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INTERNATIONAL MONETARY FUND

NORWAY

FINANCIAL SECTOR ASSESSMENT PROGRAM

July 28, 2020

TECHNICAL NOTE

INSURANCE SECTOR OVERSIGHT

This Technical Note was prepared in October 2019, before the global intensification of the COVID-19 outbreak. It focuses on Norway's medium-term challenges and policy priorities and does not cover the outbreak or the related policy response, which has since become the overarching near-term priority

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Norway. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at
http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

BP	Basis Point
BRRD	Bank Recovery and Resolution Directive
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EoF	Eligible Own Funds
EU	European Union
FSA	Finanstilsynet
FSAP	Financial Sector Assessment Program
FSCB	Financial Services Complaints Board
GDP	Gross Domestic Product
ICP	Insurance Core Principle
IAIS	International Association of Insurance Supervisors
IORP	Institutions for Occupational Retirement Provision
JBF	Jernbanepersonalets bank og forsikring
KLP	Storebrand and Kommunal Landspensjonskasse
LTG	Long-Term Guarantees
MoF	Ministry of Finance
NOK	Norwegian kroner
OECD	Organization for Economic Cooperation and Development
ORSA	Own Risk and Solvency Assessment
RoE	Return of Equity
SCR	Solvency Capital Requirement
TTP	Transitional Measure on Technical Provisions
TN	Technical Note
UCITS	Undertaking for Collective Investments in Transferable Securities
USD	U.S. Dollar
VA	Volatility Adjustment

EXECUTIVE SUMMARY

The Norwegian insurance sector is well-capitalized. In recent years, the authorities have taken steps to recapitalize weak insurers and to boost capital for the overall industry. Risk-resilience has been strengthened by stronger retention of profits leading to accumulation of reserves, better risk management, and higher capital in the run-up to the implementation of the Solvency II regulatory regime.

Several insurers still face challenges from the prolonged low interest-rate environment, but structural developments are gradually reducing risks. Life insurers in the private sector have ceased offering products with interest rate guarantees, or significantly reduced guarantees. However, as guarantees in Norway are generally provided for life, high interest rate guarantees provided in the past will affect insurers' solvency position for a long time and average guaranteed rates will fall only gradually. In 2018, the average guaranteed rate was still three percent for life insurers and slightly less (2.6 percent) for pension funds. Insurers are also particularly sensitive to interest rate risk as they have a significant asset-liability mismatch—the duration of insurers' assets is shorter than five years on average, while the duration of their liabilities is about 15 years. This leaves them with considerable reinvestment risk as assets mature.

While Finanstilsynet (FSA) is responsible for the supervision of the financial sector, the Ministry of Finance (MoF) plays a major role in regulation and operational supervisory issues. The MoF ultimately decides key prudential regulations, sets annual goals for the FSA and issues instructions to the FSA. While these goals and instructions may be discussed and agreed with the FSA, some may not fully align with the FSA's priorities and resources. In addition, the MoF can overturn the FSA's decisions through an appeal process available to the financial industry. While the FSA's expenses are financed by levies on supervised institutions, its budget is subject to the direct control of the MoF, which limits its ability to adjust resources in line with its needs and priorities.

To help the FSA achieve its supervisory objectives, the authorities are advised to strengthen the FSA's powers and independence and increase its budgetary autonomy. The FSA should be granted powers to issue binding regulations. In addition, the powers given to the MoF to issue instructions and decide on appeals to supervisory decisions should be removed since they could impair the ability of the FSA to effectively fulfill its supervisory mandate. More budgetary autonomy for the FSA and a higher level of accountability would allow it to manage and control its resources more effectively.

The FSA follows a risk-based approach to supervision, which could usefully consider a broader set of risk measures to complement its use of the solvency ratio. The FSA prioritizes its supervisory review of insurers on the basis of two factors—risk and impact. While risk is measured by a firm's solvency ratio, impact is measured by its market share. Since the insurance sector is dominated by only a few institutions, the impact factor ends up being more important in determining priority for supervision.

The authorities should consider strengthening the risk dimension of the classification by adding additional metrics to its risk classification, to include market risk, credit risk, solvency, profitability and liquidity, as well as the quality of risk management and governance. These metrics should not only identify current risk levels but also their evolution over time.

