

A photograph of a white stucco house with a blue window and a white picket fence in the foreground. The house has a red tiled roof and a white gutter. The window is blue and has a white sill. The picket fence is white and has a diamond-shaped lattice pattern. The text "Norwegian Covered Bonds Market" is overlaid on a red rectangle on the left side of the image.

# Norwegian Covered Bonds Market

# Contents

Overview of Norwegian covered bond legislation	3
Overview of the Norwegian Economy	9
Annex 1: Act on Covered Bonds	19
Annex 2: Regulation on mortgage credit institutions which issue covered bonds	22
Annex 3: Legal framework	27

## Disclaimer

This booklet is prepared by the Norwegian Financial Services Association and the Norwegian Savings Banks Association in cooperation with experts from the issuers of covered bonds. The purpose of the booklet is to give an informal overview of the Norwegian legislation and housing market in respect of covered bonds, and thus the information provided herein is of a general nature and not a professional or legal advice. The two Associations and the relevant experts accept no responsibility or liability whatsoever, and the booklet may not in any way be trusted as a legally binding document. Please note that it cannot be guaranteed that the information is up to date and correct in any way and at any time.

# Overview of Norwegian covered bond legislation

## Background

The Norwegian housing loan market has so far primarily been a banking market. Existing mortgage institutions that issued bonds prior to 2007 are relatively small and mostly focus on commercial mortgages. As bank lending has increased more rapidly than bank deposits for several years, the banks are experiencing an increasing funding gap, and are therefore looking for alternative funding sources. Banking associations and governmental bodies have for some years examined and discussed the issue, and new legislation on covered bonds is the outcome of this work. Covered bonds are viewed as the best solution for the banks' need for funding, probably being the most cost-effective solution, which also enables sizeable issuance volumes.

## The issuance of covered bonds – a specialist banking principle

Generally, it has been assumed that the best way to make use of covered bonds in Norway is by establishing dedicated mortgage credit institutions. To clear the way for covered bonds, new legislation entered into force on 1 June 2007. Relevant amendments were made to the Financial Services Act, hereafter “the Act”, and on 25 May 2007 the Ministry of Finance adopted a supplementary regulation, hereafter “the Regulation”, to the Act.

The new legislation permits specialised mortgage credit institution to raise loans by issuing covered bonds. These institutions are licensed credit institutions, supervised by the Financial Supervisory Authority of Norway – Kredittilsynet, hereafter the FSA. A commercial bank or a savings bank will not be allowed to issue such bonds in its own name, but may establish a mortgage credit institution as a subsidiary. Alternatively, a mortgage credit institution may be established as an independent institution with several shareholders.

The Act gives the bondholders a preferential claim over a cover pool in case of bankruptcy. The term “covered bonds”, or literally “bonds with preferential claim” (in Norwegian “obligasjoner med fortrinnsrett”) is protected by law. The new legislation fulfils and is in compliance with the relevant EU legislation, i.e. EU Directive 2006/48/EC.

## Regulation and supervision of mortgage institutions and their issuance of covered bonds

Mortgage and other credit institutions are regulated under chapter 3 of the Act. This chapter sets out the general provisions for a credit institution, i.e. the obligation to obtain a license and to fulfil capital requirements and undertake organisational measures etc.

The issuing of covered bonds is regulated by chapter 2, subchapter IV of the Act. The issuance of such bonds is not subject to any further governmental approvals. However the articles of association shall be approved by the FSA.

Furthermore, the institution shall notify the FSA no later than 30 days prior to the initial issuance of covered bonds.

A mortgage credit institution may raise loans by issuing covered bonds where the object of the institution, as laid down in the articles of association, is (1) to grant specified types of mortgages and public sector loans and (2) to finance its lending business primarily by issuing covered bonds. The articles of association of the institution shall state which types of loans that shall be granted or acquired by the institution. The scope of the business will therefore be restricted and the institution will have a very narrow mandate.

The Act gives the bondholders a preferential claim over the cover pool in case of bankruptcy. The assets in the pool remain with the estate in case of bankruptcy, but the bondholders have exclusive, equal and proportionate preferential claim over the cover pool, and the administrator is bound to assure timely payment, provided the pool gives full cover to the said claims.

The mortgage credit institution may also enter into derivative agreements in order to assure its payment obligations and the balance principle set out in the Act. If it has a positive market value, a derivative agreement will be part of the cover pool, if negative, the counterparties to derivative agreements will have a preferential claim over the pool, pari passu with the holders of covered bonds.

#### **Eligible assets – loan to value ratios**

According to the Act the cover pool may consist of the following assets:

- a. Residential mortgages
- b. Commercial mortgages
- c. Loans secured on other registered assets (subject to further regulations)
- d. Public sector loans
- e. Assets in form of derivative agreements (in accordance with the Regulation)
- f. Substitute assets (in accordance with the Regulation)

The mortgage loans have to be collateralised with real estate or other eligible assets within the EEA or OECD, and the public sector loan borrowers have to be located within the EEA or OECD. The Regulation adds rating requirements on the individual national government of the country where the mortgaged property or the borrower has its location. Loan to value ratios (LTV) and monitoring are fixed by the Regulation, in accordance with the EU Directive 2006/48/EC. For residential mortgages the LTV is 75 %, and for other mortgages 60 %. The mortgage credit institution shall monitor the development of the LTV of the individual asset as well as the market of the underlying assets, according to the Act, and in accordance with the said directive.

### **Derivative agreements and substitute assets**

The derivative agreements and the substitute assets are, logically, accessory to the loans. The substitute assets may only amount to 20 % of the cover pool (30 % with the consent of the supervisor). In addition, the substitute assets ought to be secure and liquid. The Regulation adds requirements necessary in order to comply with the description of covered bonds given in EU Directive 2006/48/EC. Counterparty and rating regulations in accordance with the directive apply to these two asset classes, as well as to the public sector loans.

### **Matching regulations**

The Act establishes a strict balance principle, i.e. the value of the cover pool shall at all times exceed the value of the covered bonds with a preferential claim over the pool. The Regulation establishes a strict mark to market principle of both assets and liabilities. Equally, the mortgage credit institution shall ensure that the payment flows from the cover pool enable the institution to honour its payment obligations. The mortgage institution may enter into derivative agreements in order to secure the balance principle and payment obligations. The counterparties in derivative agreements will benefit from the same preferential claim over the pool as the bondholders, in case of bankruptcy. As a corollary to this, the counterparties in the derivative agreements will be subject to same restrictions with respect to declaration of default as the bondholders. In addition to this, the mortgage institution will have to adopt strict internal regulations with respect to liquidity risk, interest rate risk and currency risk.

### **Register and inspector**

The mortgage institution shall maintain a register of issued covered bonds, and of the cover assets assigned thereto, including derivative agreements. To oversee that the register is correctly maintained, an independent inspector shall be appointed by the FSA. The inspector shall also regularly review compliance with the requirements concerning the balance principle, and report to the FSA, yearly or whenever the institution does not comply.

### **Timely payment**

As long as the cover pool fulfils the matching requirements, the bondholders and counterparties in derivative agreements have the right to timely payment, even in case of default by the issuer. The preferential claim also applies to payments that accrue to the institution from the cover pool. And, as long as they receive timely payments, the creditors have no right to declare default. Details about this will be reflected in the individual agreements between the issuer and (the trustee of) the bondholders. These provisions will also apply to any netting agreements between the institution and its counterparties in derivative transactions.

### **Bankruptcy proceedings**

In case of bankruptcy of the mortgage credit institution an administrator shall be appointed by the court. Bankruptcy or insolvency does not in itself give the bondholders right to accelerate their claims. Only payment default will give the holders of preferential claims the right to declare default. If the cover pool is not sufficient to cover all the preferential claims, the administrator shall declare default of the pool and cease payments. The administrator must respect and honour the rights of the bondholders and derivative agreements counterparties.

### **Legal background**

The legal framework regulating the housing market is well developed. This framework provides legal certainty and foreseeability for both consumers as borrowers and owners of housing, and for credit institutions as lenders and creditors. This includes specific consumer protection legislation, a centralized electronic registry system for the ownership of and rights (mortgage etc) in real property, and an effectively and expedient forced sale procedure.

The Financial Contracts Act (Act 1999-06-25 no. 46) regulates the contractual conditions in respect of a loan agreement between financial institutions and their customers, both consumers and corporate clients. The Act applies in principle to all types of loans, whether they are secured or not. This also includes mortgage backed loans included in a cover pool. The act is invariable in respect of consumer contracts, i.e. it cannot be dispensed with by agreement that is detrimental to the customer.

The Mortgage Act (Act of 8 February 1980 no. 2) regulates mortgages on real property. Mortgage rights acquire legal protection by registration in the Land Registry/Register of Deeds.

