3.24 NORWAY

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I. FRAMEWORK

The Norwegian Covered Bond Legislation came into force on 1 June 2007. Relevant amendments were made to the then governing Financial Institutions Act, and a regulation on credit institutions, that issue covered bonds, was adopted. Since then both a new Norwegian Act on Financial Institutions (hereafter "the Act") and the corresponding Regulation (hereafter "the Regulation") has been introduced. The Act, which became effective from 1 January 2016, have amended the covered bond framework so that covered bond issuers are treated the same as banks in the event of insolvency. This implies that issuers of covered bonds cannot be declared bankrupt, but will rather be placed under public administration. In addition, it enabled the Ministry of Finance (MoF) to set a legal minimum overcollateralisation requirement (a 2 % requirement was introduced in March 2017). The Regulation concerning financial institutions came into force on 1 January 2017 but did not represent any fundamental changes to the regulatory framework concerning covered bonds (merely making it more user friendly).

Issuance of Norwegian covered bonds started with an issuance denominated in euro in the second half of 2007. The issuers had thus not been active for very long before the financial crisis hit international financial markets. Norwegian banks did not experience any substantial increase in their losses on lending during the crisis. However, the turmoil in international financial markets resulted in a liquidity shortage which also affected Norwegian banks. In order to provide liquidity to the market, Norwegian authorities offered to swap treasury bills for covered bonds from Norwegian issuers, which lead to the establishment of several new covered bonds issuers and enabled the market to gain traction. During 2008 and 2009 a total of NOK 230 bn. (approximately EUR 25 bn.) of Norwegian covered bonds were exchanged in swap agreements with the government. High market demand in the following years for covered bonds gave a smooth phasing out of the swap agreement and growth in outstanding volume has been steady since then. The last covered bonds in the arrangement came to maturity in June 2014.

II. STRUCTURE OF THE ISSUER

According to the Norwegian legislation, covered bonds can be issued by specialised credit institutions only. Today there are 25 such institutions in Norway. The majority of issuers are subsidiaries of individual parent banks, while a few issuers are owned by groups of banks. The issuers are subject to a particular supervisory regime involving both an independent inspector and the public supervisor, the Financial Supervisory Authority of Norway ("Finanstilsynet"). The smallest issuers issue NOK bonds in the domestic market only, whereas the largest issuers are present in international capital markets on a regular basis.

Cover pools are dominated by residential mortgages, and the large majority of the issuers are specialised residential mortgage institutions (cf. the name "Boligkreditt"). Just a small number of issuers are specialised in commercial mortgages or in public sector loans. The issued covered bonds from these issuers constitute no more than 3 percent of the total outstanding volume.

A licensed credit institution may raise loans by issuing covered bonds where the object of the institution, as laid down in the articles of association, is to grant or acquire residential or commercial mortgages, public sector loans and loans secured by other registered assets. In addition, the company should 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 institutions will have a very narrow mandate, which ensures transparency.

III. COVER ASSETS

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

> Residential mortgages;

> Commercial mortgages;

> Loans secured by other registered assets;

> Public sector loans;

> Assets in form of derivative agreements (in accordance with regulation);

> Substitute assets (in accordance with regulation).

Mortgages have to be collateralised with real estate or other eligible assets within the EEA or OECD, and the same geographical requirement applies to the location of the public sector loan borrowers. The Regulation adds rating requirements on the national government of the country where the mortgaged property or the borrower has its location.

The substitute assets may constitute up to 20 percent of the cover pool and is required to be both secure and liquid. The FSA may in certain situations authorise the share of substitution assets to increase to maximum 30 percent for a limited period.

IV. VALUATION AND LTV CRITERIA

LTV

Maximum loan to value ratios (LTV) are fixed by the Regulation, in accordance with the CRR. For residential mortgages the LTV limit is set to 75%, while the limit is 60% for mortgages concerning holiday/leisure properties and commercial mortgages. 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 EU regulation.

Valuation

Upon inclusion of loans in the cover pool, a prudent market value shall be set. This shall be done on an individual basis by an independent and competent person. The valuation shall be documented. Valuation of residential properties may, however, be based on general price levels if justifiable by market development. For holiday/leisure properties the value may only be based on general price levels after the inclusion in the cover pool.

