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TECHNICAL NOTE—CRISIS MANAGEMENT, BANK RESOLUTION, AND FINANCIAL SECTOR SAFETY NETS

This Technical Note on Crisis Management, Bank Resolution, and Financial Sector Safety Nets for Norway was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in August 2015.

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FINANCIAL SYSTEM STABILITY ASSESSMENT

August 18, 2015

TECHNICAL NOTE

CRISIS MANAGEMENT, BANK RESOLUTION, AND FINANCIAL SECTOR SAFETY NETS

Prepared By

Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Norway. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations.

CONTENTS

TABLES

Glossary

ABS	Asset-backed Securities
AMCs	Asset Management Companies
BGF	Banks' Guarantee Fund
BRRD	Bank Recovery and Resolution Directive
BCPs	Basel Core Principles
CMG	Crisis Management Group
DGS	Deposit Guarantee Scheme
ECB	European Central Bank
ELA	Emergency Liquidity Assistance
EU	European Union
FIA	Financial Institutions Act
FSAct	Financial Supervision Act
FSA	Finanstilsynet
FSB	Financial Stability Board
GSA	Guarantee Schemes Act
G-SIFI	Globally Systemically Important Financial Institutions
KAs	Key Attributes for Effective Resolution Regimes for Financial Institutions
KA	Key Attribute
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NB	Norges Bank
NBSG	Nordic-Baltic Stability Group
NOK	Norwegian krone

EXECUTIVE SUMMARY[1]

1. Arrangements for crisis management, bank and group resolution, and the financial sector safety nets are well developed and tested. Roles, responsibilities, accountabilities and information sharing arrangements among the relevant bodies, the Ministry of Finance (MOF), the Finanstilsynet (FSA), Norges Bank (NB) and the Banks' Guarantee Fund (BGF), the private sector led deposit guarantee scheme, are generally well defined and functioning. The MOF is, de facto, the lead resolution authority, and the FSA has resolution responsibilities as well. The MOF takes decisions based on the recommendations of the FSA, which are formulated routinely in consultation with NB and often with the BGF. The FSA executes MOF's resolution decisions. Due to its private sector governance, there are impediments to integrating the BGF fully into the resolutions and crisis preparedness and management frameworks, and further steps should be considered to overcome obstacles in this regard.

2. The current legal framework provides substantial powers and flexibility to deal with failing or failed banks but needs to be strengthened in several respects. A public-private sector banking law commission is currently working to formulate new legislation to transpose the EU's Bank Recovery and Resolution Directive (BRRD) in Norwegian law. The commission and government also should take into account the requirements of the Financial Stability Board's *Key Attributes for Effective Resolution Regimes for Financial Institutions*, the internationally agreed standard, in drafting the new legislation. Key issues in this respect include ensuring the operational independence of the resolution authority as well as adequate legal protections, adopting the full resolution toolkit set out in the Key Attributes, and distinguishing between going and gone concern resolution.

3. The FSA has begun to implement a recovery plan requirement for the largest banks. However, the legal and regulatory framework for institution-specific resolution plans, and for the assessment of potential impediments to resolvability that help to underpin them, is not in place; further, substantive work toward developing resolution strategies and plans has not yet been undertaken. Resolution planning for the largest domestic banks should be initiated as soon as possible.

4. The authorities have not formally articulated their expectations regarding the Norway-specific elements of the recovery and resolution plans of foreign bank subsidiaries and branches. This is of significance to the second, third and fourth-largest banks in Norway by assets. While some policy in this regard in being formulated in the context of the work of supervisory colleges and the Nordea Crisis Management Group, and notwithstanding the roles and ultimate responsibilities of the home authorities, a comprehensive and consistent policy framework should be developed.

[1] Prepared by Mr. David Scott and Ms. Virginia Rutledge (IMF external experts).

5. The authorities make good use of simulation exercises to enhance crisis preparedness. This includes domestic unilateral, bilateral, and tripartite exercises as well as regional exercises; although it has been several years since a significant regional exercise was undertaken, one is planned for 2017. The BGF is generally not a part of the domestic exercises, and means to better integrate it should be considered.

6. Both NB and the BGF can provide emergency liquidity assistance, and the BGF can provide solvency support. Relevant policies are in place at NB but not at the BGF. There are no standing arrangements for the provision of resolution funding under the control of the resolution authorities, and one should be considered as part of the new legislation.

7. The BGF offers a high level of deposit insurance coverage and is well funded. All banks must be members. It is governed by the banking industry (five of seven board members are current bank executives) and operated by the Bankers' Association. Its private sector character impedes information flows from the FSA, and gives rise to potential conflicts of interest in decisions regarding support to members. The BGF should adopt a clear and comprehensive policy for recusal of board members in such matters. The BGF can borrow and should adopt policies regarding for what purpose and under what conditions it can borrow. At present the BGF does not have a committed back-up funding facility, and efforts to secure one should be pursued. Members must guarantee any deficiency in the size of the fund relative to a legally mandated minimum, but the current legal constraint on BGF's ability to draw on the guarantee should be relaxed.

8. See Table 1 for a summary of key recommendations.

Table 1: Key Recommendations

Recommendations	Priority	Institution
Enhance the legal framework for resolution to comply with the requirements of the Financial Stability Board's *Key Attributes for Effective Resolution Regimes for Financial Institutions*, in particular with regard to operational independence of the resolution authorities, legal protections, adoption of the full resolution toolkit, establishing earlier triggers for resolution, cross-border resolutions, and distinguishing going-concern from gone-concern resolution.	H[1]	MOF/FSA
Begin resolution planning for the largest domestic banks, including assessing potential impediments to resolvability.	H	MOF/FSA
Formally articulate expectations regarding the Norway-specific elements of the recovery and resolution plans of foreign bank subsidiaries and branches.	M[2]	MOF/FSA
Establish a source of resolution funding under the control of the resolution authority.	M	MOF
Secured a committed back-up funding facility for the BGF.	M	BGF
Relax legal constraints on the ability of the BGF to draw upon members' guarantees of deficiencies in the amount of the fund.	M	MOF
Find means to include the BGF in crisis simulation exercises.	M	All
Develop policies for recusal of BGF board members.	H	BGF/MOF
Develop policies for provision of support by the BGF.	M	BGF
Develop policies applicable to borrowing by the BGF.	M	BGF

[1] For action within the next 12 months.

[2] For action within the next 24 months.

INTRODUCTION

9. This note reviews the arrangements in Norway for crisis management, bank resolution, and financial safety nets. The objective of the review has been to identify areas in which the current arrangements may fall short of emerging international best practices and standards and make specific recommendations, where appropriate, for bringing the current arrangements into closer alignment with those practices. To this end, the current arrangements were reviewed with reference to the FSB Key Attributes for Effective Resolution Regimes for Financial Institutions. The FSB KAs were finalized in October 2011, but details on how to implement them will be further fleshed out in the accompanying methodology, which is still a work in progress. Where the KAs are applicable, the recommendations in this report reflect current thinking on how to most effectively implement them based on direct experience in providing technical assistance to IMF member jurisdictions on developing modern resolution regimes and the IADI Core Principles for Effective Deposit Insurance Systems. The note does not reflect a detailed, formal assessment of compliance with either standard.

10. The review of current arrangements has also been conducted with awareness that Norway is in the process of revising its existing legal framework for crisis management, in part in order to transpose the EU BRRD into Norwegian law. It is anticipated that this process will address many of the concerns described in this note and bring current arrangements into closer compliance with the FSB Key Attributes. In this regard, it should be noted that the BRRD largely sets a minimum level for harmonization of national laws and therefore provides some leeway for the authorities in designing their specific approach to resolution. As a result, some of the recommendations made in this technical note may go beyond what is specified in the BRRD.[2]

11. The Norwegian financial system is dominated by banks, often part of larger financial conglomerates, some of which are based in other Nordic countries. A few players command large market shares, with DNB Group ASA (DNB) having the largest share, followed by subsidiaries and branches of banks headquartered in other Nordic countries. The FSA reported that as of the end of 2013, 18 commercial banks and 106 savings banks were licensed to operate in Norway. In addition, foreign banks and credit institutions operated 42 branches in Norway.

INSTITUTIONAL FRAMEWORK

The institutional framework refers to the roles, powers, and responsibilities of entities relevant to crisis management, bank and group resolution, and the financial sector safety nets. It addresses the manner in which those entities interact and coordinate their activities, both domestically and with foreign counterparts. The comprehensiveness and cohesiveness of the institutional framework is a critical

[2] The BRRD is applicable to Norway as a member of the European Economic Area. The note reflects no conclusions on whether the BRRD itself is fully compliant with the FSB KAs in all respects.

determinant of the effectiveness of a jurisdiction in mitigating the risk of crises, and in responding rapidly, decisively and effectively should they occur.

A. Domestic Arrangements

Overview

12. Responsibilities for crisis management, bank resolution and financial sector safety nets are distributed between four bodies. These are the Ministry of Finance (MOF), the Finanstilsynet (FSA), the financial supervisory agency, Norges Bank (NB), the central bank, and the Banks' Guarantee Fund (BGF), the private sector led deposit guarantee scheme. The MOF takes all resolution decisions, and as such is the lead resolution authority. The FSA also has resolution responsibilities. In addition, it assesses the fact situation and, in consultation with NB and the BGF as it deems appropriate, formulates options and a recommendation to the MOF. As the BGF has five active bankers on its seven-member board, there are impediments to integrating it fully into the crisis preparedness and management framework.

13. The institutional arrangements are well established. Roles, responsibilities, accountabilities and information sharing arrangements are generally well defined. Establishing adequate operational independence of the resolution authorities may remain a challenge. Due to its private sector governance, impediments exist to sharing information with the BGF and incorporating it more fully into the crisis management framework. Human capital seems an important asset to highlight in Norway: institutional memories from range of stresses and crises dating to late 1980s appear to be retained and brought to bear in dealing with current situations.

The King

14. The King has certain early intervention powers as well as resolution powers under the GSA. Under Chapter 3 of the GSA, the King has the power to authorize the write-down of the share capital of an institution and to require the subscription of new share capital, the legal power underlying nationalization (temporary public ownership) as a resolution option. The King is also given resolution powers under Chapter 4 of the GSA. These powers have been delegated to the MOF and are described below.