The Forced Sales Act (Act of 26 June 1992 no.86) provides for an effectively and expedient forced sale procedure. A lender may, if a loan is accelerated and the borrower fails to pay any due amount, file an application before the county court for a forced sale of the property that backs the mortgage loan. The registered mortgage contract will itself constitute basis for such application. The court will normally appoint a real estate broker to administer the sale in order to obtain a reasonable price. Normally, six to nine months are required to repossess the property and satisfy the holder of a mortgage.

A more comprehensive description of the legal framework follows in Annex 3.





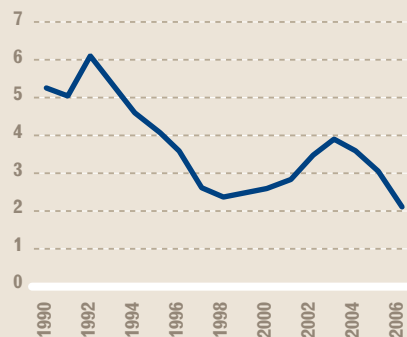
# Overview of the Norwegian Economy

## General information

A main feature of the Norwegian economy is the large production of crude oil and gas. This production stems from the hydrocarbon resources on the continental shelf off the Norwegian coast. Crude oil and gas production accounts for 27 % of the GDP and 50 % of total exports (2006). In spite of the importance of oil and gas, the Norwegian economy is very diversified, and only 1.5 % of the total workforce are employed in the petroleum sector. As indicated in the chart below the Norwegian mainland economy (total economy excluding shipping, oil and gas) has performed well during the last fifteen years. Even during the banking crisis in 1990-93 the unemployment rate was below 7 %. Today there is increased immigration in particular from the CEE member countries of the EU. Prospects are also favourable for economic growth in the years to come. (The curve for unemployment shows the absolute rate.)

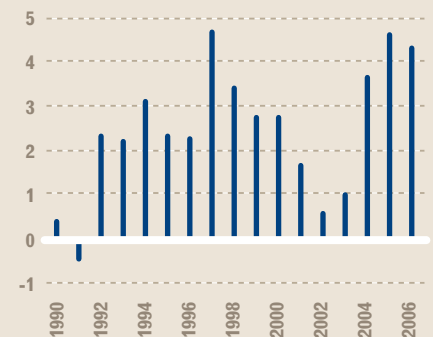
The Norwegian economy has in recent years benefited greatly from developments in the world economy. Growth in China and other low cost nations of finished goods has led to strong demand and price increases for raw materials such as oil, metals, fish and shipping services, which are all important Norwegian exports. Even if commodity prices historically have been volatile, some commodity price inflation can be expected in the future, since there gradually will be fewer and fewer new virgin areas on the earth to exploit. On the other hand, the low cost production and squeezed margins of finished goods and many services which Norway imports, have resulted in a substantial improvement in the terms of trade and the current account balance. As a result, the surplus on the current account balance has been very high since 1999. Last year the surplus is estimated to exceed 359 billion NOK - nearly 17 % of GDP. The forecast for 2007 and the years ahead are also very comfortable.

Norway - unemployment  
(In percent of labour force)



Source: Statistics Norway

Norway - GDP mainland 1990-2006  
(Percent annual growth)



Source: Statistics Norway

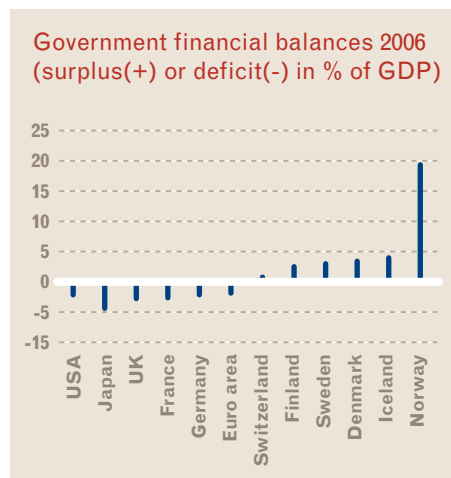
An important aspect of Norwegian public finances is the creation of the Government Pension Fund – Global, previously the Government Petroleum Fund. Thanks to this build-up of public funds the Norwegian economy is becoming less and less oil price dependent in two ways. First, oil and gas wealth is gradually transformed into financial assets worldwide. Second, a very large part of government income is not spent, thereby avoiding overheating of the economy. This will enable the government to manage the economy without fiscal tightening in case of a future fall in oil prices.

At year-end 2006, the size of the Fund exceeded 83 % of GDP – NOK 1784 billion or close to USD 300 billion or USD 63 000 per capita. The Fund is estimated to show a daily increase by more than NOK 1 billion this year.

The public sector in Norway stands out as the financially most solid among the OECD countries. The general government financial balance showed a surplus of 19.5 % of GDP last year and the estimate for this year is 18.6 %. According to OECD figures, general government net debt interest payments are estimated at minus 3.8 % of GDP this year, down from minus 3.9 % last year. No other member country comes even close to such figures.

### The EEA Agreement

Norway is not a member of the EU, but participates under an agreement between Norway, Iceland, Liechtenstein and the EU, the EEA (European Economic Area) Agreement. According to this agreement in practice the whole set of EU rules are implemented in Norway, which means Norway is bound by the Acquis Communautaire and future EU directives and regulations, with the only exception of agriculture and fisheries.



Source: Statistics Norway

The capital treatment of covered bonds in Norway is in line with the international framework, Directive 2006/48/EC and Directive 2006/49/EC, which came into force on 1 January 2007. The relevant paragraphs are found in the secondary regulation on capital requirement for credit institutions and other financial institutions dated 14 December 2006. According to this regulation the risk weighting of covered bonds is 10 % provided that the unsecured exposures from the same issuer are risk weighted 20 %. Generally, the risk weighting is one step lower for the covered bond than the one for the unsecured bonds from the same issuer.

### **Sustainable growth**

Increased investment activity in oil and gas exploration has accounted for a large share of growth in domestic activity in recent years. Nevertheless growth in total demand in the Norwegian economy is to a large extent independent of the future development on the continental shelf. During past and present periods of large surpluses on the central government budget, a fiscal rule has been adopted, according to which the net annual petroleum revenue spending shall not exceed 4 % of the Government Pension Fund. Thus, even if government petroleum revenues should fall to nil in the future, government spending will be maintained at the same level.

### **Income distribution**

Incomes policy cooperation is a key component of economic policy in Norway and has contributed to fewer labour conflicts in Norway over the past 30 years than in most other OECD countries. Like other Nordic countries, Norway has a well functioning social safety net, a high level of unionisation and coordinated wage determination. Coordinated wage determination has contributed to an even distribution of income and lower unemployment in Norway than in most other European countries. Unemployment benefits are relatively generous and contribute to the flexibility in the labour market.

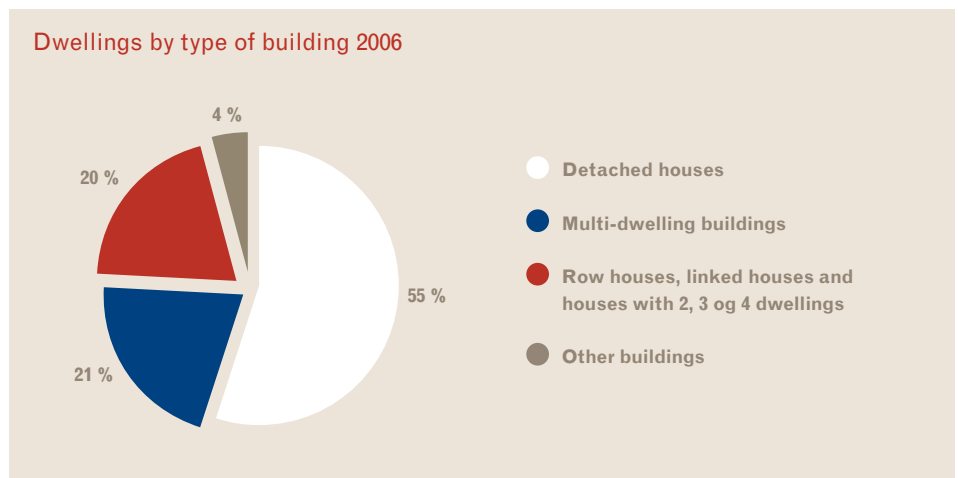
### **Housing in Norway**

According to the last Population and Housing Census from 2001 there were 1 961 548 occupied dwellings in Norway. 57.1 % of the dwellings were detached houses or farm houses. Of the total number of dwellings 76.7 % were owned by the occupants – 62.5 % by the occupants alone or through joint ownership, and 14.1 % indirectly by the occupants through a housing co-operative or limited company. The remaining 23.3 % were rented – from private individuals (13.0 %), from rental housing companies (2.5 %), from municipalities (3.8 %), as staff dwellings (1.0 %) and on other terms (3.1 %).