The credit institution shall establish systems for monitoring subsequent price developments. Should property prices fall, the part of a mortgage that exceeds the relevant LTV limit is still part of the cover pool and protects the holders of preferential claims. However, it will not be taken into account when calculating the overcollateralisation in the cover pool. The same principle applies to loans that are in default, i.e. more than 90 days in arrears.

There are four main sources of market values in Norway: Sales prices, real estate agent appraisals, surveyor values and Automated Valuation Model (AVM).

In Norway, most real property is sold through authorised real estate agents. They have undergone special training to conduct estate agency, are subject to strict authorisation rules and strict control routines on the part of the authorities. An estate agent may also give an indicative valuation of the property, but normally an authorised appraiser is hired as part of a selling process.

There is one market place, Finn.no, where most residential properties are put out for sale. This makes it easy to do proper marketing for properties for sale, and both seller and buyer are acting knowledgeably. Properties sold through Finn.no are typically sold as an open auction. The auction price will then reflect the true market valuation of the property.

Valuation is part of the real estate agent education in Norway. Agents are also trained in valuation on a regular basis. In Norway, most market value appraisals applicable for mortgages are compiled in a system called Etakst. Etakst is a digitalised system developed by the Norwegian mortgage industry and contains two parts:

1. Valuation software for the real estate agent
2. Documentation of market values for the banks

Etakst provides a standardised approach for real estate agents to compute market values. The agents will always provide the following data for the mortgage bank:

> Key data about the property (Living area, building type, lot area, ownership, standard, owners);

> Pictures of kitchen, bathroom and facade;

> Market value based on similar dwellings in the same area;

> Indexed earlier sales price;

> Lists of all properties sold previous year in the same municipality.

The bank grant access to the data when the applicant or the real estate agent provides a unique reference number to the mortgage bank. All dataflow is within a closed system, which reduces the fraud risk to an absolute minimum. The bank will also receive warnings if the applicant has done more than one valuation on their property last six months. Etakst is compliant with international valuation standards as European Valuation Standards (EVS) and International Valuation Standards (IVS).

Most Norwegian banks make extensive use of Eiendomsverdi as an AVM (automated valuation model) company, for estimating market values of residential real estate and updating the values in accordance to subsequent development in the residential real estate market. The estimations are based on a complex valuation model and on a property by property basis. The model is used both at origination, as a benchmark for physical valuations and when updating market values for the cover pool.

When mortgages have been granted, most Norwegian banks update their internal ratings of customers on a monthly basis. The purpose is to identify if there are any changes in the portfolio quality, and if any remedial action has to be implemented. Furthermore, most Norwegian covered bond issuers update the valuations on the properties in the portfolio on a quarterly basis. These updates are based on Eiendomsverdi's AVM.

For each property, updated value is calculated using information about any sales for similar properties in the neighborhood lately. Due to the richness and granularity in their database (all residential property sales in Norway are recorded daily into the database), the estimates from Eiendomsverdi model are generally perceived as robust, and will adapt to changed market conditions on a daily basis. Eiendomsverdi is also a member of the European AVM Alliance (EAA).

V. ASSET – LIABILITY MANAGEMENT

The Norwegian covered bond legislation previously imposed a strict balance principle, implying that the value of the cover pool shall exceed the value of the covered bonds at all times. With the introduction of the new Act, the Ministry of Finance was given the opportunity to set a minimum overcollateralisation (OC) requirement in addition to the strict balance principle. On the 29 March 2017, the MoF announced that the OC-requirement was set at 2 percent with immediate effect. In the press statement, the MoF emphasised that the OC-requirement will contribute in reducing uncertainty for investors and derivative counterparties. The requirement also implies that the issuers avoid the clearing obligation that follows from the EMIR-regulation.

The Regulation establishes a strict mark-to-market principle of both assets and liabilities. Only the value of mortgages within the LTV limits is taken into account in this context. Also, the Act caps the maximum exposure to one single borrower at 5% of the cover pool when calculating the overcollateralisation.