Ministry of Finance (MOF)

15. The MOF has responsibility for financial stability in the context of its responsibility for economic policy. It has responsibility to propose legislation and to issue regulations under authority delegated by the Cabinet/government (King in Council). For certain technical matters the power to issue regulations is further delegated to the FSA. The MOF has a range of powers under Chapter 2 of the Financial Institutions Act (FIA), including, inter alia, authorizing ownership in financial institutions, issuing regulations applicable to financial institutions in the interest of promoting financial stability, regulating capital requirements, regulating disclosure requirements, regulating the size of the systemic risk capital buffer, defining which institutions shall be deemed systemically important, and regulating conduct of business and prudential requirements and setting the capital buffer for such institutions, setting the requirement for the countercyclical capital buffer,[3] and regulating liquidity requirements. The wide range of powers and responsibilities means that the MOF is, in principle, involved in what would be considered to be supervisory activities in most jurisdictions. Many of these are delegated to FSA, though the extent of delegation is somewhat ambiguous, particularly with respect to larger banks.

16. The MOF is the lead resolution authority. While not formally designated as such, the MOF is deemed a resolution authority because the resolution powers given to the King under Chapter 4 of the Guarantee Schemes Act (GSA) have been delegated to the MOF. As a result, the MOF has the power to trigger resolutions, and in practice is the key decision-maker in resolving problem situations. In particular, the MOF has the power to order an institution to be placed under public administration, including its parent company and related firms, and to release an institution from public administration by ordering that normal operations be resumed.

Finanstilsynet (FSA)

17. The FSA supervises all financial institutions. These include, *inter alia*, banks, insurance companies, pension funds, and investment firms. It supervises securities fund management and market conduct in the securities market, stock exchanges and authorized market places, settlement centers and securities registers, real estate agencies, debt collection agencies, external accountants, and auditors. The FSA's supervision of financial institutions includes analysis of reported data, on-site inspections of individual institutions and thematic inspections of multiple institutions. Supervision also includes monitoring macroeconomic conditions and other developments that may pose risks to financial stability. The FSA undertakes analyses of risks facing the banks and other institutions and of possible sources of future instability in the financial system.

18. The FSA has a range of early intervention powers. These are set out under Section 4 of the Financial Supervision Act (FSAct) and Section 2–9(d) of the FIA. Under Section 5 of the FSAct it has the power to convene meetings of an institution's board of directors, control committee and supervisory board and to submit proposals at such meetings. (See Chapter on Early Intervention in this note.)

19. The FSA also has a range of early intervention powers and resolution responsibilities under the GSA, which include resolution-related decisions as well as executing the resolution decisions taken by the MOF. Under Section 3, the early intervention powers include ordering changes in the composition of an institution's governing bodies. Under the resolution provisions of Chapter 4, the FSA responsibilities include , notifying NB and the relevant guarantee fund if it determines that an institution has inadequate capital, notifying the MOF if it determines that an institution is insolvent, controlling the financial business of an institution once placed in public

[3] NB has been tasked to draw up a basis for a decision on the level of the countercyclical capital buffer, and provide an assessment and advice to the MOF about the level.

administration by the MOF, appointing and overseeing the administration board and auditor for an institution in public administration, and approving the final accounts and proposed distribution of proceeds of the liquidation of an institution under public administration.

Norges Bank (NB)

20. NB's tasks and responsibilities relevant to resolutions are set out in the Norges Bank Act (NBA). NB is responsible to monitor developments in the money, credit and foreign exchange markets (Section 1), and to inform the MOF when "there is a need for measures to be taken by others than the Bank in the field of monetary, credit or foreign exchange policy" (Section 3). NB serves as the lender of last resort to banks and under Section 19 has broad powers to "grant credit on special terms" to banks. Under Section 22 it has broad powers to lend to "entities other than banks in the financial sector." Under Section 1, and in practice, there is coordination in decision-making with the MOF.

Banks' Guarantee Fund (BGF)

21. The BGF is the deposit insurer, is funded and governed by banking industry executives, and can provide liquidity and/or solvency support to mitigate the need for or support an official resolution action. Under Section 2 of the GSA it can provide liquidity and/or capital support to banks directly or via a guarantee. Five of its seven board members are current bank executives. The other two board members are senior officials from NB and the FSA.

Domestic Collaboration

22. There are no restrictions on the exchange of non-public information between NB, the MOF, and the FSA, and various legal provisions require information sharing among them. Under the FSAct, sharing of confidential information by the FSA with NB and the MOF is permitted (Section 7). Under the NBA, sharing of information with the MOF and the FSA is explicitly exempt from the duty of confidentiality (Section 12). As noted above, under the GSA, the FSA should inform NB when it learns of liquidity or capital problems in a financial institution, and should notify NB and the BGF when a bank is potentially failing. NB and the BGF are to provide their view as to whether the bank can recover on its own, or can do so with their assistance, and should include the details of any assistance that NB or the BGF, at their discretion, are willing to offer. If the FSA believes the bank cannot be restored to health, it must notify the MOF. In this case, the MOF may order the bank to be placed under public administration.

23. The ability to fully share information with the BGF is more limited. Subject to operating procedures within the BGF that generally preclude sharing information with its (private sector) board, the FSA is able to inform BGF staff of potential problem institutions, and the two institutions' respective views on problem institutions overall are able to be exchanged. There is some coordination of supervisory activities in problem institutions, particularly the smallest. When the BGF visits problem institutions they make reports to the institutions afterwards. These reports are not sent to the FSA, but the FSA can request a copy from the institutions directly. Similarly the BGF can request a copy of the reports that the FSA makes after their supervisory visits.

24. Consultation between the MOF, the FSA and NB on financial stability matters was formalized in 2006. This takes the form of semi-annual tripartite meetings on financial stability attended by the three institutions and chaired by the Permanent Secretary of the MOF. More frequent meetings are held when appropriate, as during the recent global crisis. The meetings entail presentations by NB and the FSA on economic developments and the state of the markets. Programs for dealing with crises and other contingency planning issues are also sometimes discussed. Supervisory issues regarding individual banks generally are not discussed. There are also regular (usually quarterly) bilateral meetings between the MOF and the FSA, the NB and the FSA, and the NB and the MOF.

25. There is no formal MOU entered into by the three authorities for crisis management purposes or otherwise, and there is no formal MOU involving the BGF and any of the public authorities. The tripartite and other regular meetings have no formal role in crisis management, which is rather left to ad hoc arrangements depending on circumstances and based on a clear understanding of the respective roles and responsibilities of the different authorities. There is a bias against using inter-agency committee structures for decision-making in that doing so may undermine desired clarity regarding lines of authority and accountability. However, bilateral MOUs between NB and the FSA are in place addressing supervisory arrangement for payments and securities settlement and clearing systems where both have supervisory responsibilities.

A. Cross-Border Arrangements and Coordination

26. Norway is a party to the treaty on the European Economic Area (EEA). This treaty was entered into by the member states of the European Union and three of the EFTA member states, including Norway. Under this treaty Norway is required to implement EU directives and regulations governing the financial sector into the Norwegian legislation.

27. In 2003 NB entered into a regional central bank MOU, though activity under the MOU is limited. The MOU for the *Management of a Financial Crisis in Banks with Cross-border Establishments* agreed with the central banks of Denmark, Finland, Iceland, and Sweden sets out responsibilities and procedures for dealing crisis situations and for managing related internal and external communications. Meetings of the Contact Group as envisioned under the MOU no longer take place, with collaboration among the central banks now continuing in the context of broader regional MOUs, described immediately below.

28. Since 2010 Norway has been a party to the EU MOU on financial stability. The Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-border Financial Stability is the basis for setting out arrangements and promoting cooperation among the signatories, and preparing for the management and resolution of a cross-border systemic financial crisis.

29. The EU financial stability MOU has been further elaborated in a Nordic-Baltic cooperation agreement. In 2010 the MOF, the FSA and NB entered into a Nordic-Baltic *Cooperation Agreement On Cross-Border Financial Stability, Crisis Management and Resolution between Relevant Ministries, Central Banks and Financial Supervisory Authorities of Denmark, Finland, Iceland, Sweden, Estonia, Latvia, Lithuania and Norway*. This agreement builds upon and expands the EU-wide MOU cited above. The agreement provides for a Nordic-Baltic Cross-Border Stability Group (NBSG) and includes a "Preliminary Framework for Burden Sharing" in the event direct budgetary costs are incurred in resolving a crisis. A number of subgroups were established under the agreement but these have become mostly inactive. It was envisioned that the initial burden-sharing framework would be further elaborated but this has not occurred, due in part to lack of consensus on the necessity of doing so.

30. International coordination also occurs in the context of the Nordea Crisis Management Group (CMG). This is the resolution college for Nordea, a banking group designated by the Financial Stability Board (FSB) as a globally systemically important financial institution (G-SIFI), and for which the FSB must report annually to the G-20 leaders on progress on recovery and resolution planning. The role of the CMG under the FSB's *Key Attributes for Effective Resolution Regimes for Financial Institutions*, the internationally agreed standard, is to oversee the production by the Nordea group of a group-wide recovery plan, to prepare a group-wide resolution strategy and plan for implementing it, to assess impediments to resolution and take steps to remedy them, and to enter into a cross-border cooperation agreement setting out as much as possible the respective roles of the various CMG members in implementing resolution. All three Norwegian authorities participate in the CMG, with the MOF taking the lead.

31. As part of the process of revising its legal framework for crisis management, the authorities will need to ensure that the framework adequately addresses issues related to cross-border resolutions. In particular, consistent with FSB KA 7, the framework should provide for transparent and expedited mechanisms that would enable giving effect in Norway to foreign resolution measures, either by way of a mutual recognition process or by taking measures that support, and are consistent with, the resolution measures taken by a foreign resolution authority. The potential need for coordination of resolutions within the Nordic-Baltic region suggests that the current Nordic-Baltic coordination arrangements could serve as a useful forum for discussing how best to accomplish this and to harmonize the various national legal frameworks to support coordinated resolutions. Though some enhancement of the current legal framework will be needed to fully comply with KA 7, it should be noted that the current Norwegian legal framework does not discriminate against creditors on the basis of their nationality. In addition, it does not trigger automatic action within Norway based on initiation of resolution in another jurisdiction.

