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Introduction

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With this anniversary publication, the board and management of Kredittilsynet wish to commemorate the 20th anniversary of the agency's formation in 1986. In that year the Banking Inspectorate – into which the Securities Commission had been absorbed in 1983 – was merged with the Insurance Council, thereby creating the first integrated supervisory authority for the financial market in the western world. A growing number of countries have subsequently adopted this model. Also looking to the future, Norway's financial industry has opted for a joint organisational structure for credit institutions and insurance companies.

A joint supervisory body for the entire financial market provides a better basis for responding to the dynamic development of products and services in the market and for overseeing financial groupings across the traditional sectoral divides. Through its additional responsibility for real estate agency, debt collection and insurance mediation, its oversight of auditors and accountants and its responsibility for ensuring listed companies' compliance with the Accounting Act and international financial reporting standards, Kredittilsynet provides security for users and promotes well functioning markets.

As Sverre Knutsen shows, the practical work of supervision has evolved substantially both in regard to the financial industry and the actors in the securities market. Other articles in part I, including by former Chairman Erling Selvig, give a close account of the development of the legislative basis for supervision.

Kredittilsynet devotes its 20th anniversary to focusing attention on the challenges confronting the agency in the years immediately ahead. Hence the bulk of the articles in this publication draw on analyses of changes in markets and international and national regulatory frameworks with a bearing on Kredittilsynet's supervisory effort. The articles and discussions at the anniversary seminar on 14 September will contribute to the final stage of preparation of Kredittilsynet's Strategy for the period 2006 to 2009.

The article compilation illuminates various aspects of financial sector supervision. Part I presents Kredittilsynet's work over the past 20 years and legislative developments in the

financial and securities sphere. Part II takes up international trends, discussing the benefits of an integrated European capital market, changes in the insurance and pensions market and the role of the regulator, financial stability and the macroprudential approach to regulation and supervision, challenges to European supervisors in implementing Basel II and the UK Financial Services Authority's experiences with financial regulation and consumer protection.

As a step in preparing its new strategy, Kredittilsynet has analysed financial market developments and new challenges for the agency, and assessed objectives and performance measurements in relation to financial stability and well functioning markets. Part III presents these analyses together with articles focusing on the development of a new supervisory tool for risk-based supervision and the regulation of, and new legislation for, real estate agents.

The fourth and final part of this publication presents external perspectives on Kredittilsynet's work and areas of activity, first from the vantage point of the Norwegian Financial Services Association. This article gives their view of the supervision of the financial and insurance industry today, also in a European perspective. After that the Norwegian Savings Banks Association describes the supervision of the financial industry as seen by the savings banks – and also discusses the work done by Kredittilsynet during and after the banking crisis. The final articles deal respectively with the audit industry and Kredittilsynet's role in the financial market, in particular in relation to the consumer in a deregulated market.

We thank the article authors for their valuable contributions to the marking of Kredittilsynet's 20th anniversary and to the further debate on the challenges facing us in the years ahead. We also thank the editorial committee for their work on the anniversary publication, and trust that it will be good reading!

In recent years the Norwegian economy has shown substantial growth in the public and the private sector alike. Business investment is increasing, and many firms have obtained fresh capital in the Norwegian equity market. A solid financial industry capable of bearing risk, a sound financial infrastructure and competent securities market participants have made a positive contribution to this development. There has been a broad political consensus on legislation and framework conditions able to combine capital adequacy requirements with conditions affording a reasonably level playing field in relation to other countries and genuine competition among market actors in Norway. The Storting (parliament) and the Government have given Kredittilsynet the opportunity to build up its capacity and competence to enable active supervision of compliance with the applicable rules and to ensure sound financial institutions.

Financial stability and well functioning markets are Kredittilsynet's key objectives. Important social considerations lie behind both objectives. Financial stability and well functioning markets are necessary for economic growth and employment. Sound financial institutions with firm control of their activities reduce the risk of crises which may disrupt a favourable economic development. Competition, good information, good ground rules and norms are

important for properly functioning markets. Market actors' observance of ethical norms is a social objective of great intrinsic value to which Kredittilsynet will give weight in its work. Both these main objectives are important for protecting consumers. In its new strategy Kredittilsynet will continue to place emphasis on the interests of the users of the services provided by the institutions under supervision.

Kredittilsynet's first decade was marked by a far-reaching crisis in the Norwegian banking system. The government was compelled to take over commercial banks accounting for three quarters of this bank category's total assets. Savings banks representing half of this category's total assets were in need of substantial capital injections from the government or the guarantee fund. This aspect of the story is thoroughly documented in the book *Protection against Crises? A Century of Financial Supervision in Norway* by Sverre Knutsen and Gunhild J. Ecklund, published in 2000.