All dwellings in Norway are registered in the Ground Property, Address and Building Register (GAB). According to the last Statistics on existing buildings from 2006 there were 2.2 million dwellings in Norway, covering a resident population of 4.7 million inhabitants. Almost 693 000 dwellings, or 31 % of the total dwelling stock, are registered in buildings built after 1980.

Because of the strong rise in house prices and high housing investment, housing wealth, as measured here, has increased sharply in recent years to about NOK 3600bn.

Approximately 55 % of the dwellings were detached houses. Houses with two or more dwellings, linked and row houses account for 20 % of total buildings, and just 21 % are multi-dwelling houses. As mentioned above, the large majority of the dwellings, some 77 % are occupier owned, either directly or through housing co-operatives. The percentage of house-owners is somewhat lower in the large cities, but even in the capital, Oslo, 70 % of the dwellings are occupier owned. In accordance with this, most residential mortgages are loans to households, and traditionally the loans are refinanced each time a dwelling change hands. The mortgage loans are personal debt, and the property is taken as collateral. Mortgages account for 77 % of household debt, according to the last figures.

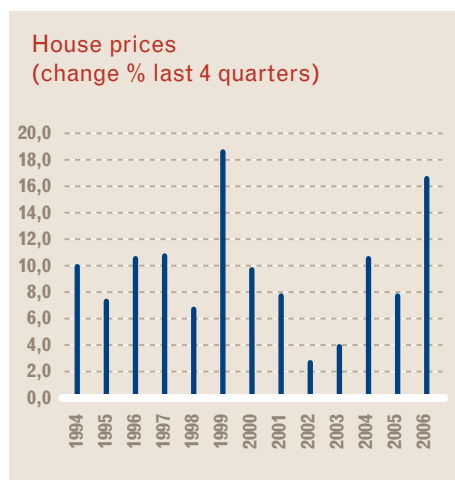


Source: Statistics Norway

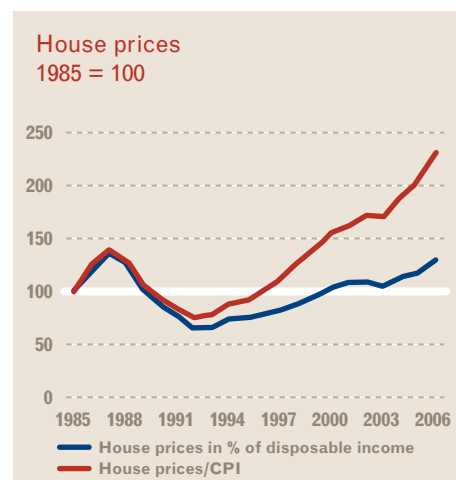
## House price developments

House prices have risen continuously over the past fifteen years. Increased competition in the mortgage market, labour inflows, domestic migration to more urban districts and expectations of low interest rates in the long term, have contributed to the house price rise. House prices have long-lasting effects on credit growth. Growth in household debt may thus remain high for some time ahead. The price increase in the secondary housing market has been strong since end-2003. House prices have accelerated over the past year, and twelve-month rise is now above 15 %. Solid growth in household income, low interest rates, low and falling unemployment and high labour migration are probably contributory factors. Lower bank lending margins due to intense competition have dampened the effect of increased policy rates on bank lending rates.

The residential property turnover rate is historically high. Resale home turnover has annually exceeded 5 % of the total stock of residential real estate in recent years. Housing starts have also been high in recent years, particularly in and around the largest cities. Growth in residential construction is related to the strong rise in house prices. Real house prices (house prices deflated by consumer prices, building costs and rents) are historically high. Growth in wages and other personal income, together with growth in the total number employed and a very low unemployment rate over many years, have contributed to the increase in activity and prices in the housing market.



Source: Statistics Norway



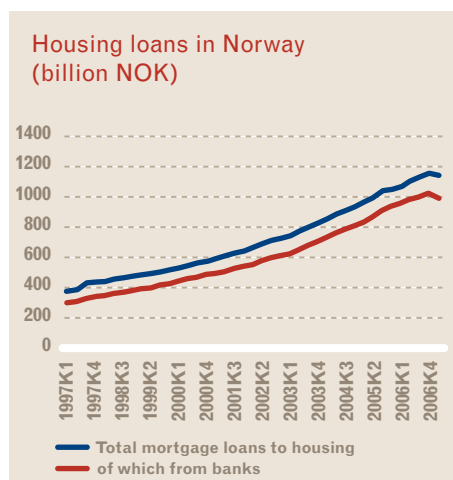
Source: Statistics Norway

## Residential mortgage loan market

Total mortgage loans outstanding stood at NOK 1156.6 billion at the end of 2006. Of this amount, 1027.3 billion – or 88.8 % – were granted by commercial and savings banks (banks). In addition to banks the main purveyors of housing loans is the Norwegian State Housing Bank (a government lending institution), other credit institutions and life insurance companies.

The chart indicates that growth in loans outstanding has been high and that banks have increased their share of total loans. In addition to gaining market shares outright, the share of the banks has also increased because of consolidating consumer loans into less expensive mortgage loans. Financing the purchase of a car by increasing the mortgage on the house is less expensive than using the car as collateral.

Traditionally most housing loans in Norway are floating rate loans (that is a main reason why banks have a strong market position in house financing). The interest rate is not directly linked to a quoted market rate, but set individually by each bank based in general on an evaluation of (i) funding costs, (ii) the competitive situation and (iii) the bank's financial situation. In accordance with the Financial Contracts Act the borrower should receive at least 6 weeks notice before an interest increase. Most banks use a similar notification procedure before an interest rate reduction. Approximately 10 - 15 % of residential mortgages are fixed-interest loans.



Source: Statistics Norway



Source: Reuters EcoWin

With a tight labour market and rising wage growth, house prices and credit to households are expected to continue to move up. Higher interest rates and a high level of residential construction may eventually lead to slower house price inflation. Household debt growth is expected to remain higher than income growth over the next few years, with the debt burden rising to historically high levels. The interest burden, which is still relatively low, will also increase gradually as the interest rate level normalises.

Household debt has increased rapidly since 2000, with an annual yearly growth of 10 – 12 %. Growth has been driven by low interest rates and a sharp rise in house prices, among other factors. In recent years banks have introduced loan products that facilitate mortgage equity withdrawal – credit lines secured on dwellings. These loan products increased strongly through 2006. Traditionally most household borrowings, including mortgages, are at adjustable interest rates. As interest rates are expected to rise, the proportion of fixed-rate mortgages may increase.

## Taxation

Income tax in Norway comprises three main elements:

- A flat tax of 28 % which is calculated based on net income, i.e. all income after interest expenses etc, and a standard allowance.
- Additional tax on wage income and other personal income, at progressive rates
- A social security contribution of 7.8 % of wage income, 10.7 % of self-employment income and 3.0 % of pensions.

Norway applies a wealth tax that is calculated based on net worth, i.e. gross wealth less debt. The maximum rate applied is 1.1 % of net wealth, and the maximum rate applies to net wealth in excess of NOK 540 000. Dwellings are assessed favourably for tax purposes and the assessed value shall not exceed more than 30 % of market value under any circumstances. Often the assessed value is far below 30 %.

As a main rule, borrowing costs, i.e. expenses relating to the establishment, service and termination of a loan are deductible from taxable income for all Norwegian taxpayers. This also includes all accrued interest expenses, expenses relating to provision of collateral, deferrals, etc. The tax rate applied is 28 %.

In the case of owner-occupied dwellings, the owner is not liable to tax on the income from occupying the dwelling. Tax deductions for other operating expenses than those cited above are not permitted.

The dwelling must be occupied by the owner for a minimum of one year to be eligible for tax-free capital gains on the dwelling. For holiday homes the period is a minimum of five years.

In connection with real estate purchases, a charge (stamp duty) of 2.5 % of the market value is payable to the state.

In Norway, there is no state property tax. However, the regulation provides municipalities with the authority to impose a property tax of a value that corresponds to 0.7 % of the assessed value of the property. At present, about half of the municipalities have chosen to impose a property tax, albeit not at the maximum rates.





## Annex 1

Act No. 40 of 10 June 1988, as amended by Act No. 11 of 6 March 2007

### Act on Financing Activity and Financial Institutions (Financial Institutions Act), Chapter 2, subchapter IV: Covered Bonds

#### Section 2-25

##### Scope of application

This subchapter governs mortgage credit institutions' right to raise loans by issuing covered bonds. The term "covered bonds" denotes standardised bearer bonds conferring a preferential claim over a mortgage credit institution's cover pool.