B. Key Recommendations

- Determine whether any or all the public authorities would find value in a domestic-level MOU among the three authorities addressing resolution and crisis preparedness related policies and processes, and if so, put one in place.

- In the process of transposing the BRRD into local law or otherwise, better integrate and leverage the BGF into the public sector institutional arrangements.

CRISIS PREPAREDNESS

Key components of the authorities' preparedness to deal effectively and efficiently with distress and crises are recovery planning by banks, in particular systemically important banks, under the oversight of the supervisory authorities, and resolution planning for such banks by the resolution authorities, supported by assessments of impediments to resolution and actions to remove them. Under the FSB's Key Attributes, recovery plans, resolution plans, and resolvability assessments should be updated at least annually, or upon material change within the bank. Preparedness is also enhanced by regular conduct of exercises to test aspects of the authorities' use of relevant policies and procedures, and by incorporating lessons learned into the policy and procedures framework.

A. Recovery Plans

32. The FSA has begun to implement a recovery plan requirement for the largest banks. Under the FSB's Key Attributes, systemically important banks, at a minimum, are to prepare recovery plans. This requirement, applicable to all banks and banking groups, is mirrored in the EU BRRD that is being transposed into Norwegian law. The impetus for the launch of the recovery plan requirement was the January 23, 2013, EBA Recommendation addressed to the home supervisors for 39 large European banks, including DNB, requesting the preparation of group recovery plans by end 2013. This triggered a letter by the FSA to DNB requesting a group recovery plan, prepared in accordance with EBA guidance, by the deadline. DNB submitted the plan in late 2013. The FSA reviewed the plan, involving members of the DNB supervisory college, and requested enhancements in June 2014. These included, *inter alia*, strengthening governance arrangements and expanding information regarding group structures (e.g. for information technology services). DNB submitted a revised plan in August 2014. Further enhancements soon will be requested by the FSA and a revised plan is expected by August 2015. The governance arrangements established by DNB for recovery planning seem sound, and the recovery plan appears comprehensive. DNB is taking measures to improve the potential effectiveness of its recovery options.

33. The recovery plan for the second largest bank, Nordea Bank Norway, was prepared and is being refined in the context of the CMG. Nordea bank's local subsidiary, designated systemically important in Norway, is covered by the Swedish Nordea Group's recovery plan being developed in the context of the FSB G-SIFI initiative cited above. The plan was initially submitted by Nordea in 2012, and was revised in 2013 based on comments from the supervisory college and CMG. The FSA comments called for additional detail on the Norwegian subsidiary. A third iteration was tabled in November 2014. The supervisory college and CMG will provide formal feedback before the second half of 2015.

34. The FSA is further rolling out recovery plan requirements in stages. A kick-off meeting was held late in 2014 with Kommunalbanken, the third of the three banks designated systemically important in Norway, and five large regional savings banks[4] setting out the FSA's expectations. All have been requested to submit recovery plans by the end of 2015. The FSA continues to rely primarily on EBA guidance in defining recovery plan requirements. To date there has been no decision on whether and how to expand the recovery plan requirement to other banks, though this will be required once the BRRD is transposed.

35. The FSA also reviewed the recovery plans of the Norwegian branches of major foreign banks operating in Norway. This work is undertaken in the context of the supervisory colleges for Danske Bank and Handelsbanken. The FSA's inputs have been confined mainly to ensuring greater specification of information on the aspects of the recovery plans as they relate to the banks' Norwegian operations.

36. The MOF and the FSA do not require a stand-alone recovery plan for the local subsidiaries of foreign banks. The authorities have not decided whether to require a stand-alone plan, including for subsidiaries that are systemically important in Norway. This decision involves consideration of the implications for Norway as home supervisor to systemically important subsidiaries in other jurisdictions (e.g., the Baltics).

B. Resolution Plans and Resolvability Assessments

37. The legal and regulatory framework for institution-specific resolution plans is not in place,[5] and substantive work toward preparing them has not yet been undertaken. Under the FSB's Key Attributes (at least for systemically important banks) and the BRRD (in principle for all banks, subject to the proportionality principle[6]), the resolution authority is to prepare resolution plans and undertake assessments to identify potential impediments to the feasibility and credibility of implementing the resolution plan (so-called "resolvability assessments"). The MOF has not yet adopted a policy framework for resolution plans or resolvability assessments, nor initiated substantive work in this regard. It thus has not specified the extent to which responsibility will be delegated to the FSA. Given its size and the attention paid to it by the European authorities, a resolution college will need to be formed soon for DNB. To date, the FSA has initiated discussion with the European Central Bank (ECB) regarding its participation in the DNB supervisory college.[7]

38. As such, resolution planning for only Nordea Bank Norway is progressing. Nordea's subsidiary is covered as a part of the draft resolution strategy for the Swedish Nordea group that had to be prepared pursuit to the requirements of the FSB G-SIFI initiative cited previously. The

[4] Sparebank 1 Nord-Norge, Sparebank 1 SMN, Sparebank 1 SR-Bank, all three of which are affiliated operationally to some extent, and Sparebanken Vest and Sparebanken Sor.

[5] See Chapter on Resolution Regime, below.

[6] This principle allow the requirements of the BRRD to be applied in a manner proportionate to the characteristics of the firm, and is intended to avoid unduly burdensome requirements being placed on smaller and simpler firms.

[7] The Lithuanian subsidiary of DNB is under the direct supervision of the ECB and, as such, ECB will be a member of the supervisory college.

strategy was developed by the Swedish authorities and shared in June 2014 with the CMG. The plan was not endorsed by the CMG.[8] Rather, it was agreed that a working group would be established within the CMG to further elaborate the strategy. The working group has yet to be formed.[9]

39. The authorities have not required or undertaken a resolvability assessment of Nordea Bank Norway. Such an assessment would help to identify impediments to the execution of any resolution strategy and plan that might possibly involve operating Nordea Bank Norway as a stand-alone entity. It would also help inform the MOF's inputs to the CMG. Reportedly the Swedish authorities' resolvability assessment of Nordea group, which in principle should address its Norwegian operations, has not been shared with the CMG.

40. There is no explicit power in current legislation to enable the authorities to require changes in the structure or operations of a bank specifically to enhance its resolvability.[10] Existing legislation does, however, provide powers to the MOF, in some cases delegated to FSA,[11] to approve structural changes in banks. The policy objectives currently applied to such approvals are generally consistent with the objectives underlying resolvability assessments, such as simplicity and transparency. But other matters relevant to enhancing resolvability (e.g., whether operational support essential to ensuring continuity of critical functions will be able to be maintained in a resolution) are not part of current policy.

C. Crisis Management Planning

41. The Norwegian authorities make good use of tripartite simulation exercises to enhance crisis preparedness. Two exercises involving the MOF, NB and the FSA were undertaken in 2012 and 2013. These full-day exercises included participation of top-level staff and executives, and cover scenarios with institution specific and systemic crisis elements. In 2012 the scenario was solvency problems in a medium sized bank, evolving into a systemic crisis. The 2013 exercise concentrated on ensuring continued operation of the payment system. Another tripartite exercise is planned for early 2016. The BGF is not part of these exercises, but rather is role-played by others.

42. The FSA and the BGF have undertaken an exercise to help ensure the ability to meet the 5-day deposit payout requirement. The exercise was undertaken in 2014, and serve to test and enhance the capacity of the banks and their data processing providers to fulfill their role in the BGF's automated payout capacity.

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[8] A key element of the plan, the identification of critical functions and core business lines, including cross-border operations, was generally agreed by CMG members.

[9] In addition, the Swedish authorities, as required by the FSB's Key Attributes, tabled a cross-border cooperation agreement (so-called COAG, in FSB Key Attribute parlance) that in part addresses the responsibilities of the various CMG members in implementing resolution.

[10] See Chapter on Resolution Regime, below.

[11] There is ambiguity as to the extent of delegation, particularly in the case of larger banks.

43. NB makes use of internal simulation exercises involving multiple units, sometimes involving FSA. NB's Crisis Management Group conducted a major simulation exercise in 2013 and one major and five minor simulation exercises in 2014. The exercise in 2013 tested ELA policies and procedures and involved the FSA. A focus was the solvency assessment required under NB policy to enable ELA. A key outcome of the exercise was a new procedure whereby relevant information is to be provided to NB to strengthen NB's own independent judgment on solvency. The major exercise in 2014 was a one-day event testing NB's response to severe market-wide funding stress, and involved senior management including the governor. The five minor exercises were geared toward improving the efficiency of analysis and decision-making in crisis situations.

44. Planning for a regional crisis simulation exercise is underway. The Nordic-Baltic region was one of the pioneers in using crisis simulation exercises to test and enhance preparedness, but a major exercise has not been conducted for several years. Under the auspices of the NBSG, a regional cross-border crisis exercise is envisioned in 2017. Given the significant presence of regional banks in Norway, the authorities may wish to advocate for more regular conduct of regional exercises.

D. Key Recommendations

- Begin group-wide resolution planning and resolvability assessments for DNB and the larger saving banks, taking into consideration Appendix I—Annexes 3 and 4 of the Key Attributes for Effective Resolution Regimes.

- Define formal policies for recovery planning specific to the Norwegian regulatory and supervisory regime, including policies on the required information content related to local operations of subsidiaries and branches of foreign banks.

- Define policies for resolution plans and resolvability assessments for banks (and insurers); including the information required on local operations of subsidiaries and branches of foreign banks, and nature of local resolvability assessments.

- Define delegations from MOF to FSA for resolution planning and resolvability assessments.

- Consider means to better integrate BGF into crisis simulation exercises.

- Consider to advocate more regular conduct of regional simulation exercises.

- See Chapter on Resolution Regime for related recommendations on the legal framework underpinning recovery and resolution planning and resolvability assessments.

EARLY INTERVENTION

A bank supervisor should have at its disposal a broad range of tools to address violations of law or regulations and unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The available measures should include the ability to require a bank to take timely corrective action or to impose sanctions at an early stage and without a finding that the bank is at or near a point of non-viability or insolvency. The types of corrective measures that may be required should be broad and unlimited, though the choice of measures in practice should be applied in proportion to the gravity of the situation.