The following decade heralded a favourable economic climate for the financial industry. Kredittilsynet has stressed that financial institutions should maintain a sound equity capital position and good internal control in order to prevent new crises and to fulfil their social role by being able to assume new risk in their lending operations. The prospects for Norwegian financial institutions appear excellent in the short term. However, international experience shows that it is precisely in periods of vigorous growth that a basis can be laid for future problems. Recent years' steep growth in house prices and household debt entails a real risk of a sudden contraction, possibly accompanied by falling house prices and potential problems for a number of late market entrants with a high loan-to-value ratio. It is still demanding for insurers to honour the returns they have guaranteed. At the same time pension obligations for an increasingly longer lived population are creating new challenges.

Hence **financial stability** will be a main objective for Kredittilsynet in the coming strategy period, as previously. There is still good reason to keep an eye on the adequacy of banks' internal control regimes and to ensure that their capital levels are sufficient to tackle changes in international conditions and in Norwegian markets. In the insurance field the chief task is to develop a body of rules and an asset-liability management model which make it easier to attend to the long-term obligations.

The Norwegian securities market has evolved greatly in the past 20 years and comes across as far better regulated and more mature than when the agency was formed in 1986. Indeed it was an absence of orderliness in the securities market which was the Ministry of Finance's most serious concern upon the establishment of Kredittilsynet. While securities markets will inevitably see fluctuations and surprises, the Norwegian equity market has in recent years shown an increasing ability to supply fresh capital to expanding Norwegian businesses.

Kredittilsynet is now additionally responsible for supervising listed companies' compliance with accounting legislation and international financial reporting standards. Alongside its oversight of auditors, accountants, insurance mediators, real estate agents and debt collection agencies, Kredittilsynet's responsibility for promoting **well functioning markets** will in due

course become just as important and acquire an equally large scale as the traditional prudential supervision of banks and insurance companies.

The new strategy will accordingly reflect two main objectives of equal standing:

financial stability and well functioning markets

Main and intermediate objectives were discussed in detail in a paper entitled “Objectives and performance measurement” from December 2005 as input to Kredittilsynet’s next strategy document. The paper also outlines how implementation of the objectives can be documented more successfully. The paper was circulated for comment to trade organisations and other parties, and Kredittilsynet has received many valuable comments for inclusion in the further work on its strategy.

In formulating rules and overseeing institutional compliance, much emphasis needs to be put on protecting the interests of the consumer and other users of financial services. Norwegian savers have traditionally turned to banks for saving purposes and adopted a reticent attitude to investing in equities, mutual funds and other savings products. Interest in new savings products is now clearly rising, spurred not least by relatively low interest rates. Unfortunately not all offerings of new savings products have shown the desired quality and balance of information. Kredittilsynet has issued regulations and further guidance on the information to be provided on composite savings products which will in due course apply to financial institutions and investment firms alike. In the forthcoming strategy period a priority task will be to develop rules and guidance ensuring that the advice provided by financial institutions and investment firms is of a high professional quality. Financial products must be given a design and be accompanied by information which gives their users a genuine opportunity to make well-informed choices, e.g. in regard to risk and potential return.

While Kredittilsynet will continue its active cooperation with the consumer bodies with a view to improving the general information on financial markets and products, resource-constraints imply that it can take only limited responsibility for consumer information and guidance.

Together with the Consumer Council and the Consumer Ombudsman, Kredittilsynet has devised a set-up for a web-based information portal for the financial sector which could prove an important tool for providing more precise and better information to ordinary consumers about various financial products and their characteristics. A letter to the Ministry of Finance and the Ministry of Children and Equality indicates the financial resources that will be needed to achieve a successful establishment of the portal. While Kredittilsynet will be able to assist in the establishment and operation of the portal, independent funding will be needed to give it sufficient weight. In Kredittilsynet’s view the job to be done by the portal goes beyond what qualifies for funding by way of the levies paid by entities under supervision.

The traditional supervision model reflected the fact that the great majority of the financial market was serviced by financial institutions licensed by the national authority in the country in which the business was conducted. The growing presence of branches from other EEA countries creates a need for a supervision model in which the home country's prudential supervision is supplemented with active host-country supervision focusing on market behaviour. This must build on the framework created under European legislation, combined with a systematic and active effort to protect user interests and to monitor compliance with money laundering and other market-related provisions.

It is Kredittilsynet's impression that the managements of the larger branches operating in the Norwegian market find it natural to maintain regular contact with the host country supervisory authority, provided that unreasonable duplication of work and unclear responsibilities are avoided. In Kredittilsynet's view the development of host country supervision will be an important task in the forthcoming strategy period with a view to preserving a coherent overview of the Norwegian financial market. Cooperation with home country supervisory authorities must be further developed in order to ensure the prudential supervision and a rational division of work.

