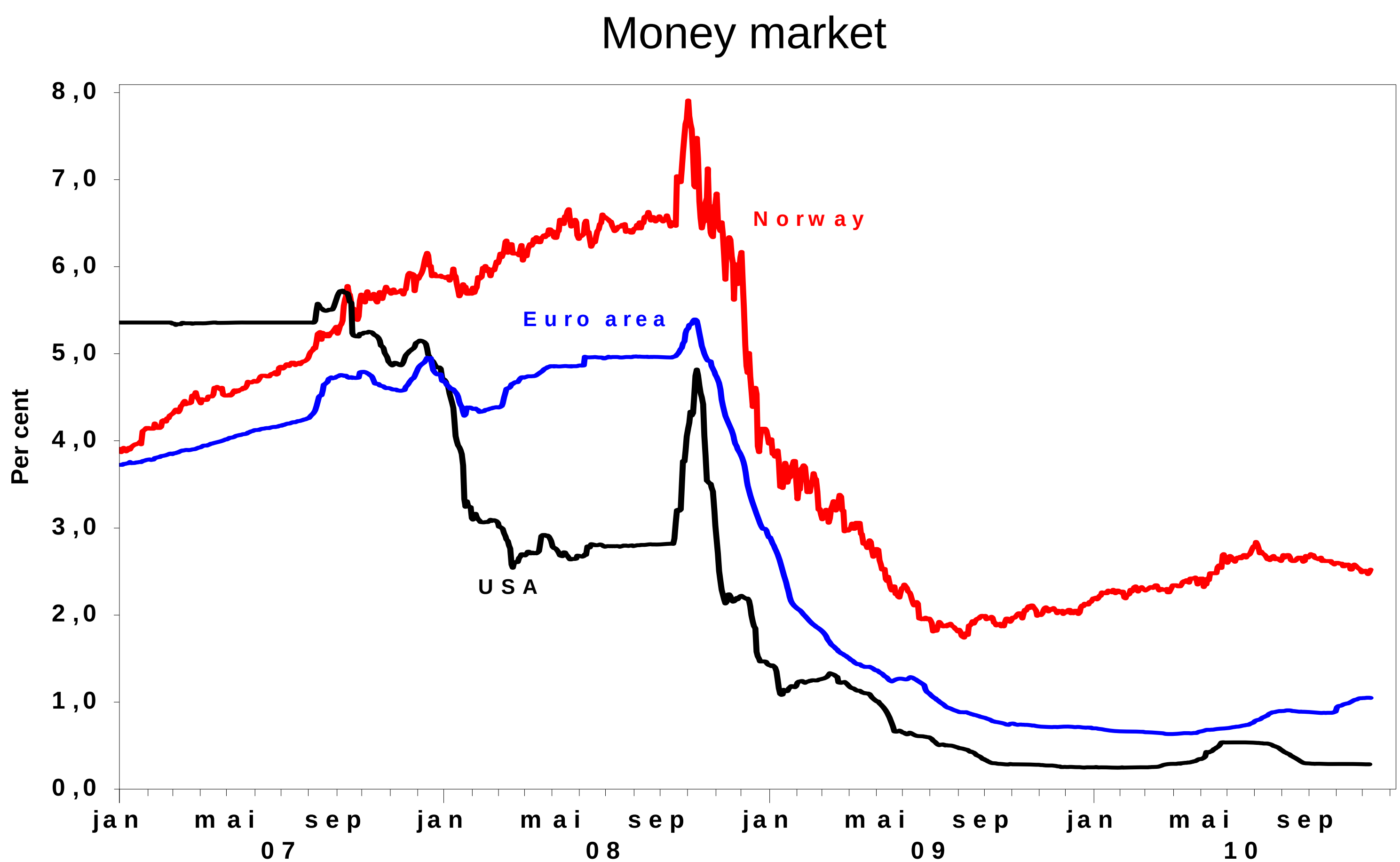

Credit growth to non-financial companies fell significantly, but has picked up again in 2010. In addition to a credit demand effect from the cyclical downturn, there was also a credit supply effect due to funding difficulties and a significantly reduced lending from foreign-owned banks

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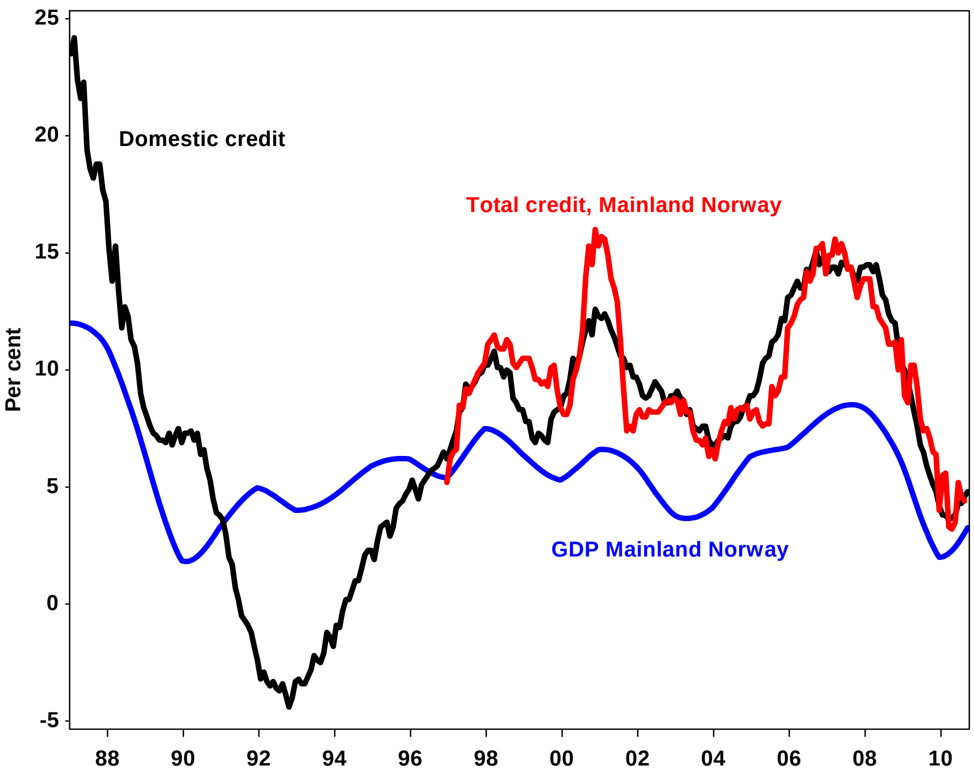