All voluntary OC is part of the cover pool and some issuers has committed themselves to a certain level of OC. Equally, the credit institution shall ensure that the payment flows from the cover pool enable the institution to honour its payment obligations towards holders of covered bonds and derivative counterparties at all times. It shall establish a liquidity reserve to be included in the cover pool as substitute assets in addition to carrying out periodically stress tests to ensure satisfactory liquidity management.

A covered bond issuer shall not assume greater risk than what is prudent at all times. It is obliged to establish a limit on the interest rate risk in relation to its own funds and potential losses. This shall be based on a parallel shift of 1 percentage point in all interest rate curves as well as non-parallel shifts in the same 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. Furthermore, a covered bond issuer shall not be exposed to any substantial foreign exchange risk and is thus obliged to establish limits on such risks. For the largest issuers, issuance is often denominated in EUR with a fixed rate, whereas the mortgages are typically in NOK and with a floating rate. Consequently, Norwegian issuers are dependent on using derivatives to remove FX- and interest rate risk and to satisfy regulatory requirements.

If a derivative agreement has a positive mark to market value, the amount will be a part of the cover pool. If the value is negative, the counterparties in the derivative agreement will have a preferential claim in the pool, and ranks “pari passu” with the holders of covered bonds. 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.

VI. TRANSPARENCY

Finance Norway and the Norwegian Covered Bond Council have recommended that all Norwegian issuers use the Harmonised Transparency Template (HTT) to increase transparency and comparability. In this relation a “Norwegian version” of the HTT, based on some common standards from the previously developed national template, has been introduced. This includes a stress test based on declining house prices in the tab for the National Transparency Template.

The HTT is only mandatory for issuers with a “label” from the Covered Bond Label Foundation. Norwegian issuers with such label are DNB Boligkreditt, Eika Boligkreditt, Nordea Eiendomskreditt, SpareBank1 Boligkreditt, Møre Boligkreditt, Sparebanken Sør Boligkreditt, Sparebanken Vest Boligkreditt and SR-Boligkreditt.

More information and the HTT for Norwegian issuers can be found on Finance Norway’s webpage:
www.finansnorge.no/en/covered-bonds/.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

Norwegian issuers are subject to a supervisory regime involving both an independent inspector (“cover pool monitor”) and the public supervisor, the FSA.

The issuing of covered bonds is regulated by chapter 11, subchapter II of the Act. The issuance of such bonds is not subject to any further governmental approvals. The institution shall, however, notify the FSA no later than 30 days prior to the initial issuance of covered bonds. There are no limitations on issuance. An exception is the FSA’s opportunity to instruct an institution to not issue covered bonds whenever the financial strength of the institution gives rise to concern.

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.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Under the Act, covered bond issuers cannot be declared bankrupt, but have to be placed under public administration if facing solvency or liquidity problems. This will give the authorities more flexibility to deal with covered bond companies, while maintaining the rights of covered bond holders. The liquidator shall ensure proper management of the cover pool and ensure that holders of covered bonds and derivative counterparties receive agreed and timely payments. Public administration or insolvency does not in itself give holders of covered bonds and derivative counterparties right to accelerate their claims. Should it not be possible to make contractual payments when claims fall due, and an imminent change is unlikely, the liquidator shall introduce a halt to payments.

The term "covered bonds", (in Norwegian "obligasjoner med fortrinnsrett" or "OMF") is protected by law and the term "covered bonds" may only be applied to bonds coming under the rules of covered bonds. The assets in the pool remain with the estate in case of the issuer is placed under public administration, but the bondholders and derivative counterparties 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 preferential claim also applies to payments that accrue to the institution from the cover pool. As long as they receive timely payments, the creditors have no right to declare that the issuer must be placed under public administration. Details about this issue may 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.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The legislation fulfils and is in compliance with the relevant EU legislation, i.e. the Capital Requirements Regulation (CRR) and in particular Article 52 (4) UCITS.[1] Hence, Norwegian covered bonds are eligible for reduced (10%) risk-weighting under the standard method for capital adequacy requirement. They are also eligible as collateral in the ECB and qualify as liquid assets under the Liquidity Coverage Ratio (LCR) given fulfilment of the specific criteria defined in the Delegated Act.