A. Current Framework

45. An overall legal framework for dealing with problem banks should establish a logical progression of increasingly stringent and intrusive powers to deal with problems of increasing severity (from relatively minor issues of noncompliance to near-insolvency or insolvency and liquidation). It is helpful to think of the framework with reference to three distinct stages: early intervention, going concern resolution, and gone concern resolution.[12] However, this framework of increasingly intrusive measures should not include any inflexible, mechanical requirements that less intrusive measures must be applied before more intrusive actions are taken, as long as the relevant triggers for each stage are met. Early intervention powers are discussed in this section, while going concern and gone concern are discussed below in the sections on the resolution regime and insolvency and liquidation.

46. Effective early intervention, which can help minimize the use of resolution powers or other crisis-management tools, requires a robust legal underpinning. Early intervention generally refers to powers that authorize the supervisory authority to take action to resolve difficulties while the bank is still under the control of its own shareholders and management. The term may include both ordinary enforcement powers as well as special provisions that are targeted at resolving particular difficulties, such as insufficient capital. The triggers for early intervention should be broad but generally will not depend on any finding regarding condition of the bank.

47. The legal framework for early intervention in Norway consists of a range of provisions in the FIA and the FSAct, which generally provide a broad basis for the FSA to require correction of identified problems before the condition of the bank deteriorates to the point that formal resolution by the authorities may be needed. As is the case for many jurisdictions, in Norway the framework combines (1) ordinary powers of the supervisory authority to require remedial measures as part of ongoing supervision, and (2) specified additional powers that may be

[12] Going concern resolution generally refers to official control of an institution without its closure, which can permit a broad range of resolution techniques. Gone-concern resolution refers to official control of an institution that is to be wound up and liquidated. In some cases, a resolution may involve the use of both. For example, good assets and deposit liabilities may be transferred to healthy acquiring bank as a going concern technique, after which the remainder of the institution is placed into liquidation.

triggered when the bank has reached a certain of difficulty or deterioration but before formal resolution is necessary.

48. Section 4 of the FSAct provides a broad basis for requiring corrective measures. In particular, it authorizes the FSA to order a bank "to rectify [any] matter if an institution's bodies have failed to discharge their duties as required by provisions laid down in or pursuant to law, or have acted in breach of the terms of the institution's license."

49. The FIA provides authority to take action focused primarily on failure to comply with capital, liquidity, and risk assessment requirements Section 2–9d provides the FSA with the power to require banks that are not in compliance with these requirements to take following actions:

- Change the organization, management, and control of the businesses and the strategies, processes, policies, and procedures.
- Maintain a capital requirement higher than the minimum.
- Change or limit the business.
- Reduce the risk associated with the business, including products and systems.
- Reduce the difference in maturity between the institutions' liabilities and assets.
- Curb the performance-related remuneration.
- Devote the profit for the year to increase tier 1 capital adequacy and not to pay out dividend and interest**.**

Though section 2-9d contains a limited list of actions that can be taken, further actions can be required under the FSAct as well.[13]

50. In addition to the powers of the FIA and the FSAct, Chapter 3 of the GSA contains additional early intervention powers that can be used to avoid the need to exercise formal resolution powers. The triggers for action include that the bank may be unable to meet obligations as the fall due, the bank may be unable to meet the capital adequacy or other prudential requirements, or that circumstances have arisen that may cause a serious loss of confidence or losses that will substantially weaken the bank's financial position. Actions that may be required include calling for audited financials, ordering a change in the composition of management or the board of directors, restrictions or conditions on activities, or convening a shareholders' meeting. If the audited financials raise concerns about loss of capital, then a sequence of steps involving the

[13] The authorities have advised that, given the overall purpose of the two acts, section 2–9d of the FIA would not be viewed as a more specific provision that would override the authority granted under section 4(7) of the FSAct.

shareholders meetings are required. Ultimately, if there is no satisfactory resolution by the shareholders, the King may unilaterally write down share capital, without regard to shareholder preferential rights, and subordinated debt. These provisions are not a precondition to exercise of formal resolution powers and therefore raise no particular concerns.

B. Recommended Revisions

51. This framework has been effective as it stands, but some enhancements could be considered. The fact that the FSA has explicit powers has been used effectively to resolve problems at bank without the need to resort to formal use of its early intervention powers. Nonetheless, the language in particular of section 4(7) of the FSAct could be updated to more clearly express the expectations of the Basel Core Principles (BCPs) that supervisor have the power to address violations of law and regulations as well as other unsafe and unsound practices.

52. Furthermore, it is advisable that the overall framework establish clear consequences for a bank that fails to carry out required corrective measures. Consistent with the recommendation of the BCP assessment, the FSA should have the authority to impose administrative fines if required corrective measures are not implemented. The law already provides a basis for revocation of a license under section 8 of the Commercial Banks Act if a bank persistently fails to take corrective action when required.[14] However, it may also be appropriate to add a trigger for placing a bank in public administration also based on persistent failure to take corrective action when required.

C. Key Recommendations

- Consider enhancing the existing framework to explicitly broaden the bases for requiring corrective measures to encompass unsafe and unsound practices.
- Consider reinforcing the corrective measures powers by adding the authority to initiate public administration for failure to implement corrective measures.

EXTRAORDINARY FINANCIAL ASSISTANCE

The resolution of banks whose failure could have systemic repercussions could require provision of extraordinary financial assistance. Jurisdictions should have in place arrangements to provide temporary financing to facilitate the implementation of the resolution strategy. Provision of such public support should be subject to strict conditionality.

[14] Section 8 of Commercial Banks Act provides the power to revoke banking licenses if (1) the board of directors is guilty of gross or persistent dereliction of duties pursuant to law, regulations, or the banks' articles of association; (2) anyone in the management of the bank is guilty of misconduct; or (3) other serious irregularities give reason to fear that continuation of the business would not be in the public interest. The Savings Banks Act contains a similar provision.

A. Emergency Liquidity Assistance (ELA)

53. **Both NB and the BGF can provide ELA**. In addition, NB offers two standing facilities.

Norges Bank Standing Facilities

Legal Basis

54. **The legal basis for NB standing facilities is the Norges Bank Act.** Under Section 19, the NB may "grant liquidity loans to, make deposits with, and extend credit in other forms to commercial banks and savings banks." Under Section 22 it has broad powers to lend to "entities other than banks in the financial sector." Under Circular 1/2012: *Guidelines for Pledging Securities and Fund Units as Collateral for Loans in Norges Bank*, a bank must have entered into an "Agreement on the pledging of financial collateral for loans from Norges Bank" in order to obtain access. This requirement need not apply to potential non-bank borrowers under Section 22.

Collateral

55. **NB publishes a list of securities and fund units eligible as collateral along with the value at which it will lend against each**. In principle the list can be updated daily. Banks may apply to use other securities or fund units as collateral. To be eligible, securities issued by foreign issuers, and bonds, notes and short-term paper issued by Norwegian private entities, are subject to credit rating requirements. However, covered bonds issued under Norwegian law by Norwegian mortgage companies are exempt from the credit rating requirement, unless they are backed by loans secured on residential or commercial property located outside Norway. Other factors that are assessed to determine potential eligibility include where the security is listed, volume outstanding, currency of denomination, and existence of a government guarantee. Additional criteria apply to asset-backed securities (ABS).

56. **Certain securities are excluded from eligibility as collateral**. These include bonds, notes and short-term paper issued by companies of which the bank (or a bank in the same group) indirectly or directly owns more than 33 percent, collateralized debt obligations and securities issued by banks and other financial institutions. However, a bank may pledge securities backed by assets issued by the bank itself or by an entity that is part of the same group (e.g., covered bonds and ABS). Also, bonds issued by holding companies that largely own insurance companies, covered bonds and other ABS are eligible as collateral.

57. **All collateral is subject to a pre-set haircut in determining its value as collateral.** All securities are classified into one of four categories for purposes of determining haircuts. Other factors influencing the haircut are residual maturity and whether the security is fixed or floating rate. Haircuts range from a low of 1 percent (e.g., for fixed or floating rate government securities rated AAA with a residual maturity of 1 year or less) to a high of 22 percent (for fixed-rate covered bonds of Norwegian issuers that are unrated or have a credit rating A- or lower, and securities issued by

private Norwegian issuers with a credit rating of A- down to and including BBB-, with a residual maturity of greater than 7 years).

58. **In 2008 at the height of the crisis, the NB relaxed eligibility requirements.** This included expanding eligibility to certain money market fund and unit trust investments, lowering certain credit rating requirements and lowering minimum volume outstanding requirements. This increased flexibility was little utilized by banks, and the increased flexibility was reversed in 2010.

59. **In 2010 haircuts were reviewed in light of the experience during the crisis and all haircuts were raised.** Among the most significant was to increase the haircut on all floating rates securities to recognize they presented counterparty risk as well as market risk, to substantially raised the haircut on ABS (to 15 percent), and to raise the haircut on foreign currency (from 3 percent to 5 percent).

60. **As of 2012 NB no longer accepts as collateral bonds issued by banks, with the exception of covered bonds.** NB had contemplated this fundamental policy change for some time and the experience of the crisis reinforced its determination to adopt it. This reflects the systemic risk inherent in a collateral pool with a significant volume of bank liabilities that cannot practicably be sold in times of systemic distress. Covered bonds were exempted given that their secured status renders their value far less correlated to the risk associated with the bank and its unsecured liabilities.