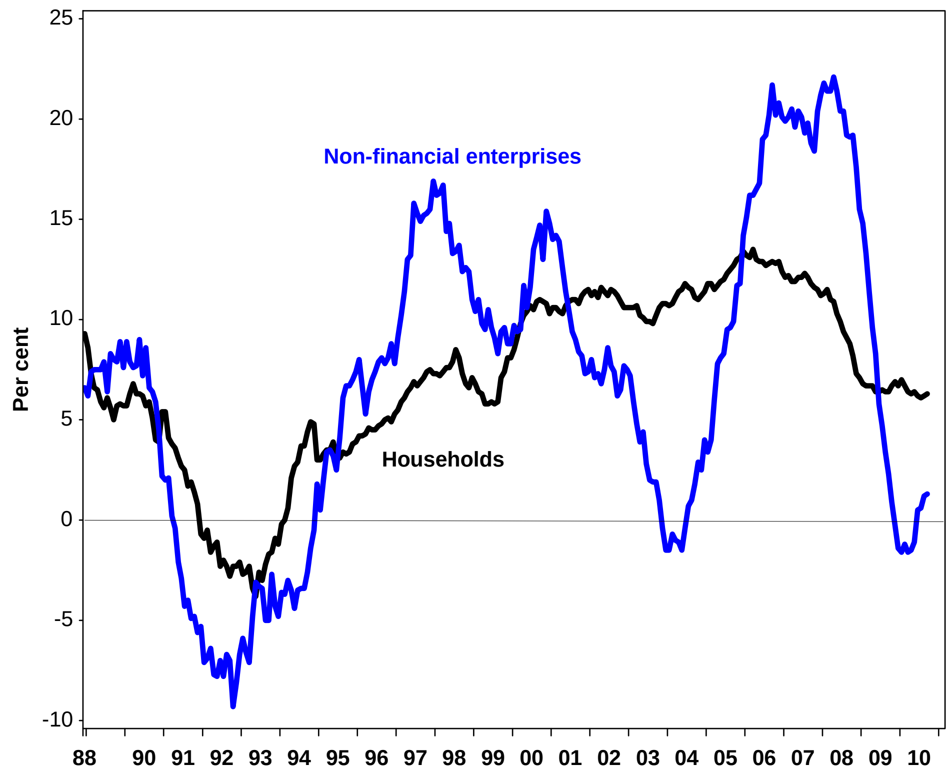

Source: Statistics Norway

Residential property prices recovered after a short correction and are now 6 per cent above the level in October 2007 (in nominal terms). Commercial property seems to have picked up in 2010

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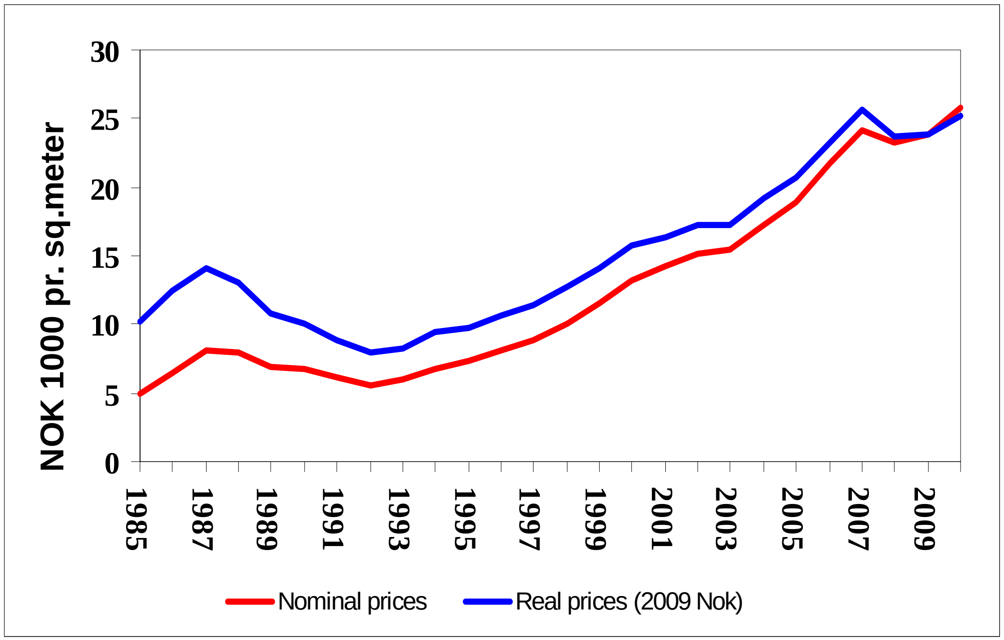
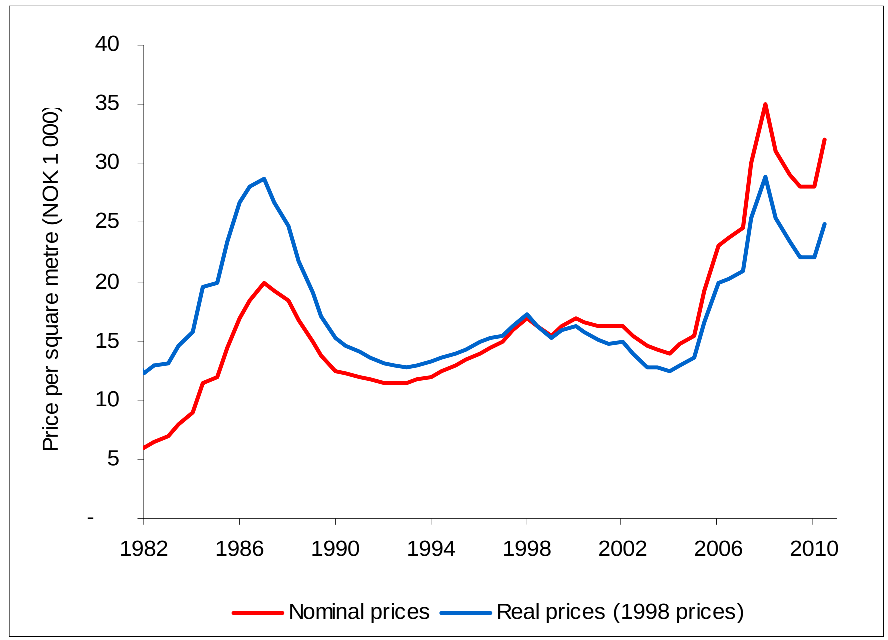
Residential



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

Commercial (offices, Oslo)



Sources: OPAK and Finanstilsynet

Banking profitability fell in 2nd half of 2008, but has remained at a high level, despite increased funding costs and downward pressure on net interest income. Loan losses have been low, and are falling.