There is scope for further improvement to the risk monitoring work of the FSA. The quarterly early-warning meetings with representatives from various FSA departments foster cooperation within the organization and ensure that different perspectives are taken into account when risks are discussed, and the supervisory program is identified. However, there is scope to strengthen the nature of analysis presented and discussed at these meetings. Regular or standing items should include a detailed analysis of Solvency II reporting by insurers as well as a discussion of conduct of business. Topical or non-recurring items could be based on recent on-site inspections or other regional/global themes. Moreover, early-warning work should complement analysis at the level of an individual insurer with that at a group (conglomerate) level and consider systemic issues for the overall insurance sector.

There is also scope to strengthen vulnerability analyses and stress testing of insurers. Stress tests of insurance firms, carried out to a consistent set of macroeconomic scenarios, would complement bottom-up analysis presently received from insurers. Sensitivity analyses for market, credit or other risks, such as physical and transition risks related to climate change, would provide additional insights. The analysis of pre-emptive recovery plans provides further insights into the robustness of insurers' business models. An extension of the duration of meetings at on-site inspections to allow for more detailed discussions on these matters should be considered.

Proposed changes to the capital requirements for counterparty default risk to align the requirements across sectors should be implemented. This could help limit portfolio transfers of retail mortgages between banks and insurers to the extent they are motivated by arbitrage considerations. The authorities should also consider establishing a comprehensive monitoring and reporting framework that focuses on both the evolution of the real estate market and the risk of residential mortgage lending to the individual insurer.

Table 1. Norway: Key Recommendations

	Recommendations and Authority Responsible for Implementation	Timing[1]
	Supervisory Objectives, Powers, Independence, and Resources	
1	Grant powers to the FSA to set binding regulations and for issuance and withdrawal of licenses for insurers (MoF, Government; ¶43)	ST
2	Limit the powers of the MoF to issue instructions to the FSA and decide on appeals of FSA supervisory decisions and measures (MoF, Government; ¶43)	ST
3	Give the FSA more budgetary autonomy to ensure that it has enough resources to carry out its mandate effectively (MoF, Government; ¶44)	ST
	Regulatory and Supervisory Oversight	
4	Strengthen risk-monitoring in early warning meetings and reports through more detailed risk assessments at solo, group, cross-sector and industry-wide levels, including these along with conduct of business analysis as standing items on the agenda (FSA; ¶66–70)	ST
5	Complement European Insurance and Occupational Pensions Authority (EIOPA) stress tests with Norway-specific market-wide sensitivity or stress tests for insurance (FSA; ¶71)	MT
6	Implement the proposed increase in capital requirements for counterparty default risk of insurers to align the requirements with those at the banking side and consider additional reporting requirements (MoF, FSA; ¶93)	I
7	Require large insurers to establish (pre-emptive) recovery plans as part of their Own Risk and Solvency Assessment (FSA; ¶77)	ST
8	Consider extending the duration of on-site inspection meetings to more than two days to allow for more detailed discussions and follow-ups. (FSA; ¶72)	ST

[1] I = Immediate (within 1 year); ST = Short term (within 1-2 years); MT = Medium Term (within 3-5 years)

INTRODUCTION AND BACKGROUND[1]

A. Scope and Approach

1. **This note provides a targeted review of insurance oversight in Norway.** The focus is broadly on Insurance Core Principles (ICPs) with macrofinancial relevance. They include the ICPs on the objectives, powers and responsibilities of the supervisor, capital and investment, risk management, business conduct and corporate governance, the exit from market and resolution, supervisory review and reporting, group-wide supervision and macroprudential supervision. The analysis is based on the regulatory framework in place and the supervisory practices employed as of October 2019, and on the ICPs issued by the International Association of Insurance Supervisors (IAIS), as adopted in November 2018. While the assessment is against the 2018 ICPs, latest changes and developments regarding some of the relevant ICPs—in particular with regard to risk management and macroprudential supervision—are also taken into account.