Facilities

61. **NB operates two standing facilities and conducts market operations.** One is an intraday facility (intraday D-loan) that gives banks access to interest-free loans against collateral, so as to ensure the smooth functioning of interbank payment settlements. If a bank fails to repay an intraday loan, the loan automatically becomes an overnight loan (overnight D-loan). Overnight loans carry an interest rate 100 basis points higher than the key policy rate. The second is an overnight deposit facility. Banks are free to choose their own level of overnight deposits in Norges Bank, but deposits are remunerated according to a "tiering" or "quota" system. Each individual bank is assigned with a certain limit (or quota). Deposits within this limit are remunerated at the key policy rate. Deposits above the limit are remunerated at the reserve rate, which are 100 basis points lower than the key policy rate. The purpose is to motivate banks with excess reserves to lend them to other banks in the interbank market. Through market operations, Norges Bank makes sure that the overall level of reserves never exceeds the sum of all individual quotas. The sum of individual quotas currently equals around 45 billion NOK. Through market operations, Norges Bank normally steers the overall level of reserves to be in a range between 30 and 40 billion NOK. Market operations are normally done through F-loans (supplying reserves), or F-deposits (draining reserves). Interest rates are determined by auction. NB decides the aggregate amount of the allotment. The banks' interest rate bids are ranked in descending order. Bids that fall within the aggregate amount will be awarded at the interest rate submitted. The maturity on F-loans and deposits is determined by NB and varies depending on the projection of structural liquidity. Maturities may vary between one day and

several weeks.[15] There are no provisions to targeting F-loans to individual banks, though it is technically feasible.

Norges Bank ELA

62. As noted above, NB has broad powers to lend to banks and other-than-banks on special terms, and has a long-standing policy on the provision of such support as it applies to banks. NB's ELA facility of special loans to individual banks, designated S-loans, is highly flexible. The facility was used extensively in the crisis of late 1980s and early 1990s. The current policy for the provision of S-loans dates to April 2004 and stipulates that ELA only be granted in situations where financial stability may be threatened if the support is not provided, and requires that the bank be solvent and that the interest rate be above the market rate. Collateral and maturity requirements are flexible. Solvency is defined as having capital in excess of the 8 percent total capital requirement. As noted earlier, a key outcome of a recent crisis simulation exercise was that NB will seek information directly from banks to enable it to make an independent judgment on solvency, as a complement to that made by FSA. No bank sought or was granted an S-loan during the recent global crisis.

63. The S-loan facility for non-banks is rarely used, is therefore not subject to specific written policy, and was used once during the recent global crisis. NB provided a NOK 5 billion loan to the BGF that in turn lent the funds to a subsidiary of an Icelandic bank for a period of less than one month that it took to arrange the sale of the subsidiary to a local savings bank.[16] NB secured the loan via liens on BGF assets held outside the NB. The BGF recovered the funds from the proceeds of the sale of the subsidiary and repaid NB.

64. During the recent financial crisis, NB and the MOF devised a program in which the MOF issued bonds that were swapped with banks in exchange for covered bonds. The bonds could be used as collateral for NB lending, sold into the market, or held on balance sheet. At least one large bank made extensive use of this facility, but overall its use was limited.

65. In addition, NB made available long-term funding to medium and small size banks that are unable to participate in the swap facility via its F-loan, or fixed interest rate, program. The loans were initially for a 2-year period, later extended to 3 years. Access and interest rates were determined by auction with a maximum allocation of NOK 1 billion.

66. There remains a legal question as to whether the rejection by NB of a request for ELA could lead to a bank challenging the decision. NB has previously raised this issue with the MOF as a potential obstacle to efficient implementation of crisis-resolution measures, and MOF has raised

[15] Occasional late day fine-tuning operations may be conducted through F-auctions as well.

[16] At the time, the BGF's investment portfolio of some NOK 20 billion was insufficiently liquid to meet the funding need, due in part to market turmoil but also due to insufficiently conservative portfolio management by the BGF, a situation since remedied. See Chapter on Deposit Guarantee Scheme.

it with the Ministry of Justice. A change in law is required to clarify the matter, and this may be included in the revisions associated with transposition of the BRRD.

Bank Guarantee Fund ELA

67. The BFG can provide ELA in order to ensure that a member can fulfill its obligations and continue its activities or have its activities transferred to another institution. Under Section 2–12(1) of the GSA, the BFG can provide liquidity support to banks directly or via guarantees. Provision of such support requires the vote of a least five board members, and cannot be granted if the balance of the fund after the provision of such support is deemed insufficient to cover its deposit guarantee obligations. Policies defining the meaning of this restriction and the circumstances under which the BFG would grant ELA have not been developed. This facility was used once in recent years, funded by a loan from NB, as described above in the section on NB ELA.

B. Solvency Support

68. There are no standing arrangements for the provision of solvency support under the control of the resolution authority (MOF). Solvency support is available from the BGF as provided for in the GSA Section 2–12(1)(c), but the MOF has no formal authority over its availability or use. As with the BGF liquidity support cited above, in order to ensure that a member can fulfill its obligations or continue its activities, or have its activities transferred to another institution, the BGF can provide capital support directly or via a guarantee. The provision of solvency support requires the vote of a least five board members, and cannot be granted if the balance of the fund after the provision of such support is deemed insufficient to cover its deposit guarantee obligations. Policies defining the meaning of this restriction and the circumstances under which the BGF would grant solvency support have not been developed. It is envisioned that in the course of transposing the BRRD into national legislation the resolution authorities will be provided a source of resolution funding.

69. Tier 1 solvency support was made available by the government at the height of the global financial crisis. The government established the State Finance Fund to provide tier 1 capital to banks considered sound. Of the NOK 50 billion made available, 28 banks applied for NOK 4.1 billion in hybrid tier 1 capital, and one bank received NOK 27 million in preference shares. All banks subsequently redeemed the capital and the State Finance Fund was closed.

C. Key Recommendations

- Take further steps to ensure availability of information to NB to make a solvency determination per its policies in the event of a sudden request for ELA, including steps to mitigate the operational challenges in making a timely assessment.

- Consider establishing a standing mechanism for resolution funding available to the resolution authorities.[17]

- Define policies addressing the circumstances under which BGF would grant ELA and solvency support.

- Define policies interpreting the potential restriction on BGF granting ELA or solvency support due to the inadequacy of the size of the fund.

RESOLUTION REGIME

Modern resolution regimes are designed to permit expeditious and orderly resolution of financial institutions to maintain financial stability and ensure continuity of critical financial services and functions, and at the same time minimize the costs of resolution and avoid unnecessary destruction of value. Minimizing costs means in particular that losses should fall on shareholders and creditors of the institution, in accordance with the applicable hierarchy of claims, rather than on taxpayers. Resolution regimes increasingly contain common features, as evidenced by the FSB Key Attributes; though specific approaches to achieving these broad requirements vary.

70. A key challenge in designing an effective resolution regime is to design a framework that strikes an appropriate balance between the public interest in financial stability and the private rights of stakeholders. In general, a resolution framework should provide maximum flexibility and discretion for the resolution authority to choose and implement an effective and cost-efficient resolution technique that will best achieve the objections of resolution. As a result, it should include a broad range of resolution tools that can be used without closure of the bank (going concern resolution) or after closure (gone concern resolution). At the same time, the resolution framework must also contain safeguards for bank stakeholders, in particular the requirement that no creditor be worse off as a result of resolution than would have been the case in a liquidation of the bank.

A. The Current Regime

71. The Norwegian resolution regime[18] provides a basis for a range of resolution techniques through public administration, which has been used effectively to resolve failing or failed banks. This, coupled with the use of the early intervention powers of Chapter 3 of the GSA described above, has provided the authorities with important experience in dealing with failing banks, and they are to be commended for their ability to effectively use the combination of current early intervention and resolution powers to deal with problems as they have arisen.

[17] The design of the standing mechanism for resolution funding should be such that any eventual losses are imposed on the industry and not taxpayers.

[18] Chapter 4 of the GSA.

72. The authorities have had to deal with bank failure in both the Norwegian banking crisis of the 1990s and, more recently, as a result of the global financial crisis in 2008. In the early stages of the 1990s crisis, the two bank-owned guarantee funds[19] handled most of the failures in smaller banks by capital injections and guarantees. Once the crisis reached systemic proportions the government decided that capital infusions into the three largest banks by the government would be necessary. The infusions were contingent on strict requirements being met, including that existing shareholders accepting a write-down to cover losses to the extent possible. Legislation was passed providing that the King in Council could under certain conditions write down a bank shares to zero to reflect losses, if the shareholders meeting failed to approve the write-down. In two of the three cases, this power was needed. Similar provisions still exist in Chapter 3 of the GSA. With the exception of the government stake in DnB, the government investments were eventually sold to the private sector. Estimates of the net fiscal costs are low.[20]

73. The authorities also dealt with the failure of a branch and a subsidiary of Icelandic banks during the 2008 crisis. A solution for the failed subsidiary was rapidly found that brought its banking business into new hands. No losses were incurred by depositors or by the BGF. As regards the branch, it was placed into public administration under Chapter 4 of the GSA and wound down. The BGF arranged for deposits up to NOK 2 million (the maximum amount of BGF coverage) to be transferred to other banks or redeemed. The finance minister's guarantee for deposits that would normally be covered by Iceland's own guarantee scheme brought calm in connection with the wind-down of the branch. Fortunately, the value of assets of the Icelandic bank in Norway meant that customers with deposits in excess of NOK 2 million also avoided loss.[21]

74. Within the last five years, the authorities have also successfully dealt with smaller problem banks before reaching a stage where formal resolution would be necessary. Two banks have been required to make changes in management due to unsound practices which led to excessive losses and withdrawal of deposits. In both cases, the changes were made without the need to initiate any formal action by the FSA. The FSA attributes their success in such cases to the fact that the legal framework clearly authorizes formal action ordering a change in management if necessary.

75. The existing framework provides for a range of resolution powers that are required under FSB KA 3 and incorporates a key safeguard. In particular:

[19] At the time, there were separate funds for commercial and savings banks. These funds were subsequently merged into a single deposit insurance fund.

[20] The description in this paragraph is largely taken from The Norwegian Banking Crisis, Norges Bank Occasional Paper No. 33 (2004).

[21] Annual Reports of the FSA (2008, 2009).

- The provisions empower the authorities to place a distressed bank under public administration, which is the mechanism through which a bank may be resolved through restructuring, returned to normal operations, or wound up and liquidated.[22]

- The administration board that takes control of an institution in resolution assumes the authority vested in the institution's board of directors and the general meeting of shareholders.

- As a result of its exercise of the authority of the board of directors and the shareholders, the administration board should be able take any action with respect to the bank that could be taken by the board or the shareholders. This means that the administration board could carry out, resolution techniques such as a transfer of activities to another institution, merger, or recapitalization.