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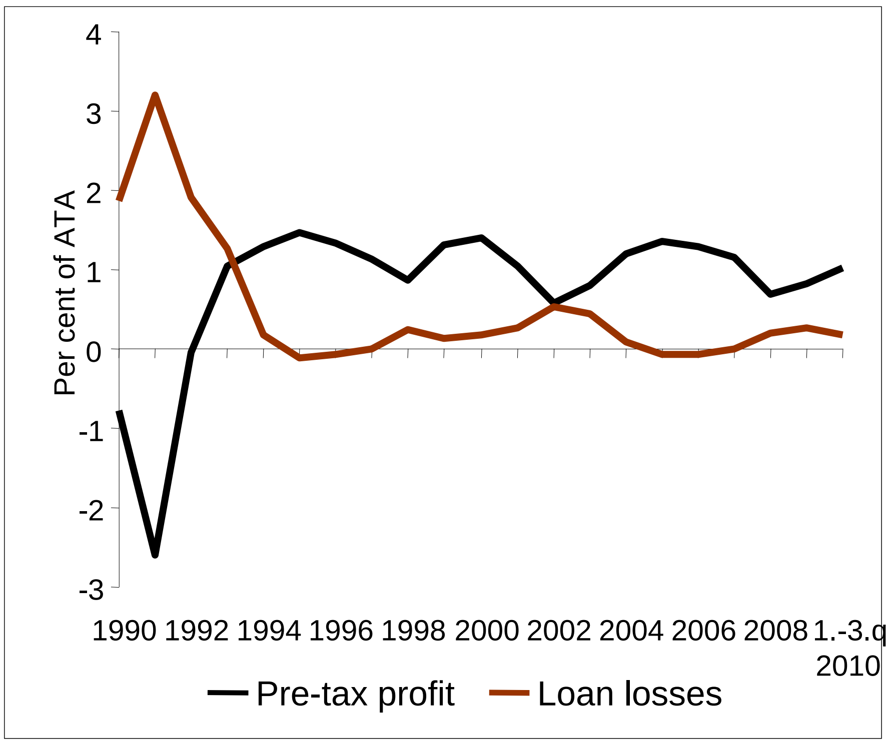
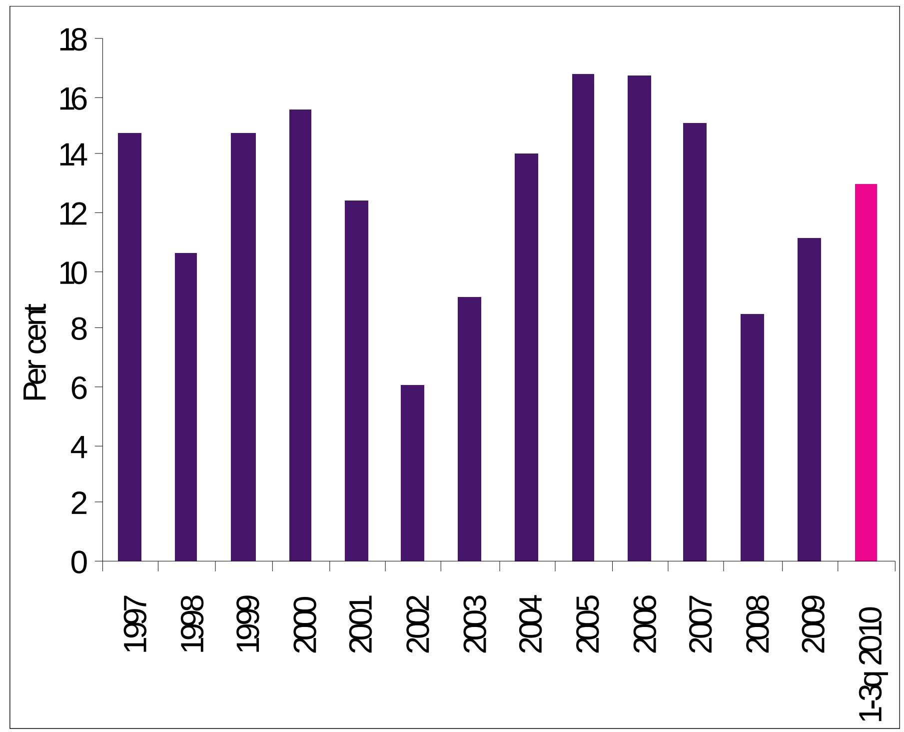
Profits (per cent of ATA)



Return on equity



What might be the reasons for the resilience of the Norwegian economy and financial sector to the international financial crisis?

Some important factors:

- Policy responses
- The structure of the economy
- Government and current account surpluses
- Regulation
- Supervision

Wide ranging policy actions reduced the negative effects on the financial sector and the economy.

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- Large fiscal stimulus in 2009, starting in January 2009, and in 2010.
- Interest reduced by Norges Bank by 450 bp to 1,25% between October 2008 and June 2009
  - Predominantly floating rates added to the effectiveness of monetary policy
- Longer-term liquidity support from Norges Bank and easing of collateral requirements
- Swap arrangement whereby banks could swap covered bonds for treasury bills
  - Limited to 350 bn NOK (whereof 230 bn was used).
- Establishment of a State Finance Fund to supply core capital to sound banks
  - Limited to 50 bn NOK (less than 10% used)
- Establishment of a State Bond Fund to boost bond funding
  - Limited to 50 bn NOK

Hitting 1,25 per cent in June 2009, policy rates were increased already in October 2009 (as the first European country), and have been raised 3 times since, to 2 per cent (last increase in May).