#### Section 2-26

##### Protected term

The term "covered bonds" may only be applied to bonds coming under the rules of this subchapter.

#### Section 2-27

##### Business restrictions and obligation to notify upon start-up

A mortgage credit institution may raise loans by issuing covered bonds where the mortgage credit institution's mission as laid down in its articles of association is:

- a) to grant or acquire residential mortgages, commercial mortgages, loans secured on other registered assets or public sector loans, and
- b) to finance its lending business primarily by issuing covered bonds.

The mortgage credit institution shall notify Kredittilsynet not later than 30 days prior to the first time it issues covered bonds.

Where consideration for a mortgage credit institution's financial strength so indicates, Kredittilsynet may instruct the mortgage credit institution not to issue covered bonds.

Kredittilsynet may consent to mortgage credit institutions engaging – in a transitional period and in parallel with other activity – in activity that consists in raising loans through the issuance of covered bonds. The said activities shall in such case be kept separate from one another. Kredittilsynet may impose conditions to ensure such separation. Kredittilsynet's consent may be given for a period of up to one year with the possibility of extension for one further year.

#### Section 2-28

##### Requirements on the composition of the cover pool

The cover pool may only consist of the following assets:

- a) loans secured on residential property, on a document of proprietary lease of a housing unit or on a certificate showing that the lessee owns a share in the housing cooperative that owns the housing structure of which the unit forms part (residential mortgages),
- b) loans secured on other real estate (commercial mortgages),
- c) loans secured on other registered assets,
- d) loans to municipalities and loans guaranteed by the State, a municipality or corresponding public body in other states (public sector loans),
- e) assets in the form of derivative contracts which meet further requirements set in regulations,
- f) assets which constitute substitute assets under the provisions of the fourth paragraph.

Upon incorporation in the cover pool, loans as mentioned in the first paragraph a) to c) shall not exceed a specified percentage of the value of the mortgaged property (loan-to-value ratio). The King may issue regulations on loan-to-value ratios for different types of assets.

Loans as mentioned in the first paragraph a) to c) must be secured on a capital asset located within the EEA or the OECD area. Public sector loans must have been granted to or guaranteed by a public body as mentioned in the first paragraph d) within the EEA or the OECD area.

Only particularly liquid and secure assets may be employed as substitute assets. Substitute assets may constitute up to 20 per cent of the cover pool at any and all times. Where special conditions are present, Kredittilsynet may authorise this proportion to constitute up to 30 per cent for a limited period. The King may in regulations lay down supplementary provisions regarding requirements on assets eligible for inclusion in the cover pool, including restrictions on the composition of the cover pool.

#### Section 2-29

##### Calculation of the value of underlying assets

Upon inclusion of loans as mentioned in section 2-28 first paragraph a) to c) in the cover pool, a prudent value shall be established for the asset furnished as security for each loan. Prudent market value may not exceed the market value resulting from a cautious assessment.

Prudent value shall be fixed by individual assessment of the registered asset concerned. Valuations shall be conducted by a competent and independent person in accordance with recognised principles. A valuation shall be documented and shall indicate who has conducted it, when it was conducted and the assumptions on which it was based. Valuation of residential properties may never the less be based on general price levels provided this is deemed prudent based on market conditions.

The mortgage credit institution shall establish systems for subsequent monitoring of asset values. The mortgage credit institution shall also monitor market trends and factors bearing on the value of the individual registered assets. Should market conditions or factors pertaining to the individual asset indicate that a significant value impairment has taken place, the mortgage credit institution shall ensure that a new prudent value is established in accordance with the first and second paragraph.

The King may in regulations establish further rules on valuation and on requirements with regard to the mortgage credit institution's systems. The King may in regulations also establish rules governing changes to loan-to-value ratios resulting from a subsequent fall in the value of assets as mentioned in section 2-28 first paragraph a) to c).

### **Section 2-30** **Pledging and execution**

Assets included in the cover pool may not be pledged or be subject to execution, attachment or other enforcement proceedings in favour of particular creditors of the mortgage credit institution. Nor may a right of set-off, right of retention or the like be declared in an asset included in the cover pool. The King may in regulations issue special rules and make exceptions from the rule of this paragraph in the case of assets as mentioned in section 2-28 first paragraph e).

### **Section 2-31** **Asset coverage requirement**

The value of the cover pool shall at all times exceed the value of covered bonds with a preferential claim over the pool. Account shall be taken of the mortgage credit institution's derivative contracts as mentioned in section 2-28 first paragraph e) when values are calculated. The King

may in regulations lay down further requirements in regard to how such values shall be calculated. The King may in regulations lay down rules in regard to mortgage credit institutions which fail to meet the asset coverage requirement set out in the first sentence.

In an assessment of whether the requirement of the first paragraph is met, loans to the same borrower and loans secured on the same collateral cannot be included in the cover assets at more than 5 per cent of the total cover pool. The King may issue regulations providing for the inclusion of loans over and above the limit of 5 per cent where additional collateral exists, and rules governing such additional collateral.

### **Section 2-32** **Liquidity requirements**

The mortgage credit institution shall ensure that the payment flows from the cover pool enable the mortgage credit institution to honour its payment obligations towards holders of covered bonds and counterparties to derivative contracts as mentioned in section 2-28 first paragraph e) at any and all times. The mortgage credit institution may enter into interest rate and foreign exchange contracts in order to meet this requirement.

The mortgage credit institution shall establish a liquidity reserve to be included in the cover pool as substitute assets. The King may in regulations lay down further rules on liquidity reserves, including rules on permitted divergence between future receipts and payments and permitted divergence between the redemption conditions for covered bonds and for assets included in the cover pool assigned to such bonds. The King may in regulations lay down rules on permitted interest rate and foreign currency risk and on the right

to enter into interest rate and foreign currency contracts.

### **Section 2-33** **Register requirement**

The mortgage credit institution shall keep a register of the covered bonds it issues, and of the cover assets assigned thereto, including derivative contracts as mentioned in section 2-28 first paragraph e). The register shall at all times contain information on the value of the bonds and the cover pool.

The King may issue regulations setting further requirements as to the register's contents, design and accessibility, as well as rules on maintaining the register.

### **Section 2-34** **Independent inspector**

An independent inspector shall be appointed for a mortgage credit institution before it issues covered bonds. The inspector shall be appointed by Kredittilsynet. Kredittilsynet may at any time withdraw the appointment and appoint a new inspector.

The inspector shall oversee that the register is correctly maintained and shall regularly review compliance with the requirements of sections 2-31 and 2-33. The inspector shall regularly inform Kredittilsynet of his observations and assessments.

The mortgage credit institution shall be obliged to provide the inspector with all relevant information about its business. The inspector shall have full access to the credit mortgage institution's register and may request further information from the institution. The inspector shall also be entitled to conduct investigations at the premises of the institution.

The inspector shall be entitled to reasonable remuneration from the mortgage credit institution for his or her work. The King may issue regulations setting further rules on the appointment and remuneration of inspectors, and on inspectors' tasks, rights and duties.

### **Section 2-35**

#### **Preferential claim over the cover pool, joint debt recovery etc**

In the event of bankruptcy, negotiation of debt under the Bankruptcy Act, winding up of the mortgage credit institution or public administration, holders of covered bonds and counterparties to derivative contracts as mentioned in section 2-28 first paragraph e) shall have an exclusive, equal and proportional preferential claim over the cover pool assigned to them. Such preferential claim over the cover pool shall rank ahead of priority as mentioned in the Act relating to Creditors' Rights to Satisfaction of Claims (Satisfaction of Claims Act, No. 59 of 8 June 1984) sections 9-2 to 9-4. In regard to bankruptcy, the provisions of the Mortgages and Pledges Act section 6-4 on a statutory security interest for the bankruptcy estate shall apply correspondingly to the estate's claim over the cover pool. The estate's statutory security interest in each individual cover pool shall in such cases comprise a maximum of 700 times the court fee.

The preferential claim shall also apply to funds which are subsequently remitted in accordance with terms of contract applying to assets included in the cover pool. Such funds shall be registered on a continual basis under the rules of section 2-33.

In the event of bankruptcy, negotiation of debt under the Bankruptcy Act, winding up of the mortgage credit institution or public administration, holders of covered

bonds and counterparties to derivative contracts as mentioned in section 2-28 first paragraph e) shall be entitled to timely payment from assets encompassed by their preferential claim for the duration of the bankruptcy or administration proceedings, provided the cover pool is essentially in compliance with the statutory requirements. Should it not be possible to make contractual payments using funds from the cover pool, and an imminent change in the liquidity situation is unlikely, the bankruptcy estate shall set a date on which payments shall be halted. The bankruptcy estate shall inform holders of preferential claims of the halt to payments at the earliest opportunity.

Should the cover pool deliver more than is needed to meet the claims of the bondholders or derivative counterparties, the surplus shall be added to the gross estate.