- The law incorporates the "no creditor worse off" safeguard, in line with FSB KA 5, by applying the Creditors Security Act, which sets out the applicable priority of claims.

76. The current resolution regime nonetheless will require strengthening and enhancement in order to come into full compliance with the FSB KAs, as the authorities recognize. Work on the planned revision of the existing framework in order to transpose the EU BRRD into Norwegian law is underway and is anticipated to address the concerns described in this section and bring the law into compliance with the FSB Key Attributes. The authorities plan to produce a document for public consultation by the end of this year and complete the draft law next year. This extended schedule is based, in part, on the stability of the banking sector and the confidence the authorities has that problems will be identified early and that their existing powers provide them with sufficient tools to deal with problems that might arise. The view of the authorities on this point is not unreasonable, but there is nonetheless concern that the current framework could prove deficient in unforeseen ways should a significant bank failure or a systemic crisis occurs. In this light, it would be advisable to complete the revisions to the law sooner rather than later.

B. Recommended Revisions

77. To assist the authorities in their work on updating the existing framework, described below are concerns with the present law that should be addressed. Key concerns are addressed first followed by a briefer discussion of some additional issues that will be important to the overall efficient functioning of the resolution framework.

78. Operational independence of resolution authorities, as required by FSB KA 2.5, is crucial to an effective resolution regime and should be clearly addressed by the new framework in Norway. Currently, the authorities have identified the MOF as the resolution authority, though the FSA has specific responsibilities as well in carrying out resolutions. These responsibilities effectively mean that the FSA is also assigned as a resolution authority, and the

[22] Chapter 4 of the GSA.

requirements of the FSB KAs for resolution authorities apply to the FSA as well. There may be some realignment of resolution responsibilities in the update of the existing law. However they are realigned, to be consistent with FSB KA 2.5 the framework should ensure the operational independence of each entity that would qualify as a resolution authority.[23] Furthermore, the framework should clearly identify the roles and responsibilities of each. Carrying out this aspect of the FSB KAs will likely be facilitated by making explicit the statutory objectives of resolution, in line with FSB KA 2.3, and thinking clearly about how the responsibilities of each resolution authority relate to these objectives. Briefly, the four objectives are financial stability and continuity of important financial services, protection of depositors, avoiding unnecessary destruction of value and minimizing costs of resolution and considering the impact of resolution actions of other jurisdictions.

79. The role of the MOF as resolution authority presents a particular challenge in establishing operational independence. An underlying concern of the requirement for independence is to minimize the risk of undue political influence on resolution decisions. This risk is naturally higher the broader the other areas of responsibilities of the resolution authority. The risk can be particularly high where a resolution authority is designated that has broad political accountability. At the same time, it must be recognized that if resolution requires the expenditure of public funds, the MOF must have a say in deciding whether any commitment of public funds is appropriate. To the extent that the MOF is involved in resolution decisions, the MOF would need to provide structural arrangements to ensure separation within the MOF of resolution decisions from the other statutory responsibilities of the MOF.

80. The law should provide for legal protection of the resolution authorities, their officers, staff, and agents for good-faith actions in resolution. The goal of this requirement is not to avoid completely legal accountability. At the same time, resolution encourages litigation because of the direct and significant impact on the private parties who are bank customers and stakeholders. To strike an appropriate balance between the need to avoid the chilling effect that the risk of litigation could have and the requirements of legal accountability, there should be a heightened threshold for possible liability for resolution actions. The general standard in FSB KA 2.6 is to protect the resolution authority and its employees and agents if they act in good faith. In Norway, under the current framework the legal protection should extend to the MOF and the FSA, their officials and staff as well as the administration board which carries out public administration. Under current law, as a practical matter, employees of government agencies are not sued because under the general

[23] KA 2.5 requires that a resolution authority have operational independence consistent with its statutory responsibilities. This is similar to the requirement of operational independence in other international standards, including the BCP. A main focus of these requirements is to ensure that decision-making by the relevant authority is free from undue political or industry influence. However, another focus of the KA is to ensure that, where a resolution authority also has other statutory responsibilities, such as supervision in the case of the FSA, or broader financial and economic policies, as in the case of the MOF, that there are arrangements in place to ensure that other responsibilities do not improperly influence decisions about resolution. It is anticipated that the methodology for assessing compliance with the KAs, which is still under development, will provide more detailed guidance on this topic.

tort act (NO: "Skadeerstatningsloven"), because the agency itself is responsible for their acts. It is not clear that this meets the requirements of the FSB KAs. Full compliance may require a specific statutory provision directly protecting employees from lawsuits if the good faith standard is met.[24] At a minimum, there should be clear arrangements for indemnification of employees for the costs of any lawsuits against them so long as they are acting in good faith.

81. To be consistent with FSB KA 3.1, resolution should be triggered at a minimum when a bank is no longer viable or is likely to be no longer viable and well before a bank reaches the stage of balance sheet insolvency. Under the current framework, the only basis for initiating public administration other than insolvency (either on a cash flow or a balance sheet basis) is if the institution is unable to meet the capital adequacy requirements. The goal of the KAs is to ensure that resolution can be initiated early and well before a bank reaches balance sheet insolvency, but focus solely on capital adequacy seems too narrow. The current trend is to have a range of both quantitative and qualitative triggers. Qualitative triggers can be based on supervisory judgment, similar to the basis for intervention under Chapter 3 of the GSA based on circumstances that may entail serious loss of confidence or losses that will substantially weaken or threaten the institution's financial position. Quantitative triggers are often based on prudential requirements, such as failure to meet specific capital or liquidity thresholds. The goal of having a range of triggers is to provide the resolution authority with the flexibility to respond to a range of circumstances in order to deal with failing or failed banks. In addition, such triggers can allow authorities to take control of an institution in circumstances where there is reason to be considered about the condition of the bank but it may be unclear whether it has reached the point of likely non-viability. This can happen for instance when significant fraud is discovered that brings into question the accuracy of information that has been relied on.

82. The resolution framework should contain distinct sets of provisions for going concern and gone concern resolution. Because the current framework does not do so, it does not provide a sufficiently robust framework for either. In part this is because blurring the two processes does not fully take into account the fundamental difference between going concern and gone concern resolutions. A gone concern resolution (winding up and liquidation) necessitates taking a snapshot of claims against the bank as of a specified date, disposing of the assets, and distributing the proceeds to the claimants in accordance with the order of priority for liquidation. A going concern resolution involves no such fixing of claims and distribution of proceeds. Furthermore, by not more clearly establishing robust rules for a going concern resolution, the framework may undermine the objective of resolution of avoiding unnecessary destruction of value. Finally, the objective of maintaining the continuity of systemically important financial services and critical functions requires a broad toolkit of resolution techniques through both going concern and gone concern resolutions.

[24] It is recognized that Norway does not seem to be a highly litigious society, which may substantially diminish the chances of lawsuits below what would be the case in other jurisdictions. The mission team, nonetheless, believes that these issues should be addressed as long as there is the theoretical possibility of lawsuits. Stress situations such as the failure of a bank or a full-scale financial crisis can have a significant impact on the likelihood of litigation.

83. For the purpose of creating a distinct set of rules for both going concern and gone concern resolution, the authorities should consider the following:

- The institution should clearly remain open and should be able to continue to conduct normal business. In this regard, it would be advisable to eliminate the existing provisions that prohibit acceptance of deposits or payments to depositors and creditors without FSA approval and substitute instead authority for the FSA to impose a moratorium on payments if necessary.

- The existing provision that provides that deposits and other liabilities established during the period of administration are regarded as preferential debt could be reconsidered. In ordinary insolvency proceedings applicable to companies, such a rule is typically applied to loans that are provided to an entity that has been placed in liquidation, but not to debts that arose during the ordinary course of business. If the bank is still open and resolved through a merger or a transfer of assets and liabilities, it is not clear what would be the intended effect of the preference. Even if the bank is eventually closed, it is not clear that these depositors or creditors should have preference over the depositors and creditors that preceded them.

- The provision for summoning creditors and setting a closing date for claims should not apply to going concern resolutions. This process would normally be part of what happens in the event a bank is closed and wound up.

- The current provision that authorizes resumption of ordinary operations would be unnecessary, given that a going concern resolution already involves the continuation of normal operations. However, the framework should establish the procedure for ending public administration and returning the bank to private control. The current provision of law only specifies that the administration board arranges for election of new officers but does not address what should happen with respect to the directors and shareholders of the bank.

- The provisions relating to reduction of claims should be reformulated to establish a robust basis for bail-in as contemplated by the FSB KAs. As currently worded, the existing provision seems to assume that there will have been a determination of claims as would occur in the event of a liquidation. As a general proposition, bail-in is a key technique for a going concern resolution in which the entity continues to operate but its balance sheet liabilities are restructured through write-down and/or conversion of debt to equity. [25]

- To contribute to the ability to carry out an orderly resolution, the resolution regime should authorize impositions of a moratorium on payments by the bank and a stay on actions against the bank once resolution has been initiated. Current law effectively authorizes a moratorium on payments through the provision that prohibits payments unless the FSA approves. However, it would be conceptually more consistent with going concern resolution to reverse the emphasis

[25] From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions, IMF Staff Discussion Note SDN/12/03 (April 24, 2012), available at http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf .

by eliminating this provision and instead inserting express authority to impose a moratorium when appropriate.

84. Additional issues of importance to address in updating the framework are the following:

- *Disparate treatment of similarly-situated creditors.* Though the law already incorporates the "no creditor worse off" safeguard, it should be amended to allow disparate treatment of creditors within the same class of priority, as set out in KA 5, if necessary to contain the potential systemic impact of a firm's failure or to maximize the value for the benefit of all creditors as a whole. Experience has shown that in some cases this power is needed to carry out an effective resolution.

- *Suspension of early termination clauses in contracts.* Clauses in contracts between the bank and third parties that might permit termination by the third party as a result of the initiation of public administration, so-called early termination clauses, would need to be suspended. This suspension would not affect rights to terminate a contract for nonperformance. In the case of financial contracts, the suspension should be limited in accordance with FSB KA 4.3 to ensure that markets for derivatives and other financial contracts are not unduly disrupted.