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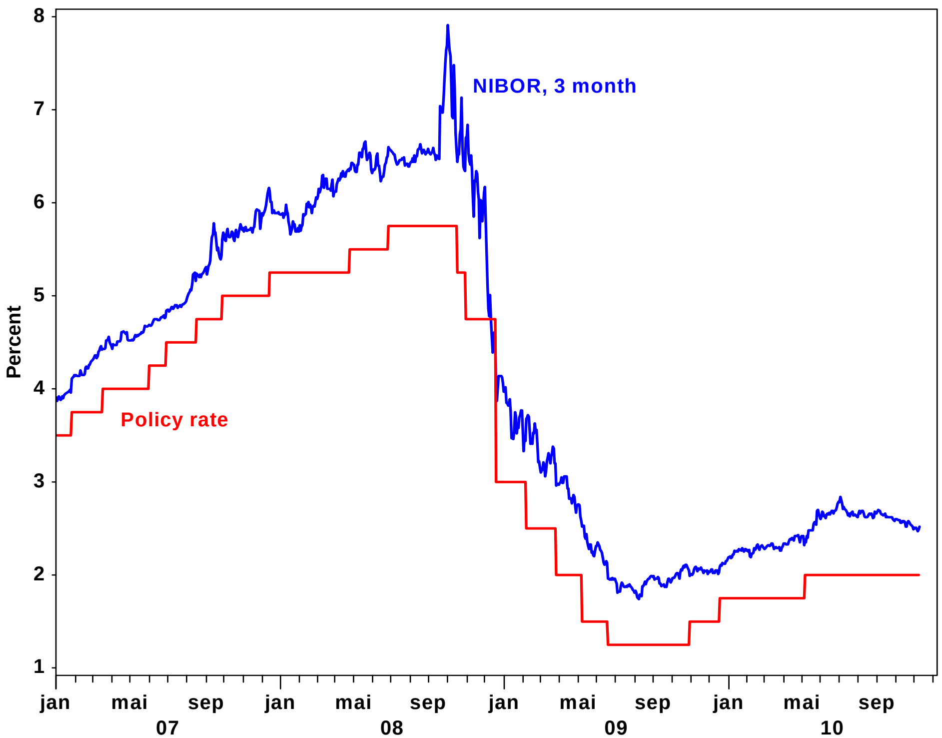
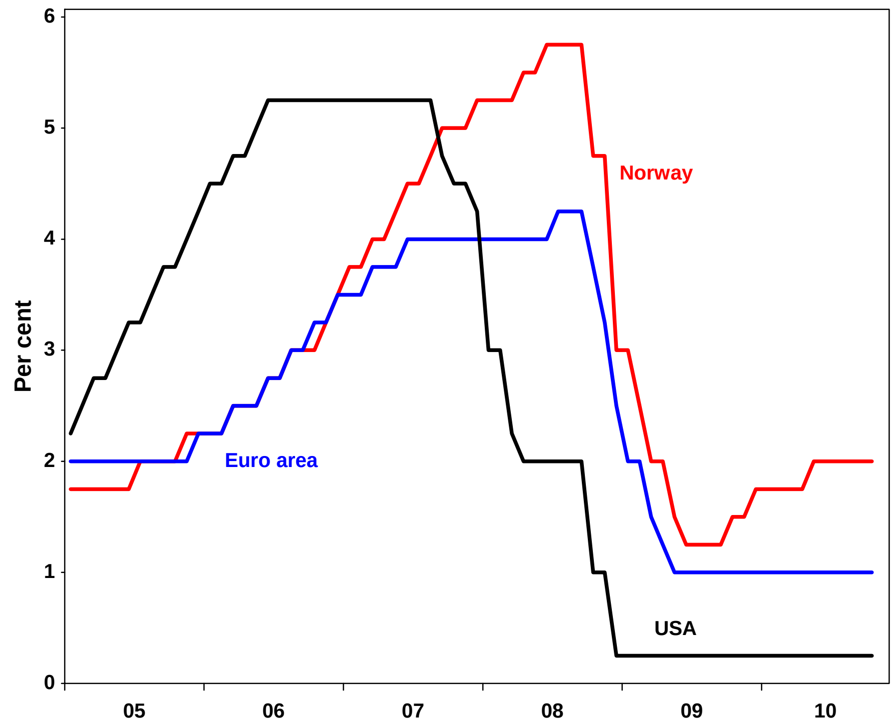
3-month interbank rates



Policy rates



Source: Reuters EcoWin

The Norwegian economy is strong, with large current account surpluses (14% of GDP in 2009) and net government assets of appr. 150% of GDP. The Goverment Pension Fund-Global has reached 3000 bn NOK (120% of GDP).