The issuers are licensed credit institutions under supervision of the Norwegian FSA, and as such they are bound to comply with all relevant single market directives and regulations applicable to European credit institutions. Pending the inclusion of relevant newer EU regulations in the EEA-agreement with the EU, Norwegian authorities have implemented the necessary provisions directly into Norwegian legislation.

X. ADDITIONAL INFORMATION

Legislation supplementing the covered bond legislation

The legal framework regulating the housing market provide 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 centralised electronic registry system for the ownership of and rights (mortgage, etc.) regarding real estate, and an effectively and expedient forced sale procedure.

The Act on Financial Contracts and Financial Assignments (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 it is secured or not. The act is invariable in respect of consumer contracts, i.e. it cannot be dispended by agreement that is disadvantageous to the customer.

1 Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): https://hypo.org/ecbc/covered-bonds/.

The Mortgage Act (Act of 8 February 1980 no. 2) regulates mortgages secured by 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.

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.

Temporary mortgage regulation extended

On 15 June 2015, the government announced a new strategy for the housing market. The objective of the strategy was to simplify regulations and bureaucracy to increase housing supply in relevant areas, as well as tighten credit regulations to dampen the growth in house prices and household debt. The latter led to a change in regulation which was temporary and set to last until 31 December 2016. The regulation was later revised and a tightened version was applied from the 1. January 2017 with an expiration date of 30 June 2018. On 19 June, the Ministry of Finance decided to prolong the regulation until 31 December 2019. The current mortgage regulation consists of the following requirements:

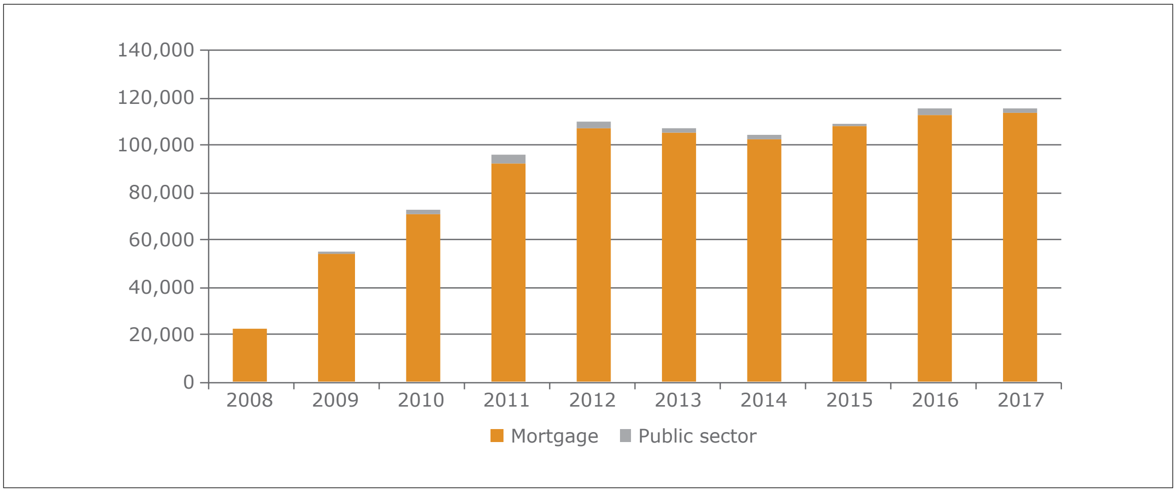
- Loan-to-value (LTV) requirement of max. 85%
- Stress test: Households must be able to service their debt in the event of a five percentage points increase in mortgage rates
- Maximum debt-to-income (DTI) ratio requirement of five times gross annual income
- A minimum principal payment requirement (2.5%) if the LTV ratio exceed 60%
- Interest-only periods on mortgages and home equity lines of credit may only be granted when LTV is below 60%
- Flexibility quota: Up to 10% of the value of new loans can deviate from one or more of the requirements above each quarter
- For mortgages located in Oslo, the deviation limit is set to 8% of the value of new loans each quarter. In addition, there is a LTV requirement of max. 60% for secondary homes

Market overview and additional information

According to Finance Norway's covered bond figures, a total of approximately EUR 22 bn. of covered bonds was issued in 2017, a small decline compared to 2016. The total level of outstanding bonds remained stable at just above EUR 115 bn. 44 percent of the outstanding bonds are denominated in NOK, 48 percent in EUR, 5 percent in USD, and the remaining 3 percent in other foreign currencies.