- *Ability to act without consent of counterparties and customers.* The need to maintain financial stability and provide continuity of services requires that the resolution authority have the power to quickly and decisively resolve the bank, which is achieved by providing the resolution authority the power to implement resolution measures directly, without consent or approval of private stakeholders. Therefore, the legal framework must override shareholders consent for resolution actions, as well as contractual rights f of customers or counterparties to consent to, or contractual prohibitions on assignment in the context of resolution.

- *Bridge banks and Asset Management Companies (AMCs).* The framework should explicitly provide for the use of bridge banks. Though the authorities indicate that there is implicit power to establish a bridge bank or an AMC, as is the case in several jurisdictions, it is advisable to address this authority explicitly in the legal framework for transparency. It is also useful to address in advance certain policy issues that arise in the context of using bridge banks. For example, it may be advisable to set a time limit on the existence of the bridge bank to ensure that it does not become simply a permanent bank that would not be viable but for its status as a government-controlled entity. For AMCs, the exact scope of their powers should also be addressed in detail, particularly if they are to have extraordinary powers to efficiently realize the value of assets.

- *Use of BGF funds in a purchase and assumption transaction.* The law should clarify that BGF funds may be used to facilitate a purchase and assumption transaction, whereby good assets are acquired by a healthy institution along with the assumption of insured deposits. In such transactions, the value of the good assets is typically less than the amount of liabilities assumed, so cash or liquid assets must also be transferred to the acquiring bank in order to make the transaction commercially feasible. The nature of this provision of cash or liquid assets is not clearly either liquidity or solvency support. However, payment of this amount by the deposit insurance fund is easily justified as a payment to protect the insured depositors that is in lieu of a payout directly to those depositors. Furthermore, because of the transfer of good assets to cover part of the insured deposit liabilities transferred, the payment by the BGF will be less than in would have to pay if it simply made direct payments to all insured depositors ("least cost test"). The current provision of the GSA that authorizes various forms of support by the BGF does not clearly cover a payment of this type.

- *Role of courts and judicial review*. It is preferable to explicitly address the role of the courts in connection with resolution to ensure that resolution actions may not be stayed or unwound, and to provide that the only remedy for a complainant if a challenge succeeds is compensation. The concern is that delay of a resolution action or a requirement to unwind a resolution transaction after the fact undermines the ability of the resolution authority to maintain financial stability. One court has ruled to this effect in a challenge brought during the 1990s crisis and the expectation is that other courts would follow suit. However, for certainty, it would be preferable to memorialize these principles in legislation.

85. Given the need to act quickly in the interest of financial stability, the authorities should also conduct a review of other potentially applicable laws to ensure that their requirements do not create obstacles to effective resolution. This is particularly likely to occur under the companies' law or the securities law. The requirements of the companies' law may come into play, for example, in connection with write-down of shares or the issuance of new shares in the event of a recapitalization. Streamlining or overriding such requirements may be necessary to strike an appropriate balance between the objectives of those laws and the importance to financial stability of expeditious resolution of banks. Similarly, disclosure requirements under the securities laws in connection with certain corporate transactions may need to be streamlined in order to avoid undue delay of a resolution.

86. Finally, the law should include legal underpinnings for both recovery and resolution plans and resolvability assessments. In particular, the FSA should have the authority to require banks and insurance companies to submit satisfactory recovery plans. It should also have the authority to require a bank or financial group to restructure if found to be necessary as a result of a resolvability assessment.

C. Key Recommendations

- Clearly identify the roles and responsibilities of the resolution authority, or each resolution authority if more than one is designated, and should ensure operational independence.

- Provide legal protection from liability for the resolution authorities, their officers, and staff for good faith actions in resolution, including the administration board appointed to carry out resolutions.

- Establish earlier triggers for resolution relating to the point of non-viability to ensure that resolution can be initiated well before the point of balance sheet insolvency.
- Establish distinct sets of rules for going concern and gone concern resolutions.
- Authorize disparate treatment of creditors in specified circumstances when necessary to contain systemic effects or to maximize value for the benefit of all the creditors as a whole.
- Suspend early termination clauses but provide appropriate safeguards for financial contracts.
- Ensure the ability to transfer asset and liabilities without the consent of shareholders or contractual counterparties.
- Explicitly authorize use of bridge banks and AMCs.
- Clarify that BGF funds can be used to facilitate a transfer of insured deposits and good assets to a healthy institution, subject to a "least cost test."
- Ensure that courts cannot unwind resolution actions and the remedies for affected parties, in the event a decision of considered unlawful, are limited to monetary compensation.

BANK LIQUIDATION AND INSOLVENCY

General insolvency frameworks are not suitable for orderly resolution of banks because they focus on maximizing value for creditors and do not take into account the need to preserve financial stability. Because insolvency and liquidation proceedings are a form of resolution, the liquidation framework will ideally be a predominately administrative proceeding under bank-specific provisions that permit the resolution authority to address the objective of resolution, including preserving financial stability, protecting depositors, and avoiding unnecessary destruction of value.

A. The Current Regime

87. Reliance on the provisions of the general Norwegian bankruptcy law for winding up and liquidation of banks should be reconsidered. It is useful that the current framework for the winding up and liquidation of banks is an administrative process that is run by the FSA through the public administration process. However, the provision that ordinary bankruptcy provisions apply to this process can be problematic. In the first instance, under the current framework, it is not clear precisely how such provisions come into play, given that the law provides that they apply "insofar as appropriate." It is not clear who decides what is appropriate, and no guidance on the basis for the determination is stated.

88. In general, an ordinary bankruptcy is aimed primarily at the protection of creditors, without regard to financial stability. In addition, the long freeze over balance sheet assets in an ordinary bankruptcy tends to cause rapid and severe deterioration in the value of banking assets.

Even in liquidation proceedings, the framework should permit the swift transfer of insured deposits and good assets to a healthy institution or a bridge bank as a means of minimizing the destruction of value.

89. It is advisable that the winding up and liquidation procedure not only be administratively handled, as it is now, but that the primary rules for conducting the liquidation be specified in the resolution framework itself. At a minimum, the authorities should review the potentially applicable general bankruptcy rules and make whatever adjustments are needed to ensure that the interests of financial stability are adequately addressed. These adjustments should address the following:

- Express power to transfer to a third party including a bridge bank subsets of assets, liabilities, and combined portfolios of both (i.e., P&A transactions) in the case of actual insolvency before the completion of liquidation.

- Authority of the liquidator to organize rapid transfers of assets such as shares in single purpose vehicles of the failed bank charged with, for instance, information technology, and payment system services. In case those services would not be separately incorporated, the liquidator should have the power to transfer rapidly all relevant assets, contracts, and staff from the insolvent estate to a solvent acquirer so as to ensure continuity of those functions.

- A depositor preference that gives depositors a higher claim against assets of the bank than other unsecured creditors.

- Consideration of the role of a creditors committee, if any, to eliminate the possibility that creditors can block a resolution action that is required to fulfill the objectives of bank resolution. Generally, the nature of banks and the interest in financial stability weigh against inclusion of a creditors committee.

- There should be clear triggers for the initiation of winding up and liquidation that do not depend on the passage of a specified period of time or require the completion of specified actions by the resolution authority beforehand.

B. Key Recommendations

- Revise the current framework for liquidation to permit resolution actions, such as a swift transfer of assets and liabilities to a healthy institution that can help achieve the objectives of resolution to preserve financial stability, minimize disruption, and avoid unnecessary destruction of value.

DEPOSIT GUARANTEE SCHEME

A deposit guarantee scheme is a key component of the financial sector safety net and the institutional arrangements for bank resolution and crisis management. Besides offering protection to deposits up to a certain size, thereby underpinning depositor confidence, since they are mostly or entirely funded by the industry, they can be not only a source of resolution funding but also a means to allocate any losses incurred in the provision of such funding to the industry and not to taxpayers.

A. Legal Basis

90. The legal framework for Norway's deposit guarantee scheme is set out in the GSA. The BGF is funded and operated by the industry for the purpose of supporting its customers.

B. Scope and Coverage

91. Commercial and savings banks with their head office in Norway must be members of the BGF.[26] Branches of banks with head offices in other EEA states are entitled to join, provided that the deposit-guarantee scheme in their home country does not give the branch's depositors protection equal to that of the BGF. At present there are 131 members in total, including 124 bank members and 7 foreign branch members. There are 16 specialized subsidiaries of foreign banks licensed by FSA to take deposits but not members of the BGF.

92. Deposits are insured to NOK 2 million.[27] This is reduced by the amount covered by any foreign DGS. The fund may not cover losses on certain deposits, such as those of companies in the same group as the member institution, or deposits derived from activities judged criminal. When the BGF makes a disbursement to cover losses incurred by depositors, it is subrogated to the rights of the depositors.[28] It is anticipated that level of coverage will be reduced to EUR 100,000 in order to comply with EU requirements after a transition period ending January 1, 2019.

93. At the current high coverage level nearly all depositors are fully insured. At end-June 2014, total deposits eligible for coverage were NOK 2,067 billion, of which NOK 1,163 billion or 56.3 percent were insured. Of total depositors, 98.6 percent were fully insured.

C. Governance

94. The BGF is a special legal entity governed by the industry, though the MOF must approve its Articles of Association. No member has a proprietary right to the BGF's funds, and no winding-up proceeding may be initiated against it.[29] The general meeting of members, held once a

[26] Section 2–1.

[27] Section 2–10(2).

[28] Section 2–13.

[29] Section 2–4(2).

year, is its highest authority,[30] and elects five board members and five alternates.[31] Each member has one representative and one vote. The full board consists of seven members, including one each from NB and the FSA.[32] The elected members are appointed for two years. The chairman and deputy chairman are appointed by the board for terms of one year, traditionally from among the five elected directors.[33] The five elected board members are nominated by the board's elections committee and usually are CEOs of member banks. Traditionally, the election committee nominates a representative of DNB and Nordea, the two major banking alliances, and a fifth member from among the smaller independent banks and branches. Board decisions can be taken by the vote of four members, the exceptions being that, as noted in the Chapter on Extraordinary Financial Assistance, at least five members must vote in favor of a proposal to provide financial support to a bank.[34] The MOF must approve the BGF's Articles of Association and therefore has certain degree of influence over its policies and the manner in which it operates.[35]

95. The BGF board has engaged a Business Manager, who is simultaneously and by tradition the Managing Director of Finance Norway, the Bankers' Association. The board has delegated the responsibility to manage the BGF to the Business Manager. It also has delegated to the Business Manager certain powers to act on behalf of the board in times of emergency, including the power to grant support of NOK 100 million on a secured basis and NOK 50 million unsecured. The BGF is run day-to-day by a full-time staff of twelve. Finance Norway provides legal and IT support. It also provides addition staffing in times of need.