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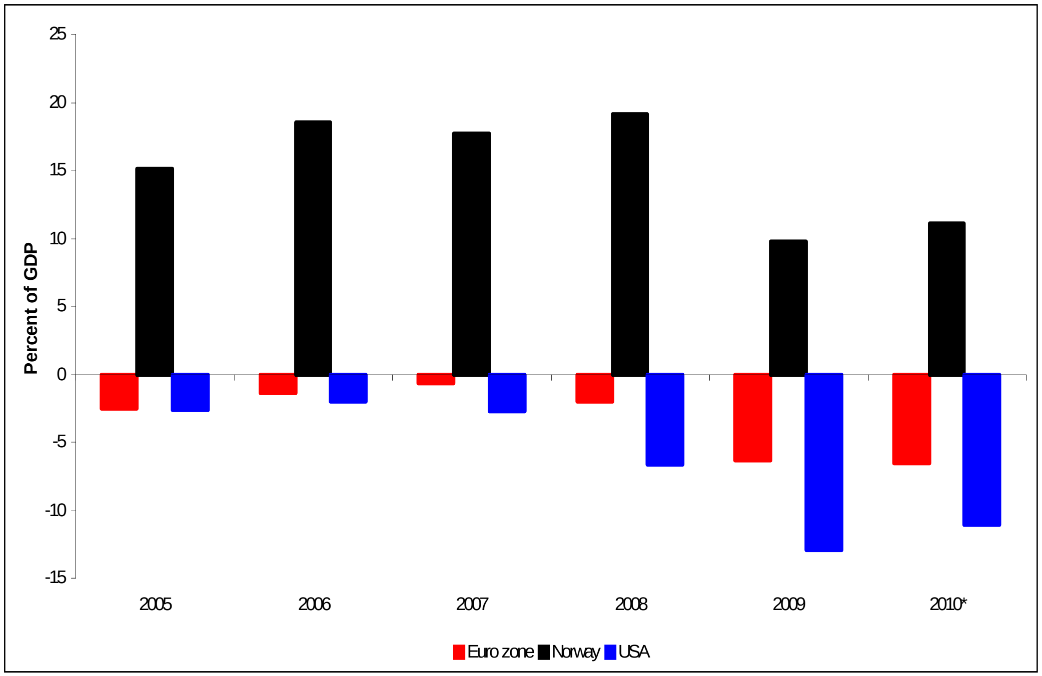
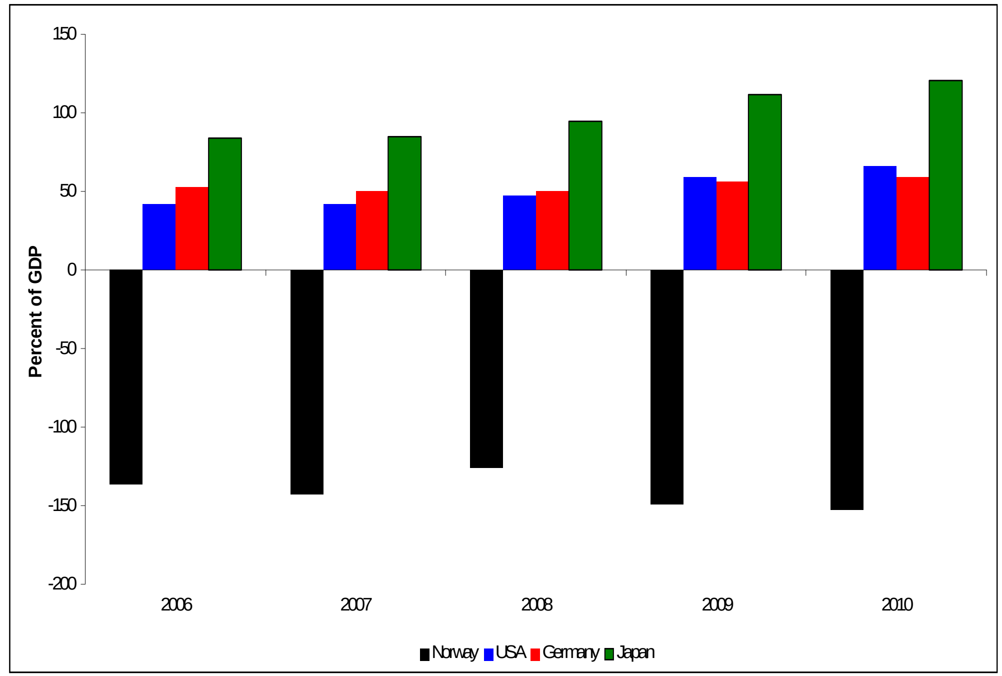
Government surplus



Government net debt



* Forecast for 2010

Sources: IMF, Eurostat and Statistics Norway

Norway has benefited from the growth in Asia, high oil prices and improving terms-of-trade (oil and gas was 46% of total exports in 2009). The manufacturing sector in Norway is relatively small (appr 9% of GDP, compared to 22% for oil/gas and shipping).

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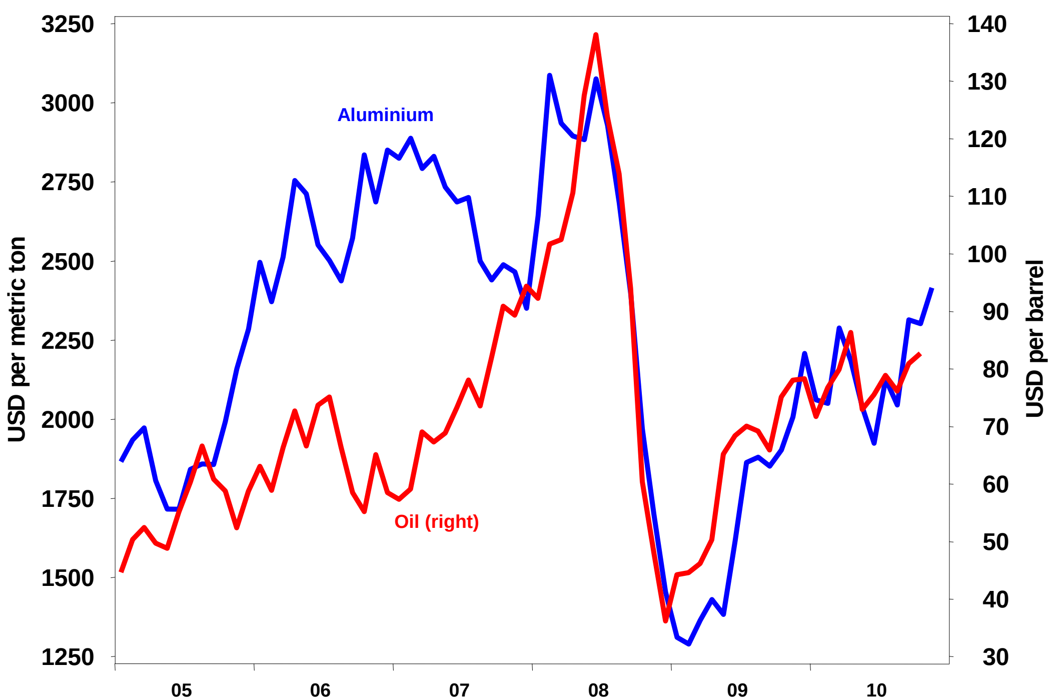
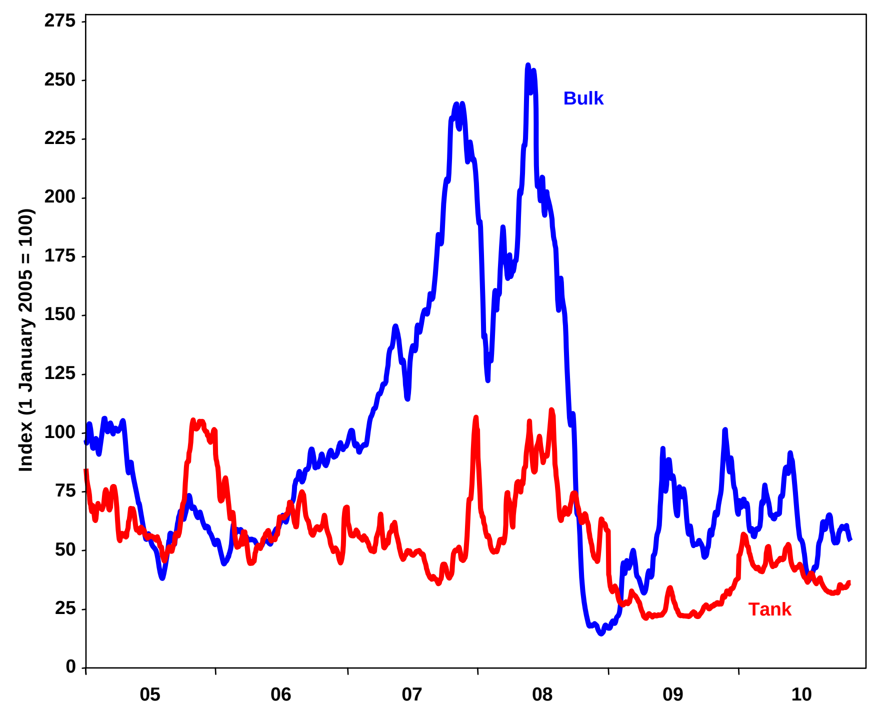
Prices of oil and aluminium