The King may in regulations lay down further rules on the implementation of bankruptcy proceedings, public administration, negotiation of debt or winding up of mortgage credit institutions coming under this chapter, including rules to restrict the opportunity of the bankruptcy estate, debt restructure committee, administration board or liquidation board to dispose over loans and other assets included in the cover pool when this can be done without impairing other creditors' ability to enforce a claim. Such regulations may depart from the rules of legislation governing bankruptcy, public administration of financial institutions, negotiation of debt and execution.

## Annex 2

### Regulations on mortgage credit institutions which issue bonds conferring a preferential claim over a cover pool consisting of public sector loans and loans secured on residential property or other real property (covered bonds)

Laid down by the Ministry of Finance on 25 May 2007 pursuant to the Act on Financing activity and Financial Institutions (Financial Institutions Act, No. 40 of 10 June 1988) sections 2-28, 2-29, 2-30, 2-31, 2-32, 2-33, 2-34 and 2-35, and Royal Decree of 25 May 2007.

#### Chapter 1 Activity of mortgage credit institutions

##### Section 1 Scope of application

These regulations apply to mortgage credit institutions which issue covered bonds, cf. the Financial Institutions Act chapter 2 subchapter IV, when such bonds confer a preferential claim over assets as mentioned in section 28-2 first paragraph a), b) and d) of the Financial Institutions Act. A mortgage credit institution's articles of association shall state which of the types of loan mentioned in section 2-27, first paragraph a) of the Financial Institutions Act shall be granted or acquired by the institution.

##### Section 2 Holders of covered bonds

"Holders of covered bonds" means holders of covered bonds and parties to derivative contracts as mentioned in the Financial Institutions Act section 2-28, first paragraph e), cf. Financial Institutions Act section 2-35, first paragraph.

##### Section 3 Capital requirements regulations

"Capital Requirements Regulations" means Regulations on Capital Require-

ments for Commercial Banks, Savings Banks, other Credit Institutions, Holding Companies in Financial Groups, Investment Firms and Management Companies (Capital Requirements Regulations, No. 1506 of 14 of December 2006).

"Credit quality steps" as referred to in these regulations means credit quality steps as mentioned in the Capital Requirements Regulations part II on the calculation of credit risk using the standardised approach.

##### Section 4 Requirement for rating of the home country of a loan and collateral, and requirement on systems

Where loans are granted or acquired, the central authorities in the country where the collateral is present, or where the borrower or guarantor in the case of a public sector loan is domiciled, shall qualify for credit quality step 2 or better.

A mortgage credit institution shall have systems that document fulfilment of the Financial Institutions Act section 2-31 (asset coverage requirement) and section 2-28 (cover pool composition requirement).

##### Section 5 Interest rate risk

A mortgage credit institution shall not assume greater risk than is prudent at any and all times. A mortgage credit institution is obliged to establish a limit on the interest rate risk which shall be fixed in relation to the institution's own funds and potential losses resulting from a parallel shift of 1 percentage point in all interest rate curves and resulting from distortion of the interest rate curves. The interest rate curves shall be divided into time intervals, and value changes for each time interval shall be limited to a prudent

portion of the overall limit on interest rate risk that is set for the institution.

The limit on interest rate risk shall apply to each cover pool and to the institution as a whole. Where an institution has two or more cover pools, its own funds shall for the purposes of this calculation be allocated on a pro rata basis to the overall value of each cover pool. The limit on interest rate risk within each cover pool shall not exceed the level of interest rate risk applying to the institution as a whole under the first paragraph.

##### Section 6 Liquidity risk

A mortgage credit institution shall not assume greater liquidity risk on each cover pool than is prudent at any and all times.

A mortgage credit institution shall establish limits on divergence between future receipts and future payments.

A mortgage credit institution shall carry out periodic stress tests to document a satisfactory liquidity reserve and that the requirement of the Financial Institutions Act section 2-31 is met. In calculating liquidity risk, account may be taken of committed drawing rights if the counterparties qualify for credit quality step 2 or better.

##### Section 7 Foreign exchange risk

A mortgage credit institution shall not assume greater foreign exchange risk than is prudent at any and all times. A mortgage credit institution is obliged to establish limits on foreign exchange risk.

##### Section 8 Derivative contracts

This section applies to derivative contracts entered into by an institution as

mentioned in the Financial Institutions Act section 2-28 first paragraph e). The purpose of such derivative contracts shall be to ensure compliance with the asset coverage requirement of the Financial Institutions Act section 2-31 and to enable the institution to honour its payment obligations.

Derivative contracts may be entered into with the following types of counterparty:

1. Clearing houses established in the EEA or the OECD area
2. States and central banks in the EEA or OECD area
3. Credit institutions established in the EEA or OECD area

Such counterparties shall have a risk classification conforming to the provisions of section 9 second and third paragraphs.

The Financial Institutions Act section 2-30 shall not prevent agreed set-offs of cash flows in the same currency and with the same due date from being completed between the counterparties to derivative contracts included in the same cover pool. An institution may also agree with a derivative counterparty to replace one or more ongoing derivative contracts with one or more new contracts, provided the asset coverage requirement under the Financial Institutions Act section 2-31 and the liquidity requirement under the Financial Institutions Act section 2-32 are met.

Any claim against a mortgage credit institution arising from a derivative contract may only be used for set-off against other contracts in the same cover pool provided the mortgage credit institution's estate halts payments under section 17 in accordance with the rules concerning set-off in the Satisfaction of Claims Act chapter 8. The Securities

Trading Act chapter 10 applies correspondingly following a halt to payments under section 17.

If, in the course of the contract period, a party to a derivative contract no longer meets the requirement as to risk classification in section 9 third paragraph, that party shall furnish adequate security in the form of a cash deposit, guarantee or charge over assets that meets the requirements of section 9 third and fourth paragraphs.

### **Section 9 Cover pool**

Assets as mentioned in the Financial Institutions Act section 2-28 first paragraph a) and b) may not have a loan-to-value ratio higher than the following upon inclusion in the cover pool:

1. 75 per cent of prudent market value in the case of residential mortgages.
2. 60 per cent of prudent market value in the case of commercial mortgages.

Assets in the form of public sector loans as mentioned in the Financial Institutions Act section 2-28 first paragraph d) must be granted to or guaranteed by central authorities (states), central banks, regional and local authorities and state-owned enterprises within the EEA or OECD area. Public sector loans to counterparties within the OECD area, but outside the EEA, shall be granted to or guaranteed by counterparties as mentioned in the first sentence, multilateral development banks or international organisations which qualify for credit quality step 1 or better. Similarly, assets which qualify for credit quality step 2 may constitute at most 20 per cent of the nominal value of outstanding covered bonds. The Capital Requirements Regulations sections 5-1 to 5-5 concerning risk weighting of on-balance sheet items apply insofar as appropriate.

The requirement as to risk classification of public sector bodies mentioned in the second paragraph similarly applies where the latter are party to derivative contracts or to contracts involving assets used as substitute assets as mentioned in the Financial Institutions Act section 2-28 first paragraph e) and f). Claims (exposures) on institutions etc as mentioned in the Capital Requirements Regulations section 5-6 which qualify for credit quality step 1, shall in aggregate not exceed 15 per cent of the nominal value of outstanding covered bonds. Amounts due to operation and management of the cover pool, including settlement of loans, and transfers of payments to preferential creditors shall not be included for the purpose of the 15 per cent limit. The same applies to covered bonds issued by other institutions, cf. fourth paragraph. Claims on institutions within the EEA with a maturity of up to 100 days shall qualify for credit quality step 2 or better.

Substitute assets in the form of securities issued by credit institutions with a preferential claim over a cover pool under the Financial Institutions Act chapter 2 subchapter IV, or equivalent statute in another EEA country, and securities issued under the Financial Institutions Act chapter 2 subchapter V with a basis in securitised residential mortgages or commercial mortgages, or equivalent statute in another EEA country, which qualify for credit quality step 1, may in aggregate constitute no more than 20 per cent of the nominal value of outstanding covered bonds.

Within the constraints of the Financial Institutions Act section 2-28, the cover pool may otherwise contain such assets as are established by the authorities in the state concerned in accordance with the requirements of Directive 2006/48/EC, Annex VI, part 1, no. 12 points 68-71.

Assets which do not conform to the above-mentioned risk classification, quantitative limits, loan to value ratios or other requirements under this section, may nonetheless be included in the cover pool, but shall not be included for the purpose of verifying the institution's compliance with asset coverage requirement under the Financial Institutions Act section 2-31. Assets which exceed the above-mentioned quantitative requirements or loan to value ratios, may be included in respect of that portion which meets the requirements. The value of residential mortgages and commercial mortgages may be included up to the limits stated in the first paragraph even if a subsequent value change indicates that the limits have been exceeded, cf section 10 second paragraph.