96. Internal procedures seek to minimize potential conflicts with respect to the private sector board members. Information regarding specific banks is not shared with the board until a potential decision is required. Thus the board is not informed of the watch-list of problem banks.

97. The composition of the BGF is an impediment to its integration into the public safety net. The fact that the board consists of five current bank executives is impediment to the flow of information between the FSA and the BGF. The FSA relies to some extent on the internal restrictions on BGF staff sharing information with board members, but impediments remain.

98. Board policies for the recusal of members for potential or perceived conflicts of interest are not in place. While at the outset of each meeting the administration and the board members themselves evaluate if any board members should recuse themselves based on the agenda, there are no policies specifying in detail the basis for mandatory recusal.

[30] Sections 2–4(3) and 2–14.

[31] Sections 2–4(3) and 2–15.

[32] Section 2–15(1).

[33] Section 2–15(2).

[34] Section 2–15(3).

[35] Section 2–3.

99. The need for recusal may undermine the ability of the board to function, particularly in the case of a medium or large problem bank. It is possible that the institutions by which a large number of board members are employed may have an actual or potential financial interest in matters before the board, particularly those involving a medium- or large-sized bank (e.g., actual or contingent credit exposures, potential acquirer). While board members have elected alternates, it is possible that they too would have to recuse themselves. A board decision to provide liquidity or solvency support to a bank requires the vote of at least five of the seven board members.

D. Operations

100. BGF staff is active in identifying problem banks. It meets semi-annually with the FSA for the purpose. The BGF maintains its own list of problem banks and, in coordination with FSA, conducts onsite visits to them.

101. The BGF has invested significantly in automating the deposit payout process. The objective is to comply with a recent change in law requiring payouts in five-days rather than the prior three months. This capacity in now largely in place, and as noted previously, elements are being regularly tested and enhanced in coordination with FSA.

102. The BGF recently overhauled its investment policy and outsourced management of the fund. Prior to the recent financial crisis, the BGF's policy was to preferably finance ELA by temporary loans taken from the market. However, market conditions during the fall of 2008 were unfavorable for such loans. Due to large losses on equities and insufficient liquidity in the corporate bond market the sale of portfolio holdings was not considered a feasible option. As a result of this, the BGF was granted a NOK 5 billion loan by NB in order to be able to meet its liquidity needs.[36] After that experience, it changed its investment policy by increasing the portion of government bonds in the fund to close to 75 percent. In order to facilitate being able to meet the five-day payout time introduced in 2013, the BGF again changed its investment policy to limit the fund to investments solely in global government bonds with a credit rating of AA or higher. At the same time, the fund outsourced its portfolio management and changed the form of management from active to passive, which significantly reduced the operating expenses of the fund.

E. Fund Characteristics

103. The minimum level of the fund is set out in law, and there is no cap.[37] The fund must be at least equal to the sum of 1.5 percent of guaranteed deposits plus 0.5 percent of the sum of the measurement bases for the capital adequacy requirements for members. Should the fund fall short

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[36] See reference in Chapter on Extraordinary Financial Assistance.

[37] Section 2–6.

of this amount, the shortfall must be guaranteed by the members, calculated in the same manner as the calculation for the annual fee.[38] There is no cap on the size of the fund.

104. The mandatory minimum fund balance for 2014 was NOK 24.3 billion. The actual balance at beginning of 2014 was NOK 26.4 billion. As per the new investment policy cited immediately above, that balance was invested almost entirely in government securities (NOK 26 billion).

105. The current fund balance represents 2.7 percent of insured deposits. However, assuming a reduction in the insured deposit level to the EU standard (EUR 100,000), the fund balance would represent 6.2 percent of insured deposits. This compares well with combined required minimum resolution fund and deposit insurance fund balances under the BRRD of 1.8 percent.

106. The BGF can borrow, though there are no written policies for doing so. Under its Articles of Association, the board may decide that the BGF can raise loans if necessary.[39] At present there are no policies in place addressing for what purposes and under what conditions it can borrow. As noted, the BFG was required to borrow for liquidity purposes once during the recent crisis.

107. There is no committed back-up funding facility in place. While, as noted, members must guarantee any deficiency in the fund balance relative to the minimum mandatory fund balance, the BGF may only draw on those guarantees in the amount of 10 percent of the minimum mandatory fund balance in a single year.[40] A request for a committed facility at NB was declined, and a previous line of credit with a foreign bank was re-priced on terms not acceptable to BGF and allowed to lapse.

F. Deposit Insurance Premium

108. The deposit insurance premium is risk-based. The basis for the annual fee is the sum of 0.1 percent of total guaranteed deposits plus 0.05 percent of the measurement base for the capital adequacy requirement. For members with tier 1 capital adequacy below 8 percent, the fee is increased by a percentage addition of 4 times the number of percentage points by which the tier 1 capital adequacy falls short of 8 percent. For a member with a tier 1 capital adequacy of greater than 8 percent, the fee is reduced by a percentage deduction of 4 times the number of percentage points by which the tier 1 capital adequacy exceeds 8 percent, up to a maximum deduction of 35 percent.[41]

[38] Section 2–8.

[39] Section 8.

[40] Section 2–8.

[41] The annual member fee is calculated on the basis of guaranteed deposits and risk-weighted assets at the end of the third and fourth quarter of the calendar year, two years prior to the year of payment and at the end of the first and second quarter of the calendar year, prior to the year of payment.

109. The prior holiday on annual fees when the fund reached the minimum size has been eliminated. The GSA was amended as of January 1, 2013, to provide that members must contribute to the BGF regardless of the size the fund.[42] There is no provision for a reduction in the annual fee based on the size of the fund.

G. Reimbursement

110. Deposit payouts can be triggered under several circumstances. Under the GSA, these include a decision to place a bank under public administration, or when the FSA concludes that a bank is not in a position to repay deposits, and in any case not later than 21 days after the FSA learns that the bank has not repaid deposits that have fallen due. In practice, as noted previously, MOF decides on all resolutions, which may involve a deposit payout.

111. Operational capacity to enable a payout period of 5 business days or less is nearly in place. As noted above, the GSA was amended to provide that "disbursements to depositors in the event of a banking crisis should occur within one week." The BGF expects to be able to achieve this objective for all but a few types of deposits, for which it will apply to MOF for an exemption from the requirement.

112. Disbursements for deposits of branches of foreign banks are to be made only to the extent they are not covered by the DGS of the home jurisdiction. Disbursements to cover losses on deposits in a member's branch in another EEA state cannot exceed the disbursement that would have been made by the most comparable DGS in the branch's host state or cover depositors other than those covered by the host's scheme.[43]

H. Key Recommendations

- Define explicit policies addressing under what conditions board members must recuse themselves, considering both actual and prospective conflicts, including for example the potential that the bank by which they are employed might be a potential acquirer of a bank requiring support subject to board approval.
- Define policies addressing conditions under which BGF would or would not consider granting liquidity and solvency support to avert the failure of a member. The criteria in the EU DGS Directive (Article 11) should guide such policies.
- Define policies addressing acceptable BGF loan collateral and related criteria.
- Define policies addressing for what purposes and under what conditions BGF can borrow.
- Seek to formalize a back-up funding arrangement.

[42] Prior to that date, fees were not payable if the fund balance exceeded the minimum required level.

[43] Section 2–11.

- Relax the legal restriction on the ability to draw on members' guarantees in the case of a fund balance deficiency.
- See additional recommendations applicable to the BGF in the Chapter on Emergency Financial Assistance above.

IMPACT OF ASSET ENCUMBRANCE ON RESOLUTIONS

Asset encumbrance has the effect to increase the financial cost of the resolution of a failing bank to unsecured creditors, depositors, and the deposit insurer. As such, supervisory and resolution authorities need to be able to either limit the extent of encumbrance or devise an alternative mechanism to minimize its impact in resolution, particularly on depositors and the deposit insurer.

A. Summary

The extent of asset encumbrance has stabilized. After substantial growth from inception in the mid-2000's, at year-end 2014 banks in total had transferred 54 percent of their residential mortgages to mortgage companies funded by covered bonds. This was 2 percentage points lower than at year-end 2013. Both the group of the largest banks and the group of the medium sized banks showed a decline of about 2 percentage points of assets transferred in 2014. On average, about 23 percent of banks assets have been encumbered via this mechanism. See table 2. There are no other substantial means by with banks can encumber assets (e.g., there are no repo markets, no ABS markets[44]).

Table 2: Assets Transferred to Mortgage Companies (In billions of NOK)

Type bank	Total assets	Assets transferred to mortgage company	As a percentage of total assets
Large banks	3637	849	23 %
Medium-sized banks	684	152	22 %
Smaller banks	313	61	19 %
Total	4634	1062	23 %

113. New requirements for the minimum level of liabilities eligible for bail-in may be the most effective means to address any concerns regarding excessive asset encumbrance. The new MREL requirement (minimum requirement of eligible liabilities) for the application of the bail-in tool set out in Article 45 of the BRRD provides resolution authorities an indirect but potentially effective mechanism by which to limit asset encumbrance. The MREL requirement, to be set individually for each bank based on its characteristics, could be set at a higher level should in the authorities' view excessive assets be encumbered. As covered bonds and secured liabilities in

[44] With the exception of one small issuance by one bank. New legislation pending in Parliament eliminates the possibility to issue ABS.

general are not eligible for MREL, this would serve to ensure the existence of a sufficient stock of other non-encumbered eligible liabilities that would be available to serve as a buffer for depositors and the deposit insurer.

B. Key Recommendations:

- Include the extent of asset encumbrance among the criteria for setting individual bank's MREL requirements.