Freight rates



Source: Reuters EcoWin

A conservative regulatory regime has underpinned the resilience of domestic financial institutions.

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- A consolidated approach to regulation covering all parts of the financial market
  - No incentives to set up e.g special investment vehicles
- Capital requirements on consolidated, sub-consolidated and solo levels
- Strict regulation of securitisation
  - New regulation in 2007
  - Covered bonds issued only by mortgage companies
- Conservative approach to hybrid capital
  - A minimum requirement of 7% to raise tier-2 hybrid
  - Limited impact on Norwegian banks of the Basel III proposals to raise the quality (and level) of capital

Supervision has contributed to moderate risk appetite, robust capital buffers and relatively high long-term funding

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- Finanstilsynet the first integrated supervisor in Europe, due to the emergence of financial groups and need for consolidated supervision
- A risk-based supervisory approach with strong emphasis on on-site inspections
  - Near 60 on-site inspections in banks (and finance companies) in 2009 (appr 200 in 2006-2009)
  - On-site supervision with focus on strategies, risk control, risk exposures and stress tests
  - Final reports from inspections published
  - Staff with very low turnover (6% in 2009) and recruitment of staff with experience from the industry
- Regular dialogue and meeting with top management of the largest institutions
- Active use of pillar-2 and the use of pillar-2 capital add-ons
  - Due to i.a. concentration risk, macro-risks, IRB- model and calibration risks
- More supervisory attention on long-term funding and liquidity risk after events in 2002. After 2008 further stepping up of supervision of liquidity risk.

Finanstilsynet has used macroeconomic surveillance, based on experience from the banking crisis in 1988-1993, as an active ingredient of supervision since 1994

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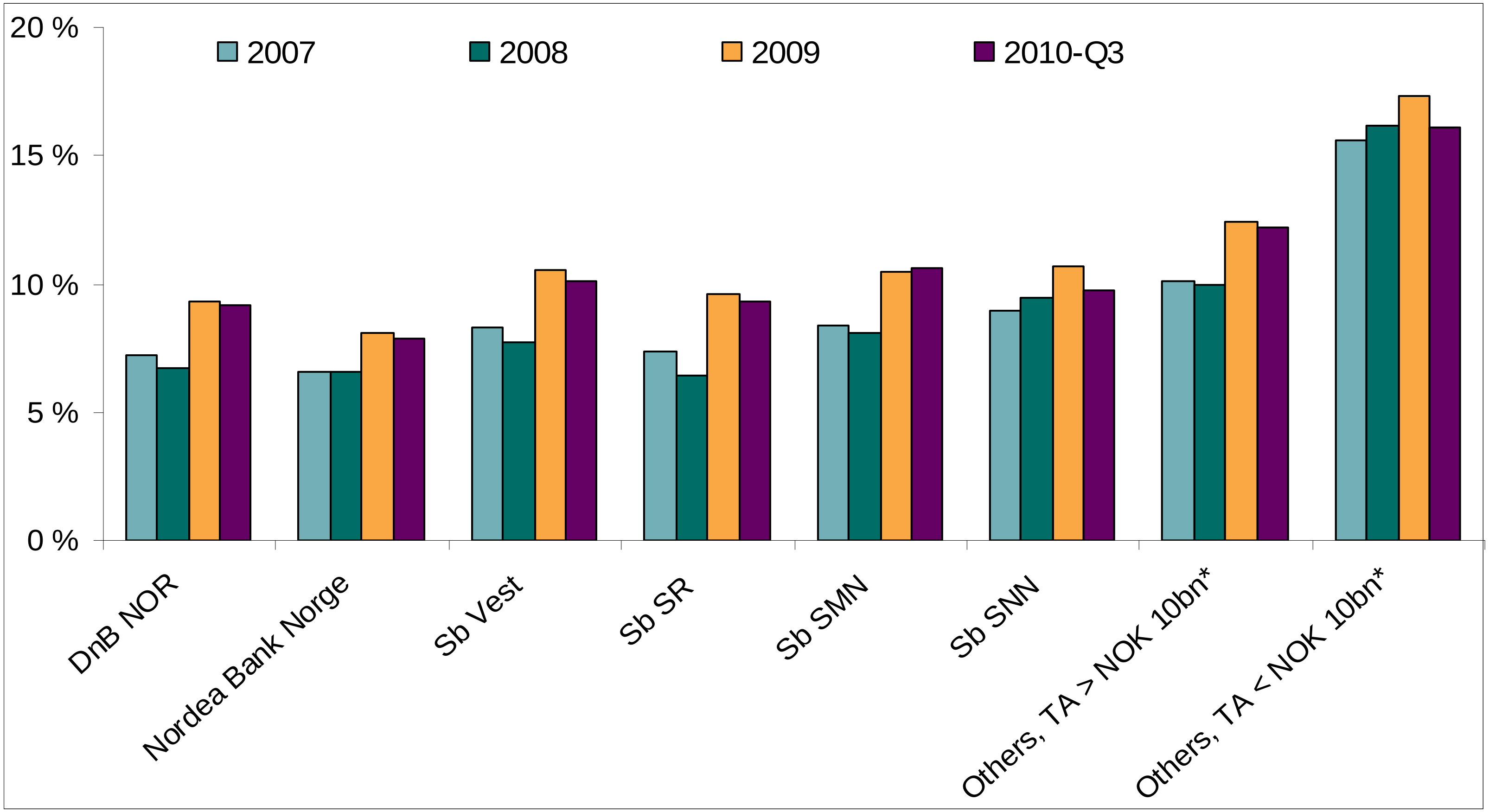
- Assessment of single institutions' profitability and financial strength has to be carried out on the background of asset markets and the economic cycle