Interest rate and foreign exchange contracts and substitute assets shall be assigned to the cover pool and the associated bond issue to which the contracts and the substitute assets relate. Where a mortgage credit institution has issued two or more bonds not conferring a preferential claim over the same cover pool, interest rate and foreign exchange contracts and substitute assets shall be held in separate bank or CSD accounts for each cover pool.

Interest income on the cover pool shall at all times exceed the sum of the costs of the bond issue. In calculating the costs, account shall also be taken of the cash flows accruing from interest rate and foreign exchange contracts entered into.

Loans which a mortgage credit institution has recorded as non-performing shall not be taken into account in calculating the cover pool under the Financial Institutions Act section 2-31.

### **Section 10 Valuation**

In assessing whether the value of the cover pool exceeds the value of preferential claims under the Financial Institutions Act section 2-31, loans, interest rate contracts and foreign exchange contracts and substitute assets shall be valued at prudent market value. Bank deposits redeemable at notice up to 30 days and floating rate loans may be valued at nominal value. Bond issues shall be valued at the sum of the discounted value of nominal and discounted coupon payments. Kredittilsynet may lay down further rules on the discount rate as mentioned.

Property furnished as collateral for residential mortgages and commercial mortgages shall be valued in accordance with the Financial Institutions Act section 2-29 first paragraph. The Capital Requirements Regulations section 17-1 concerning general requirements as to security provision, section 17-6 first paragraph c) and d) concerning valuation of real estate and section 18-4 first paragraph a) concerning prudent market value apply correspondingly.

### **Section 11 Requirements as to register and independent inspector**

A mortgage credit institution shall for each cover pool establish a register of loans, interest rate contracts and foreign exchange contracts, substitute assets and covered bonds. Such registers shall at minimum contain:

- 1) An overview of loans containing the following information:
  - a) Borrower's name
  - b) Borrower's personal identification number or organisation number
  - c) Borrower's address
  - d) Original and outstanding loan amount

- e) Loan's maturity structure and cash flow
  - f) Titleholder, address and register designation of the collateral
  - g) Value of the collateral established in accordance with section 10
  - h) If applicable, the guarantor's name, organisation number and address, amount and type of guarantee
  - i) Any other claims that the mortgage credit institution has against the borrower or the titleholder of the collateral
  - j) Statistical data, appraisals and other material concerning current valuation of the collateral included in the cover pool
- 2) An overview of assets and liabilities in the form of derivative contracts containing the following information:
    - a) Counterparty's name or firm and any identity number, as well as the latest applicable rating
    - b) Counterparty's address
    - c) Original and outstanding contract amount
    - d) Contract's maturity structure and cash flow
    - e) Titleholder, address and register designation of any collateral
    - f) Any other claims that the mortgage credit institution has on the counterparty or the titleholder of the collateral
  - 3) An overview of substitute assets containing the following information:
    - a) Borrower's name or firm and any identity number, as well as the latest applicable rating
    - b) Borrower's address
    - c) Original and outstanding loan amount
    - d) Loan's maturity structure and cash flow
    - e) Titleholder, address and register designation of any collateral
    - f) Name or firm and address of any guarantor

- g) Any other claims that the mortgage credit institution has on the borrower or the titleholder of the collateral
- 4) An overview of covered bonds containing the following information:
  - a) Nominal value
  - b) Interest terms
  - c) Maturity date

The institution shall put forward an independent inspector who shall be appointed by Kredittilsynet in accordance with the Financial Institutions Act section 2-34 first paragraph, unless Kredittilsynet deems this individual to be unfit for purpose. The institution's elected auditor may be appointed under the first sentence.

The inspector shall at least every third month check that the requirements of the Financial Institutions Act sections 2-31 and 2-33 are met. The inspector shall each year inform Kredittilsynet of the observations and assessments arising from the inspections. If the inspector has cause to believe that the requirements are not met, he shall inform Kredittilsynet accordingly. The Financial Supervision Act section 3a) last paragraph applies correspondingly.

## **Chapter 2**

### **Joint recovery of debt etc**

#### **Section 12**

##### **Relationship to bankruptcy legislation etc**

Except as otherwise stated in the Financial Institutions Act chapter 2 subchapter IV or these regulations, the ordinary rules on proceedings in bankruptcy and negotiation of debt, winding up or public administration shall apply. Where the regulations make exceptions from these rules, the exceptions shall apply both to covered bonds and to derivative contracts as mentioned in the Financial Institutions Act section 2-28 first paragraph e).

The Bankruptcy Act section 64 shall not prevent bankruptcy proceedings from being started against a mortgage credit institution upon petition by holders of covered bonds.

The provisions of the Act on Guarantee Schemes for Banks and Public Administration etc., of Financial Institutions section 4-6 first paragraph d) concerning Kredittilsynet's approval of payments and section 4-9 second paragraph concerning reduction of claims, shall not apply to holders of covered bonds.

The rules of chapters 2, 3 and 4 of these regulations concerning bankruptcy proceedings apply correspondingly to debt negotiation, public administration and winding up insofar as they are appropriate.

#### **Section 13**

##### **Payment of expenses**

Payment of expenses on operation, management, recovery and realisation of the cover pool may be demanded before the holders of covered bonds receive payment from the cover pool.

## **Chapter 3**

### **Administration of an estate where timely payment can be made from the cover pool**

#### **Section 14**

##### **Timely payment etc**

The bankruptcy administrator shall ensure proper management of the cover pool to secure the assets in the cover pool. The bankruptcy administrator shall also ensure that the provisions concerning the composition of the cover pool and the provisions concerning liquidity, currency and interest rate risk are complied with on a continuous basis.

The bankruptcy administrator and creditors' committee shall ensure that holders of covered bonds receive agreed and timely payment from assets encompassed by their preferential claim as provided in the Financial Institutions Act section 2-35 third paragraph.

Bankruptcy or negotiation of debt or public administration of a mortgage credit institution shall not in itself be sufficient cause for termination or similar remedy by holders of covered bonds. Neither may actions as mentioned in the Financial Institutions Act section 2-30 be undertaken or carried out. In the case of forced recovery this also applies after the expiry of the period stated in Bankruptcy Act section 117 third paragraph, cf. section 17 second paragraph. This does not prevent derivative contracts as mentioned in the Financial Institutions Act section 2-28 first paragraph e), which meet the requirements of section 8 of these regulations, from continuing to run in accordance with their terms so that agreed set-off of cash flows in the same currency and with the same maturity date can be undertaken between the parties in the same cover pool. Neither, in relation to derivative contracts as mentioned in section 8, does this prevent the bankruptcy administrator and creditors' committee from agreeing with a derivative counterparty to replace one or more ongoing derivative contracts with one or more new such contracts, so long as the asset coverage requirement under the Financial Institutions Act section 2-31 and the liquidity requirement under section 2-32 are met.

The bankruptcy administrator and creditors' committee may take any action considered necessary to redeem preferential claims over the cover pool, including selling assets and issuing new bonds and derivative contracts conferring

a preferential claim. The bankruptcy administrator and creditors' committee shall as soon as possible inform holders of covered bonds of decisions assumed to be of material significance to them.

#### **Section 15**

##### **Estate's disposal over the cover pool**

The bankruptcy administrator and creditors' committee may dispose over assets included in the cover pool solely for the purpose of meeting the requirement of timely payment.

If deemed necessary in the interests of the other creditors' ability to enforce a claim, the bankruptcy administrator and creditors' committee may none the less sell the entire cover pool provided the proceeds obtained provide at minimum full satisfaction to holders of covered bonds.

Full satisfaction means settlement of interest rate contracts and foreign exchange contracts at market value based on pricing of comparable interest rate contracts and foreign exchange contracts. Full satisfaction in respect of bond issues entails settlement of all accrued interest and charges as well as agreed future cash flow (principal and interest) up to the ordinary maturity date, discounted at the market rate for comparable bonds in the relevant currency.

#### **Section 16**

##### **Estate's assumption of the debtor's position in derivative contracts**

The bankruptcy estate shall without specific decision assume the debtor's position in the debtor's derivative contracts as mentioned in the Financial Institutions Act section 2-28 first paragraph e). The other party shall not be entitled to invoke insolvency as a ground for termination based on the nature of the contract.

### **Chapter 4**

#### **Administration of the estate when timely payment cannot be made from the cover pool**

#### **Section 17**

##### **Halt to payments**

Should it not be possible to make contractual payments using assets from the cover pool as and when the claims falls fall due up to the agreed redemption date, and an imminent change that will ensure such contractual payments is unlikely, the bankruptcy administrator and creditors' committee shall introduce a halt to payments. A halt to payments shall be introduced even if the cover pool assures correct ongoing payments in the purely short term.