The European legislative process creates both opportunities and challenges for Norwegian business. Devising a common body of rules for close to 30 European countries clearly tends to lead to rules which are more complicated and detailed than each individual country previously needed. In the years ahead an important task must be to consider the possibilities for simplifying the overall body of rules – both when implementing new EU rules and when reviewing existing Norwegian legislation.

The prudential supervision of financial institutions will be influenced by the substantial changes in capital adequacy and supervisory systems resulting from the Basel II reform. The capital requirements will do more to reflect actual risk than was previously the case. There is however a risk that model calculations coloured by recent years' favourable development in the economy and the business sector entail insufficient buffer capital to meet possible future setbacks and economic problems. Kredittilsynet will need to make allowance for fluctuation in the economy and business conditions. The safety margins and freedom of action needed to meet unexpected situations must be combined with constructive dialogue with affected trade organisations and with a body of rules and supervisory practices which are designed in such a way as to avoid unnecessary competitive disadvantages for Norwegian businesses.

The Storting's decision on the future pension system has prompted all businesses to establish pension schemes for their employees. Norwegian rules and supervisory traditions have brought a large measure of security for employee rights, regardless of whether they have turned to pension funds or to life insurance companies to save for retirement. In contrast to some other countries, Norwegian employees have not missed out on the pension rights they have been promised. With thousands of new businesses having to offer their employees pension schemes, and many market actors actively competing for customers, the period ahead will see major demands made on guidance and on overseeing that pension schemes are established in a satisfactory manner. Emphasis must in particular be put on ensuring that information activities and insurance mediation are carried on in a manner that serves the interests of the users, both firms and their employees.

Another important trend affecting the majority of supervised entities is the increased weight which has to be given to operational risk. This is not least tied up with institutions' increased dependence on information and communication technology both in the running of their business and in their contact with the customers. It has to be expected that institutions will fairly frequently be exposed to attempts by criminal groupings to penetrate their electronic systems in the hope of misappropriating funds. Kredittilsynet bases its supervision on the premise that the responsibility for business operations rests with the board and the day-to-day management. It will be particularly important for institutions to maintain adequate internal control of the various types of operational risk they are faced with. Even so, Kredittilsynet will naturally need to continue, and step up, its efforts in regard to operational risk, not least in the ICT area. For Kredittilsynet the main priority must be to put in place measures of common significance for a wide range of entities, such as secure operation of infrastructure and protection against attacks by criminal groupings.

Integrated supervision provides the best basis for effective supervision – but with new tasks and frequent revision of international and national rules, keeping a coherent overview while concurrently discharging all individual tasks in a satisfactory manner makes great demands. In developing Kredittilsynet's organisation and activities, it will be essential to ensure optimal coordination of case handling and supervision. One way to achieve this is by further developing electronic reporting and case handling. Kredittilsynet aims to set the stage for electronic application processing in several areas. The agency has made a strategic decision to link much of its further effort as regards reporting and dialogue with supervised entities to the Altinn system, a common electronic reporting channel for businesses to file government forms. Since the Brønnøysund Register Centre and the Tax Administration and other Norwegian authorities are doing likewise, this should provide practical benefits for entities under supervision and for Kredittilsynet itself.

Kredittilsynet has focused on improving its services, for example by establishing a 30-day target for processing the majority of administrative cases. Further delegation of decision-making competence from the Ministry of Finance to Kredittilsynet would be appropriate both in the interest of service quality and effective public resource use. The aim should be to bring the Norwegian system more into line with arrangements in other European countries where cases in the financial sector are handled by a single body, i.e. the supervisory authority.

Both the financial industry and the other entities supervised by Kredittilsynet are of major significance for Norwegian economic activity in general. A competent, sound Norwegian financial industry and capable, orderly practitioners of securities trading, auditing, accounting and mediation activities can make important contributions to continued growth and development in the Norwegian economy in the years to come.

Several years of robust development of the Norwegian economy and financial saving have provided a new basis for a strengthening of the financial industry. An improvement of Norwegian actors' position on the domestic market and abroad may also benefit the users of financial services. The challenge for Kredittilsynet will be to promote a body of rules, and to enforce them, in way that provides the best possible competitive environment for the

Norwegian financial industry while at the same time attending to the fundamental requirements of stability and well functioning markets.

Kredittilsynet's premise is that the responsibility for developing business activity in entities under supervision rests with their board and day-to-day management. It is not Kredittilsynet's job to play a leading role in the development of new products and business activities. At the same time Kredittilsynet will be concerned with dialogue and cooperation with trade organisations and entities under supervision with a view to ensuring that rules, administration and active supervision can provide a good basis for the development of strong Norwegian actors and industries. This dynamic perspective will be important for Kredittilsynet in the years ahead and for shaping a new strategy.