2. **The findings of the 2015 Financial Stability Assessment Program (FSAP) provide a useful reference point for the analysis.** While the coverage of the insurance sector in 2015 was mainly about stress testing, the recommendations provide a relevant starting point for the 2019 FSAP. The recommendations in the 2015 technical note on insurance sector stress testing highlighted the following aspects:

- Allocate more resources to assess the liability-side risks of insurers and validate models and assumptions used in the bottom-up stress tests.
- Apply macroprudential stress scenarios for insurance companies.
- Continue building a top-down stress test framework for the insurance sector.
- Prepare a recovery plan and achieve recapitalization of weakly capitalized insurance companies. Continue to restrict dividend payouts by the companies with weak capital adequacy and ask the weakly capitalized institutions to prepare a recovery plan.
- Identify systemically important companies, ask for a resolution plan, and conduct their resolvability assessments.

3. **The note is broadly organized as follows.** In the next section, it provides first an overview of the market structure, the types of products sold and the performance given current market conditions and a new regulatory regime for insurance, Solvency II, introduced in 2016 across the European Union (EU) and the European Economic Area (EEA). The sub-section on risks and vulnerabilities highlights the challenges the insurance sector in Norway is facing in the current environment and provides a segue into the analysis of insurance oversight. A brief introduction on the regulatory set up completes the background of this section. The second part of the note then reviews the regulatory and supervisory oversight framework for the insurance sector in Norway. It evaluates how the existing framework copes with the identified current challenges or potential future risks and formulates policy recommendations that account for existing constraints in a small financial market.

[1] Prepared by Bernhard Mayr (IMF external expert).

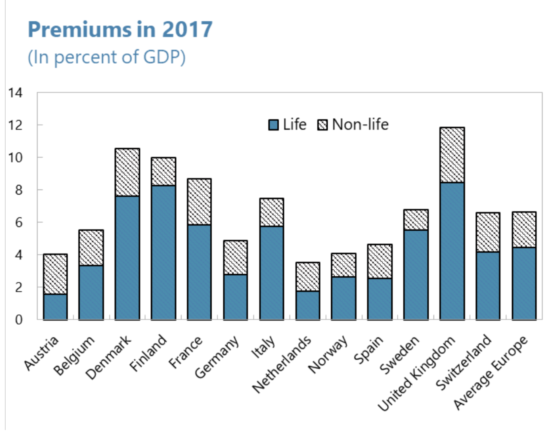
4. The FSAP mission team is grateful to the authorities and private sector participants for their excellent cooperation. The note draws on extensive discussions with experts from Finanstilsynet, the Ministry of Finance and private sector participants. The author is grateful to the authorities and private sector participants for their cooperation. The work benefitted greatly from their readiness to discuss issues and share information.

B. Market Structure, Insurance Products and Industry Performance

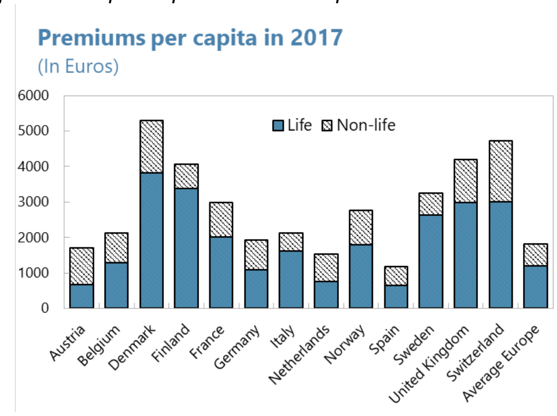
5. The insurance sector is important in Norway's financial system. The sector has accumulated total balance sheet assets of about 1,700bn Norwegian kroner (NOK), which is slightly less than 50 percent of gross domestic product (GDP) or around 17 percent of the financial system. The life sector, particularly its long-term pensions business, contributes about 90 percent thereof. Insurers are, hence, significant players on Norway's capital market. With an insurance penetration (total insurance premiums to GDP) of three percent for life and 1.4 percent for nonlife insurance, however, the Norwegian insurance market is considerably smaller than many of its European peers. The situation is more nuanced when comparing insurance density data, which measures total premiums by the size of the population. The respective figures in 2018 were NOK 19,709 per person for life business and NOK 9,488 for nonlife insurance. Both figures are considerably above the European average. The difference also reflects Norway's high GDP per capita (relative to the peer group).