The bankruptcy administrator and creditors' committee shall as soon as possible inform holders of covered bonds of the halt to payments and the date on which such halt to payments is to be introduced.

#### **Section 18**

##### **Effect of halt to payments**

Where a halt to payments is introduced under section 17, further administration of the estate shall proceed under the general rules of the bankruptcy legislation. The bankruptcy administrator and creditors' committee shall inform the holders of covered bonds of the further treatment of the cover pool. The bankruptcy administrator and creditors' committee shall, when making material decisions about the cover pool, consult the holders of covered bonds in accordance with the Financial Institutions Act section 2-35 first paragraph.

#### **Section 19**

##### **Calculation of claims**

The size of all preferential claims over the cover pool shall be calculated on the date that the bankruptcy administrator and creditors' committee introduced the halt to payments. Claims shall be calculated by discounting them to present value in accordance with the provisions of section 15 third paragraph.

### **Chapter 5**

#### **Entry into force**

#### **Section 20**

##### **Entry into force**

These regulations enter into force on 1 June 2007.

## Annex 3

### Legal framework

#### 1) The Financial Contracts Act

The Financial Contracts Act (Act 1999-06-25 no. 46) regulates the contractual conditions in respect of a loan agreement between financial institutions and their customers, both consumers and corporate clients. The act applies in principle to all types of loan, whether it is secured or not. This also includes mortgage backed loans included in a secured bond portfolio. The act is invariable in respect of consumer contracts, i.e. it cannot be dispensed by agreement that is detrimental to the customer.

Loan contracts are covered by the general provisions in chapter 1 of the act, and by chapter 3 that regulates loan agreements in specific. The latter regulates issues as contractual information, including pre-contractual information, an obligation to dissuade, changes to the terms of the contract, interest, early repayment, transfer of the lender's claim, change of creditor, and default.

Section 46 (1) sets out the pre-contractual information requirements for the lender. The lender shall before entering into the contract, inform the borrower in writing of:

- a) the effective annual interest rate (APRC),
- b) the nominal annual interest rate, and charges and other loan costs to be charged to the borrower,
- c) the size, number and due dates of payments throughout the period of the loan, the relationship between instalments, interest and other costs at each payment, and the total amount payable,

- d) reservations in the contract concerning changes in the interest rates, charges and other expenses, cf. section 49,
- e) the borrower's right to early redemption, and charges etc, which may accrue if this right is exercised.

Section 48 requires that a loan contract with a consumer shall include information as set out in section 46 (1) a to e (see above). Moreover, the loan contract shall include information about the relevant dispute resolution arrangement as mentioned in section 4 and 5.

Such an alternative dispute resolution system, The Complaints Board for Consumers in Banking, Finance and Mutual Fund matters, was established in 1988. This is a non-governmental body established by agreement between the financial industry associations and the Consumer Council. The By-laws of the board were approved by Royal Decree May 2000. Statements made by the board are advisory, but are in most cases followed. In 2006, the average case processing time was three months.

The lender shall dissuade the customer in writing, before entering into the contract, if the lender has to assume that the financial capacity or other circumstances of the borrower indicate that he/she seriously should consider to refrain from taking the loan, cf. section 48. The lender's failure in this respect may lead to a reduction of the borrower's obligations, to the extent reasonable.

The terms of a loan contract may not be changed unilaterally by the lender, cf. section 49. Exceptions are made for interest rates, charges or other costs, provided the provisions for this are included in the pre-contractual information and the loan contract, cf. section 46, section 48 (5).

The lender shall notify the borrower of any changes in a loan contract, cf. section 50. If the interest rates, charges or other costs in a contract for a repayment loan, including a self-amortizing loan, are changed, the notification shall contain information as set out in section 46 (1) a and b, and the effect on loan profile. Where the borrower is a consumer, changes in e.g. interest rates and cost etc may be implemented not earlier than six weeks after the written notification from the lender. A shorter time-limit may be set where the interest rate is changed as a result of a materiel change in the money market rate, bond market yield or general level of interest rates for deposits with and borrowing by institutions. For fixed rate loans there are specific provisions and time limits for loans where the interest rate etc may only be regulated at specific dates, i.e. end of an interest rate period.

In the event of late payment, the lender may demand penalty interest, cf. section 51. The penalty interest rate is regulated in the Act on Interest on late payments. For consumers the interest rate may not be higher than set out by Act.

The borrower is entitled to repay the loan entirely or in part at any time, cf. section 53. Borrowing costs shall only be payable for the utilized credit period. The institution may not demand any other contractual charge where the borrower is a consumer. In the case of fixed interest rate loan, the lender may also demand coverage for loss in the lock-in period, provided the lender's rights are set out in the contract and included in the pre-contractual information (cf. section 54). For fixed rate loans there are specific provisions for repayment connected to the end of a lock-in period and a new offer for the borrower (consumer). When the contract entitles the lender to cover loss, a consumer shall

to the same extent be credited any interest gain accruing to the lender. This right may be departed from in the contract, and the lender's right shall also be included in the pre-contractual information.

The King (Ministry of Justice) has issued regulations concerning the calculation of interest, including the APRC, and other compensation.

The lender may demand redemption of the loan before maturity in the case of default. The grounds for such demand for early redemption from a consumer are mandatory set out in section 52. This includes i.a. the case where the borrower is in, or it is clear will be in, material breach of the contract and in the case of bankruptcy or debt settlement proceedings.

Except with the borrower's special consent, the lender's claim may only be transferred to an other financial institution, cf. section 45. The change of creditor may not reduce the rights of the customer in respect of the new lender.

## 2) The Mortgage Act

The Mortgage Act (Act of 8 February 1980 no. 2) regulates mortgages on real property. Ownership and special rights in real property may be mortgaged under the provisions set out in Chapter 2 of the Act, cf. section 2-1. This also includes lease and a right of dwelling, and also parts in cooperative building societies.

Unless otherwise agreed, real property mortgage comprise the land, houses and building that the mortgagor owns and accessories and rights as set out in law, cf. section 2-2. A mortgage may also be established on a lease of land or an owner section in a building/freehold apartment, cf. section 2-3 and section 2-4.

Mortgage rights acquire legal protection by registration in the Land Registry/ Register of Deeds. See below.

According to section 1-7 of the Act, the mortgage debtor has an obligation to provide proper care and maintenance of the property so that the mortgagee's security is not reduced. Furthermore the mortgagor has a duty to take out standard insurance for the property. Most lenders holding mortgages will obtain a certification from an insurance company to ascertain that the property or dwelling actually is properly insured. In the case of mortgages of less than NOK 7.5 million, the credit institutions will normally rely on a self statement of insurance from the customer. The latter is based on the fact that a mortgagee is secured by a separate guarantee scheme (pool), the "Panthavergaranti-ordningen", in an amount of up to NOK 7.5 million in case the property is not insured.

Should the debtor be in arrears of instalments etc, the mortgagee may accelerate the loan cf. section 1-9 of the act. However this has to be read in connection with the provisions under section 52 of the Financial Contracts Act (see above) that sets out mandatory rules for a credit institution's call for early redemption by a consumer. If the provisions for accelerating the loan are fulfilled and the debtor fails to pay, the mortgagee may file for forced sale of the property (see below).

## 3) Land Registry – Register of Deeds

The Norwegian Parliament resolved to transfer responsibilities to land registration from the courts to the Norwegian Mapping and Cadastre Authority (NMCA). To implement this decision the Department for Cadastre and Land Registry was established in January 2003. As of April 2007, the transfer had not yet completed for all local county courts. However, this has no legal effect.

The registration process and the effect of this are regulated in the Title of Registration/Deed Registry Act (Act of 7 June 1935 no. 2). The ownership and other rights, including mortgage (lien), in real property, presuppose that the relevant property has been individualized and registered by number designation in the land register. Each property will have its own "page" in the register (grunnboka) and the register is electronic. The register is based on the principle that the information included in the register is correct, and the information that is not stated therein does not exist, i.e. the credibility and reliability of the register has in principle both negative and affirmative effect.

Rights, including ownership and mortgage, acquire legal protection by registration in the Land Registry/Register of Deeds. This also applies to parts in cooperative building societies. Exemptions are, to the extent provided for by law (statutory liens according to section 6-1 of the Mortgage Act), made for e.g. taxes on the property and for joint expenses in building societies and owner sections-companies (freehold apartments). To provide for the administration of a bankrupt estate, there is also a statutory lien for the bankrupt estate equivalent to 5 % of the value the property, limited to 700 times the standard court fee (NOK 860 as of April 2007), cf. section 6-4 of the Mortgage Act.

## 4) Forced sales Act

The Forced Sales Act (Act of 26 June 1992 no. 86) provides for an effectively and expedient forced sale procedure.