- Since 1994 biannual reports to the Board and discussed with Norges Bank and the Ministry of Finance. Published annually from 2003 ("Risk Outlook"), biannually as of 2010.
  - Internal reports without the same confidentiality constraints still produced

- Identified areas of concern fed into supervisory processes
  - Input in selection of institutions subject to on-site inspection, selection of areas for thematic inspections, risk assessments in pillar-2 (SREP and ICAAP), regulatory initiatives (LTVs, model approvals), as well as raising awareness of risks to the public or other authorities

- In macroprudential supervision a supervisor has the advantage of combining macro information with insight into micro behaviour.

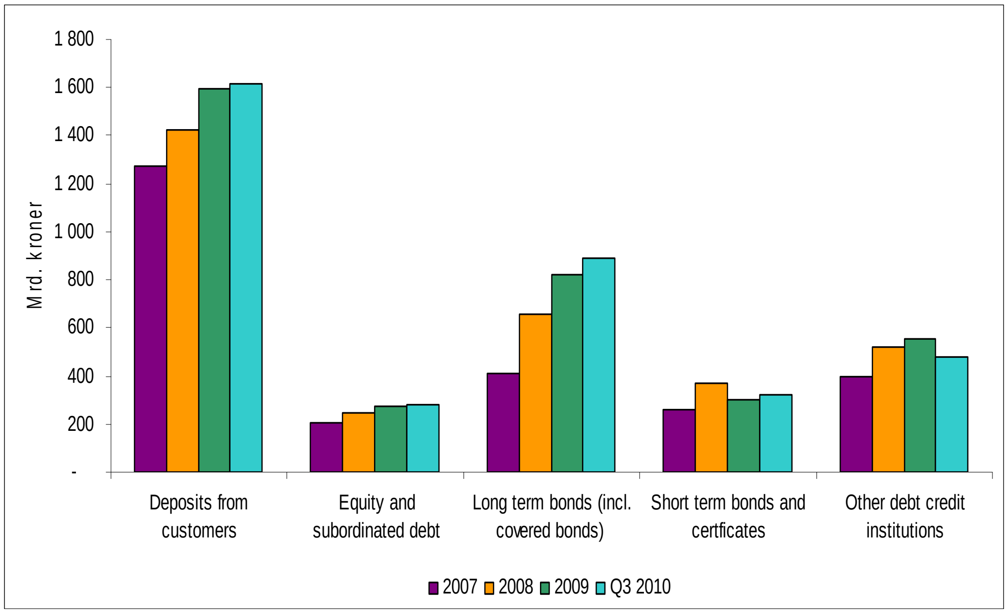
In 2009 a particular focus on capital levels due to increased risk, capital injections in several international banks and heightened market requirements. Half of the largest banks were required to increase capital in 2009



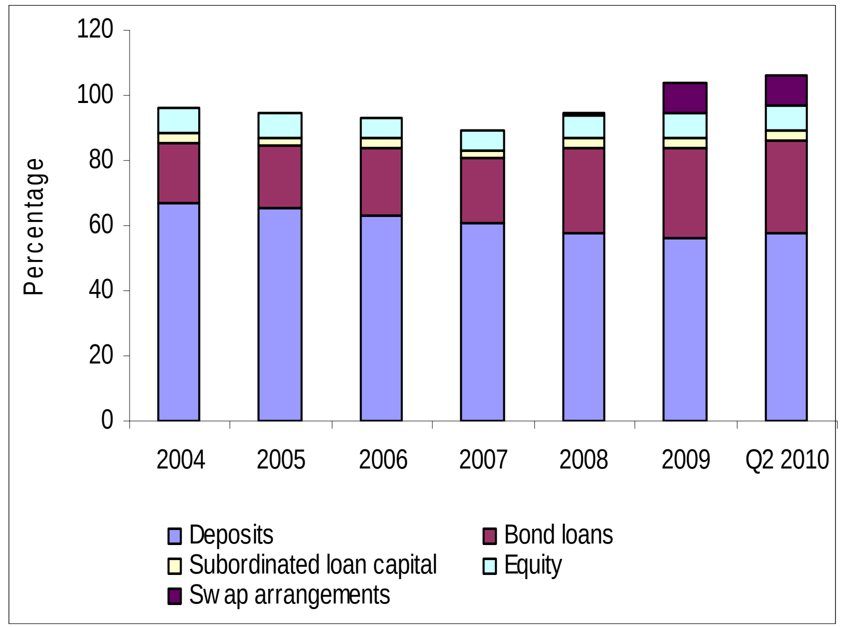
*Basel II standardised approach, the others IRB-banks

Liquidity risk supervision was stepped up in 2002. Indicators of long term funding are reported and banks with deteriorating positions compared to benchmarks, followed up through reporting and on-site. Short-term funding still relatively high, and remains a risk due to the significant uncertainty in international capital markets.

