3.27 NORWAY

By Michael H. Cook, Finance Norway

I. FRAMEWORK

The Norwegian Covered Bond Legislation came into force on 1 June 2007. Since then, both the new Norwegian Act on Financial Institutions (hereafter "the Act") and the corresponding Regulation (hereafter "the Regulation") have been introduced. The Act, which became effective from 1 January 2016, has amended the covered bond framework so that covered bond issuers are treated the same as banks in the event of insolvency, i.e. 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). The legislation provides investors very strong protection on their investments and is closely linked to corresponding EU directives and regulation.

Issuance of Norwegian covered bonds started with an issuance denominated in euro in the second half of 2007. The covered bonds market in Norway was barely untested before the global financial crisis hit the following year. Norwegian banks did not experience any substantial increase in losses during the crisis, but the liquidity shortage triggered by the turmoil in international financial markets also spread to Norwegian markets.

In order to provide liquidity to the market, the authorities offered to swap treasury bills for covered bonds from Norwegian issuers. During 2008 and 2009 a total of 230 bn kroner (about EUR 23 bn euros) of Norwegian covered bonds were exchanged in swap agreements with the government. A high demand for covered bonds in the following years gave a smooth phase out of the swap agreement. In June 2014, the final bonds used in the swap agreement came to maturity.

A proposal on Norwegian implementation of the EU-framework on covered bonds has been prepared by the Supervisory Authority and was sent on public consultation by the Ministry of Finance in 2020. The authorities have pointed to the fact that there is little need for major changes in Norwegian legislation when implementing the framework. The Ministry of Finance has also expressed its intention to establish a harmonised framework in line with other European jurisdictions. It has been stated that the new legislation will enter into force in Norway in line with the EU (i.e. 8 July 2022).

II. STRUCTURE OF THE ISSUER

According to Norwegian legislation, covered bonds may only be issued by specialised credit institutions. Today there are 24 such institutions in Norway. A majority are subsidiaries of individual parent banks, while a few issuers are owned by groups of banks. The institutions are subject to the same type of regulations as other Norwegian financial institutions, for example capital adequacy requirements, liquidity management requirements etc. The issuers are subject to a supervisory regime that involves both an independent inspector and a public supervisor, the Financial Supervisory Authority of Norway ("Finanstilsynet"). The smallest issuers only issue bonds in local currency (NOK) in the domestic market, while the largest issuers are on a regular basis present in international capital markets.

Cover pools are dominated by residential mortgages, and majority of issuers are specialised residential mortgage institutions (cf. the name "Boligkreditt"). Only a small number of issuers are specialised in commercial real estate or in public sector loans. Covered bonds from such issuers constitute just below 2% 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

Under 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.

IV. VALUATION AND LTV CRITERIA

LTV

The maximum loan-to-value ratio (LTV) is fixed by the Regulation. 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.

Valuation

Upon inclusion of loans in the cover pool, a prudent market value shall be set. The valuation shall be documented. The valuation of residential properties may, 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 the property prices decline, 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: sales prices, real estate agent appraisals, surveyor values and Automated Valuation Model (AVM).

In Norway, most real property is sold through authorized real estate agents. They have undergone special training to operate as an estate agent and are subject to strict authorisation rules and control routines on part of the authorities.

There is one marketplace, "Finn.no", where most residential properties are put up 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 sold as an open auction.

Valuation is part of the real estate agent education in Norway. Most market value appraisals applicable to 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 data on key features (pictures, market value based on similar dwellings in the same area etc.) for the mortgage bank.

The bank is granted access to the data when the applicant or the real estate agent provides a unique reference number to the mortgage bank. Etakst is compliant with international valuation standards such as European Valuation Standards (EVS) and International Valuation Standards (IVS).