A lender may, if a loan is accelerated and the borrower fails to pay any due amount, file an application before the county court for a forced sale of the property that backs the mortgage loan, cf. section 4-4 of the

Forced Sales Act. The registered mortgage contract will itself constitute the basis for such application, cf. section 11-2 and 12-2. There is no need for additional judgment by the court to provide such basis for a forced sale.

There are specific provisions for a 14 days prior written notice of the debtor before an application for a forced sale can be filed on the basis of the registered mortgage contract, cf. section 4-18.

The court will, after giving the debtor a right (with time limit) to comment upon the application, decide if the forced sale shall be carried out, cf. section 11-9. The court will normally appoint a real estate broker to administer the sale in order to obtain a reasonable price. However this is rare, the court may also decide that the forced sale shall be carried out through an auction if this is deemed to give a better price, cf. section 11-12. The court may also decide to evict the debtor from the premises if the sales procedure is hindered or there is a possible loss of value of the property, cf. section 11-14.

The lender (applicator) may ask the court to affirm a bid on the property, cf. section 11-28. The court shall affirm the bid provided the provisions in section 11-30 are fulfilled, i.e. that such bid gives full redemption to creditors with better priority than the applicator and there is no reason to believe that a higher bid is possible to obtain. The court will then by a decision distribute the dividend of the sale to the creditors that hold lien in the property. Normally, 6-9 months are required to repossess the property and satisfy the holder of a mortgage.

### **5) Creditors Recovery Act**

The Creditors Recovery Act (Act of 8 June 1984 no 59) sets out the provisions and limits for the creditors' recovery in the case of bankruptcy, forced sale etc.

In the case of forced sale of debtor's necessary housing or dwelling rights, the law gives the court an initial right, upon the debtor's request, to decide that the forced sale may only be executed if the debtor is provided with another dwelling which in terms of location, size, price and other factors satisfies reasonable requirements, cf. section 2-10 and section 11-7 of the Forced Sales Act.

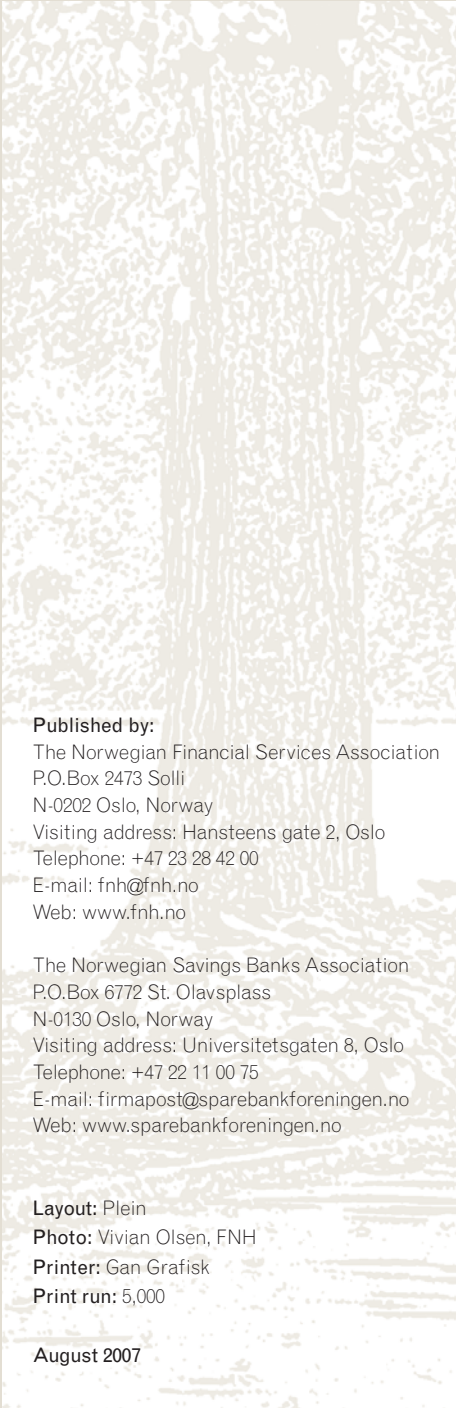
However, some important exemptions apply with regard to the debtor's right to another dwelling. First, the right does not apply if the debtor has failed to do what he can to procure another dwelling or the forced sale is executed for the collection of rent etc. Second, and more important for credit institutions, the debtor's right to a new dwelling is also excluded if the forced sale is executed to collect interest or ordinary matured instalment of loan secured by mortgage on the property, the lease or the document of access. And third, if collection is sought for more than the matured amount, the same applies if the extraordinary amount has fallen due because the terms of the mortgage have been defaulted by material neglect of the maintenance of the property or the duty to uphold insurance for the property. Due to these exemptions applying to the debtor's right to another dwelling, the credit institutions will in practice solely apply for forced sale on the basis of interest and matured instalments.

### **6) Debt settlements Act**

The Debt Settlements Act (Act of July 17 1992 no. 99) provides for the debtor's right, in case of severe debt burden, to apply for debt settlement. A debt settlement estate is opened and handled by the public enforcement authorities (the County court as Court of Seizure and the enforcement officer). The court may only initiate debt settlement proceedings if this is not deemed to be obviously offensive to other debtors or for society in other respects, cf. section 1-4.

Debt settlement may be voluntary or mandatory for the creditors, and can imply delays in payment or a reduction in claims, cf. section 4-1. The debtor has a further right to keep personal assets and means of transportation to the extent reasonable, cf. section 4-5. The debtor will only have a duty to sell the dwelling if this will provide better coverage for the creditors and the dwelling exceed what can be deemed reasonable dwelling for the debtor and his or her family, cf. section 4-4. If the debtor may keep his present dwelling, then the value of the dwelling shall be set by the enforcement officer and two other competent persons (valuers), cf. section 4-7. For debt secured by dwelling, i.e. mortgage loan, then debt secured within the set value plus 10 % shall receive payment of interest under the debt settlement period. No instalments shall be paid in this period, but no reduction shall be made in the principal outstanding, cf. section 4-8.





**Published by:**

The Norwegian Financial Services Association  
P.O.Box 2473 Solli  
N-0202 Oslo, Norway  
Visiting address: Hansteens gate 2, Oslo  
Telephone: +47 23 28 42 00  
E-mail: [fnh@fnh.no](mailto:fnh@fnh.no)  
Web: [www.fnh.no](http://www.fnh.no)

The Norwegian Savings Banks Association  
P.O.Box 6772 St. Olavs plass  
N-0130 Oslo, Norway  
Visiting address: Universitetsgaten 8, Oslo  
Telephone: +47 22 11 00 75  
E-mail: [firmapost@sparebankforeningen.no](mailto:firmapost@sparebankforeningen.no)  
Web: [www.sparebankforeningen.no](http://www.sparebankforeningen.no)

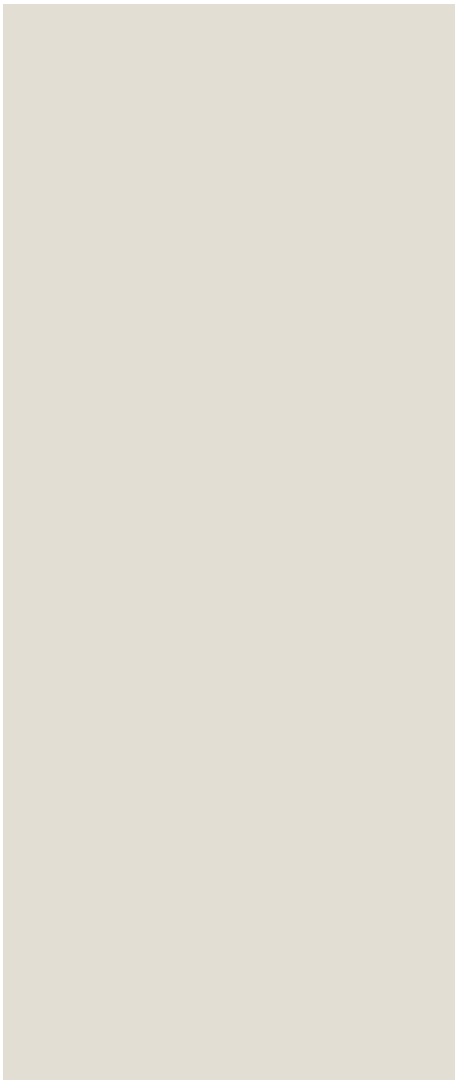
**Layout:** Plein

**Photo:** Vivian Olsen, FNH

**Printer:** Gan Grafisk

**Print run:** 5,000

**August 2007**



NORWEGIAN FINANCIAL  
SERVICES ASSOCIATION



Sparebankforeningen  
The Norwegian Savings Banks Association