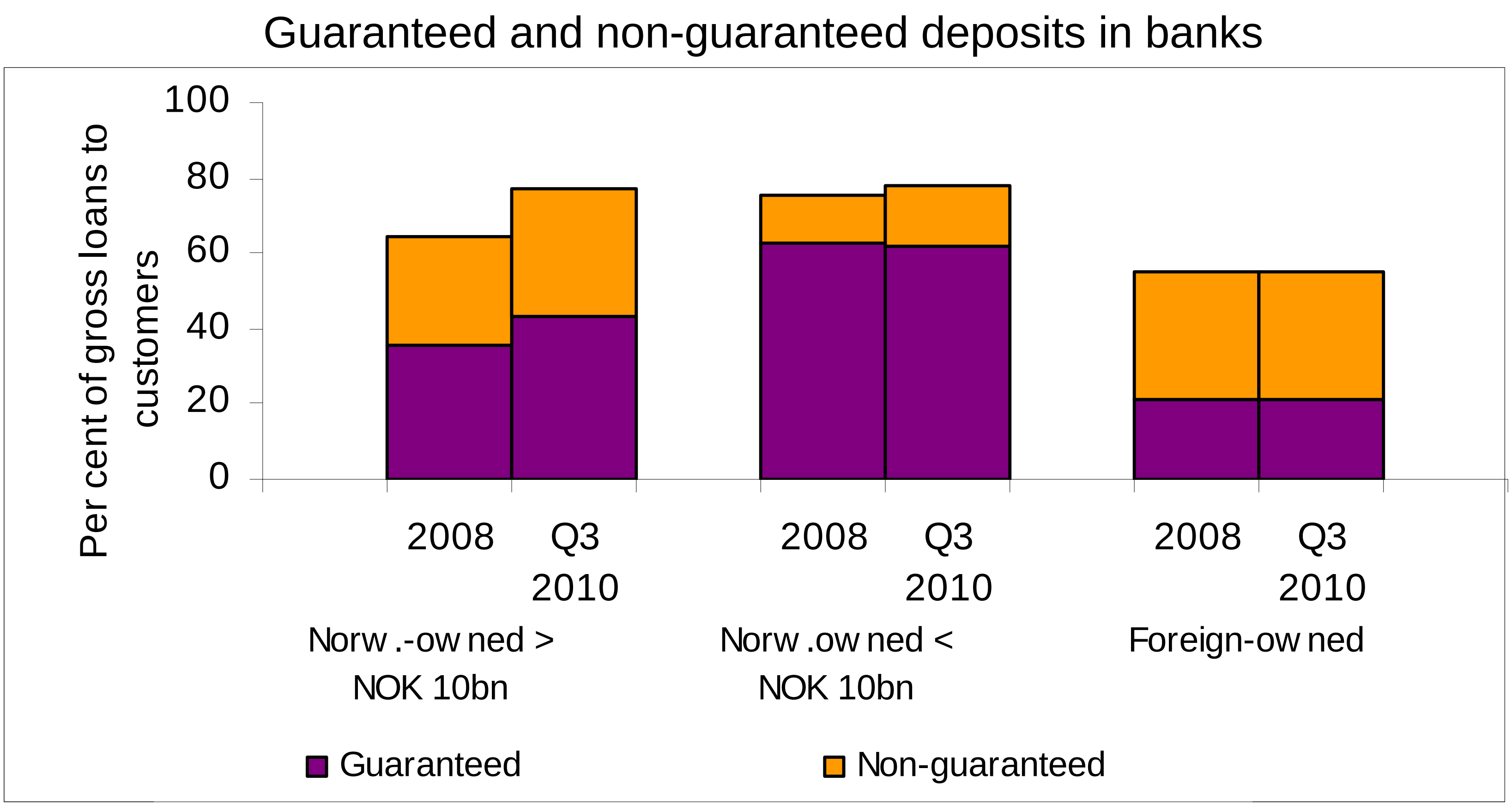
Banks' (incl. mortage companies) funding (bn NOK)



Long term funding (as percentage of illiquid assets)



A robust deposit guarantee scheme contributed to keeping deposits stable during the turbulence. Deposits up to 2 mill. NOK (appr 250 000 EUR) covered. Foreign branches use the topping-up option. Norway did not issue blanket guarantees neither for deposits nor other funding.



Effective and coordinated measures by authorities have contributed to reducing the effects of the crisis

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- Issues related to financial stability have moved up on the agenda of the Norwegian authorities the last decade.
- Norges Bank (biannually), Finanstilsynet (biannually) and the Ministry of Finance (annually) all publish assessments of financial stability.
- Tri-partite meetings have been arranged since 2006, to secure a common understanding of the situation and coordinate measures. Frequent meetings during the international crisis.
- There are also bilateral meetings to discuss stability issues, at different levels of the three organisations.

Experience from the banking crisis in 1988-1993 has probably been important in avoiding the worst of the current international crisis

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- Several financial crises in Norway; in the 1870s, in the 1890s, in the 1930s and in the 1990s, all of them with significant macroeconomic elements (and most involving property markets)

- The last crisis had classic ”boom-bust” features:
  - Deregulation and liberalization,
  - Largely pro-cyclical macroeconomic policies
  - Exceptional lending growth
  - Relaxation of capital regulation and supervision

  - A macro shock (oil prices triggered devaluation, fiscal policy tightening, interest rate increase and private sector consolidation).
  - A deep recession led to large loan losses, wiped out capital in several institutions. Smaller banks merged with larger banks, and the three largest banks were nationalised.

- Regulation, supervision, and the moderate risk appetite in most institutions have to be seen against the background of experiences from the Norwegian banking crisis 20 years ago.

- Several senior staff in banks, the ministry, Norges Bank and Finanstilsynet have experience from the 1988-93 crisis.

Summing up

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- Norway weathered the international financial crisis well. Growth picked up early from a mild recession and unemployment remained very low

- No Norwegian-owned banks failed, and no blanket guarantees were issued

- Experience is gained through mistakes, and Norway learnt some lessons from the banking crisis in 1988-1993

- A conservative regulatory regime and active supervision have contributed to moderate risk taking and underpinned the resilience of the financial sector

- Effective cooperation between authorities and wide ranging policy actions, as well as the structure of the Norwegian economy, limited the negative effects of the crisis

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