Figure 1. Norway: Insurance Activity

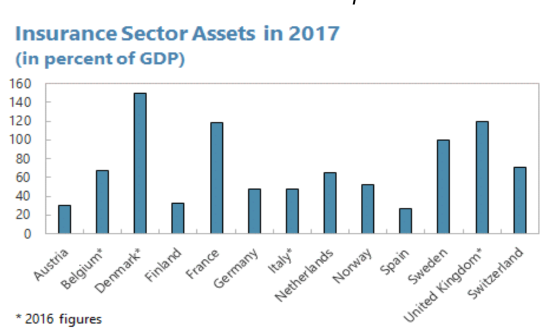
Premium revenue is comparatively low in comparison to European peers



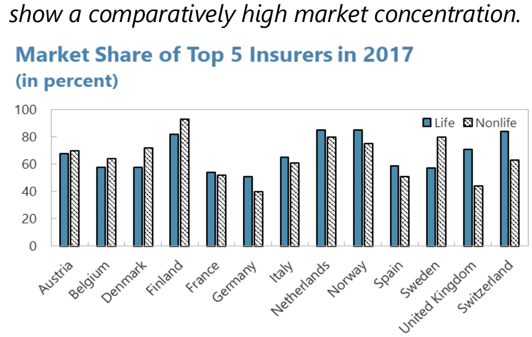
The situation is more nuanced when comparing premiums per capita across Europe



With around 50 percent of GDP, insurance sector assets are less than in several other European countries.



Both the life and nonlife insurance sectors in Norway show a comparatively high market concentration.



Source: Insurance Europe, European Insurance Industry Database, World Bank, - Nonbank financial database.

6. The Norwegian insurance market is characterized by comparatively high concentration. In 2018, there were 18 insurers that provided life insurance products; 12 of which are pure life insurers. The other six insurers are nonlife insurers that provide risk products with lump sum payments but have a very small market share. In terms of total assets, the largest five life insurers represent almost 92 percent of the market. In terms of gross written premiums, they represent around 85 percent. The nonlife sector consisted of 67 insurers at the end of 2018 but also shows similarly high concentration, if one includes the two large foreign insurance branches, Tryg and If. These two branches cover about 34 percent of the market.

7. In Norway, no stand-alone reinsurance companies exist. Some of the large nonlife insurance undertakings are providing reinsurance for Norwegian insurers, mainly related to fire insurance.

8. The Norwegian insurance market is dominated by financial conglomerates, i.e., financial groups that offer their services in multiple financial sectors. There are five Norwegian financial conglomerates, two of which are insurance led conglomerates, Storebrand and Kommunal Landspensjonskasse (KLP), and three are bank-led, Jernbanepersonalets bank og forsikring (JBF), Eika Gruppen and DNB. In addition, two Norwegian insurance companies Nordea Liv (life) and Danica Pensjon (life) are parts of foreign financial conglomerates, headed by the Finnish Nordea Bank and the Danish Danske Bank, respectively. Together, financial conglomerates represent slightly more than 93 percent of total assets of the life insurance sector or around 52 percent of total assets of the nonlife insurance sector.

9. Life insurance business in Norway is dominated by group pension products. Private and municipal group pensions together cover about 82 percent of total written premiums; or 38 and 44 percent respectively. While in 2014, gross written premiums for defined benefit schemes in the private sector was similar to defined contributions, the share of defined contribution schemes has increased substantially since then. They now account for more than three quarters of the premiums. But in terms of insurance liabilities, the situation still looks different. Defined benefit schemes cover about 60 percent of insurance liabilities; down from 74 percent in 2014. The next largest product type in the life insurance sector is individual endowment policies with death and disability benefits, covering about 12 percent of total written premiums. The remaining seven percent of the market are shared by personal pensions and group life products.