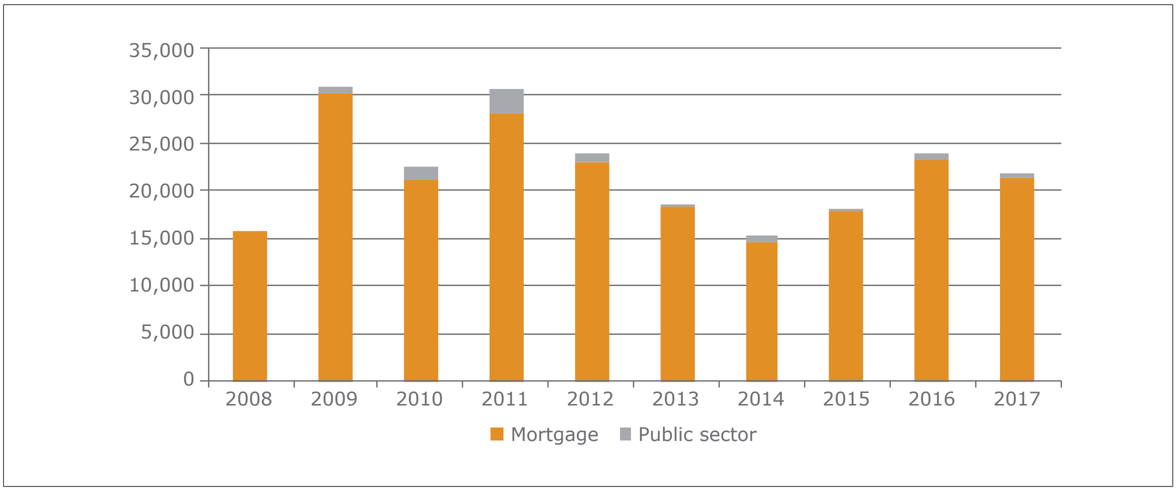
For more information and additional statistics see "Covered Bonds" on Finance Norway's webpage: www.finansnorge.no/en/. Finance Norway is the industry organisation for the financial industry in Norway. It represents about 240 financial companies with around 50,000 employees. Through dialogue and analysis, Finance Norway works to ascertain the best prerequisites for the functioning of the financial sector. We work to increase confidence in the industry and contribute to the safe and efficient operation. Finance Norway follow the covered bonds market and the associated legal framework closely, supported by an expert group (The Norwegian Covered Bond Council) consisting of high level representatives from the largest Norwegian issuers.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2008-2017, EUR M



Source: EMF-ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

Issuers: Bustadkreditt Sogn og Fjordane AS, DNB Boligkreditt AS, DNB Næringskreditt AS, Eiendomskreditt AS, Eika Boligkreditt AS, Fana Sparebank Boligkreditt AS, Gjensidige Bank Boligkreditt AS, Helgeland Boligkreditt AS, KLP Boligkreditt AS, KLP Kommunekreditt AS, Landkreditt Boligkreditt AS, Møre Boligkreditt AS, Nordea Eiendomskreditt AS, OBOS Boligkreditt AS, Sandnes Sparebank Boligkreditt AS, Sbanken Boligkreditt AS, SpareBank 1 Boligkreditt AS, SpareBank 1 Næringskreditt AS, Sparebanken Sør Boligkreditt AS, Sparebanken Vest Boligkreditt AS, Sparebanken Øst Boligkreditt AS, SR-Boligkreditt AS, Storebrand Boligkreditt AS, Totens Sparebank Boligkreditt AS, Verd Boligkreditt AS.

ECBC Covered Bond Comparative Database: http://ecbc.eu/framework/75/Norway.

COVERED BOND · LABEL · : DNB Boligkreditt AS (1 pool), Nordea Eiendomskreditt AS (1 pool), SpareBank 1 Boligkreditt (1 pool), Eika Boligkreditt AS (1 pool), SR-Boligkreditt (1 pool), Møre Boligkreditt AS (1 pool), Sparebanken Sør Boligkreditt AS (1 pool), Sparebanken Vest Boligkreditt (1 pool).