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

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, market value estimates are calculated using information on the specific property, comparable sales, and other attributes relevant for the housing market. Due to the richness and granularity in Eiendomsverdi's database (all residential property sales in Norway are recorded daily into the database), the estimates from Eiendomsverdi's AVM are perceived as robust, and will adapt to changes in market conditions on a daily basis. Eiendomsverdi is a member of the European AVM Alliance (EAA) and comply with the "European Standards for Statistical Valuation Methods".

V. ASSET – LIABILITY MANAGEMENT

The Norwegian covered bond legislation has traditionally imposed a strict balance principle, implying that the value of the cover pool always shall exceed the value of the covered bonds. On the 29 March 2017, the MoF announced that an OC-requirement, in addition to the strict balance principle, was set at 2% with immediate effect.

The Regulation establishes a 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. The Act caps the maximum exposure to one single borrower at 5% of the cover pool when calculating the overcollateralisation.

All voluntary OC are part of the cover pool and some issuers have 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. 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, the 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, ranking pari passu with the holders of covered bonds. As a corollary to this, the counterparties in the derivative agreements will be subject to the same restrictions with respect to the 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 has been developed based on some common standards from the previously developed national 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.

The HTT for Norwegian issuers can be found on Finance Norway's webpage:
https://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 institution shall notify the FSA no later than 30 days prior to the initial issuance of covered bonds. No further approvals from the authorities are needed when issuing covered bonds with an exception should the financial strength of the institution gives rise to concern. However, the issuer needs to apply to the FSA before establishing the setup for OMF standard (European Covered Bond) or OMF premium (European Covered Bond Premium).

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 regularly review compliance with legislative requirements and report to the FSA.

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

The term "covered bonds", (in Norwegian "obligasjoner med fortrinnsrett" or "OMF") is protected by law and may only be applied under the rules of covered bonds. The same applies for the new European covered bonds or OMF standard and European covered bonds premium or OMF premium.

Covered bond issuers cannot be declared bankrupt but have to be placed under public administration if facing solvency or liquidity problems. This gives 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 the 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 covered bond owners and derivative counterparties have an exclusive, equal and proportionate preferential claim over the cover pool, and the administrator is bound to assure timely payment, provided the pool gives full coverage to the said claim.

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 do not have the 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 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.

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 effective 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 an agreement that is disadvantageous to the customer.

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. Unless otherwise agreed, real property mortgage comprises 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 effective 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

Due to the authorities concern regarding housing prices and its correlation with household debt, the Ministry of Finance introduced a regulation on requirements for new residential mortgage loans in 2015. The goal of the regulation is to ensure a sustainable development in household debt. The regulation is temporary and have been assessed on several occasions since its introduction. In December 2020 the MoF announced that the mortgage regulation will be merged with similar requirements on unsecured debt. The joint regulation applies until 31. Dec 2024 but will be re-assessed in the autumn 2022. For mortgages the following apply:

> Loan-to-value (LTV) requirement of maximum 85%

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/.

> 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 in 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 an LTV requirement of maximum 60% for secondary homes in Oslo.

Register on unsecured debt

In 2019 the Debt Information Act entered into force. The Act requires that banks and other financing companies report information on consumer loans and credit card debt to central debt registers. Banks can now access these registers and receive updated information on a borrowers' consumer debt, and hence receive a complete picture of a borrowers' debt situations.

Market overview and additional information

According to Finance Norway's covered bond figures, a total of approximately EUR 21 bn. of covered bonds was issued in 2021. The total level of outstanding bonds is close to EUR 132 bn. 47% of the outstanding bonds are denominated in NOK, 47% in EUR, and the remaining 6% in other foreign currencies.

Since the start of 2018 a total of 12 Norwegian issuers have issued green covered bonds based on residential mortgages. Issuances have been done in NOK, SEK and EUR with a total outstanding volume of approximately 11 bn. EUR at year-end 2021.

More information and additional data are available on Finance Norway's webpage:
www.finansnorge.no/en/

Issuers: Bustadkreditt Sogn og Fjordane AS, DNB Boligkreditt 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, Toten Sparebank Boligkreditt AS, Verd Boligkreditt AS.

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).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Norwegian market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.