10. Life insurance liabilities are mainly comprised of profit participation products, including defined benefit pensions and paid-up policies. These made up 49 percent of life insurance premiums or 77 percent of insurance liabilities in 2018 but are not sold anymore. While the obligations for defined benefit schemes are decreasing, the proportion of obligations for paid-up pensions have increased. This is largely a consequence of the fact that paid-up policies are issued when companies close their defined benefit plans and move into defined contributions.

Table 2. Norway: Number of Norwegian Insurance Companies and Market Concentration

The number of insurers has been stable in Norway over the last years. One nonlife insurer entered the market. One life insurer was transferred into public administration, three mergers took place in the nonlife sector.

Number of Insurers (year-end)

	2014	2015	2016	2017	2018
Life	19	19	19	19	18
Non-life	69	68	69	69	67
Reinsurance	0	0	0	0	0
Captives	12	11	11	10	10
Total	**100**	**98**	**99**	**98**	**95**

Both life and nonlife insurance sectors are highly concentrated. Many of these insurers belong to a Norwegian or Nordic financial conglomerate.

Life Sector - Largest Solo Entities

	Name of solo entity	Total Assets (in NOK millions)	% of life sector
1	Kommunal Landspensjonskasse gjensidig forsikringsselskap	564,982	36.3
2	Storebrand Livsforsikring	327,813	21.0
3	DNB Livsforsikring AS	321,517	20.6
4	Livsforsikringsselskapet Nordea Liv Norge AS	121,451	7.8
5	Oslo Pensjonsforsikring AS	96,667	6.2
6	Sparebank 1 Forsikring AS	58,515	3.8
7	Gjensidige Pensjonsforsikring AS	32,415	2.1
8	Danica Pensjonsforsikring AS	18,630	1.2
9	KLP Bedriftspensjon AS	5,614	0.4
10	Nordnet Livsforsikring AS	5,580	0.4

Non-Life Sector - Largest Solo Entities

	Name of solo entity	Total Assets (in NOK millions)	% of non-life sector
1	Gjensidige Forsikring ASA	61,999	37.99
2	Equinor Insurance AS	27,179	16.66
3	Protector Forsikring ASA	12,742	7.81
4	Sparebank 1 Skadeforsikring AS	11,193	6.86
5	Den Norske Krigsforsikring for Skib Gjensidig forening	7,678	4.71
6	Norwegian Hull Club Gjensidig Assuranseforening	5,479	3.36
7	Eika Forsikring AS	4,960	3.04
8	KLP Skadeforsikring AS	4,254	2.61
9	Frende Skadeforsikring AS	3,161	1.94
10	DNB Forsikring AS	2,852	1.75

Source: Finanstilsynet.

11. **Unit-linked and index-linked products are growing rapidly.** Gross premiums written for unit-linked and index-linked business have increased by 23.6 percent since 2016 (compared to an increase of about eight percent for with profit business in the same period) and represented 42 percent of total written premiums. Health insurance represents six percent of total written premiums.

12. **Norway's nonlife insurance business is dominated by fire, motor (motor vehicle liability and other motor insurance) and marine, aviation and transport insurance.** Together they cover 74 percent of total written premiums in 2018 (76 percent in 2016).

Table 3. Norway: Premium Income

Nonlife: Gross Premiums Written in NOK thousands, 2018

Line of Business	Gross Written Premiums (in NOK thousands)	% of nonlife sector
Fire and other damage to property insurance	17,612,907	31.68
Other motor insurance	10,211,659	18.37
Marine, aviation and transport insurance	7,569,117	13.61
Motor vehicle liability insurance	5,872,435	10.56
Income protection insurance	3,835,808	6.90
Assistance	2,534,718	4.56
Workers' compensation insurance	2,349,552	4.23
Medical expense insurance	1,868,796	3.36
Miscellaneous financial loss	1,802,217	3.24
General liability insurance	1,307,416	2.35
Legal expenses insurance	540,966	0.97
Credit and suretyship insurance	97,680	0.18

Life: Gross premiums written in NOK thousands, 2018

Line of Business	Gross Written Premiums (in NOK thousands)	% of life sector
Insurance with profit participation	51,990,685	48.63
Index-linked and unit-linked insurance	45,312,158	42.39
Health insurance	6,540,045	6.12
Other life insurance	3,058,546	2.86

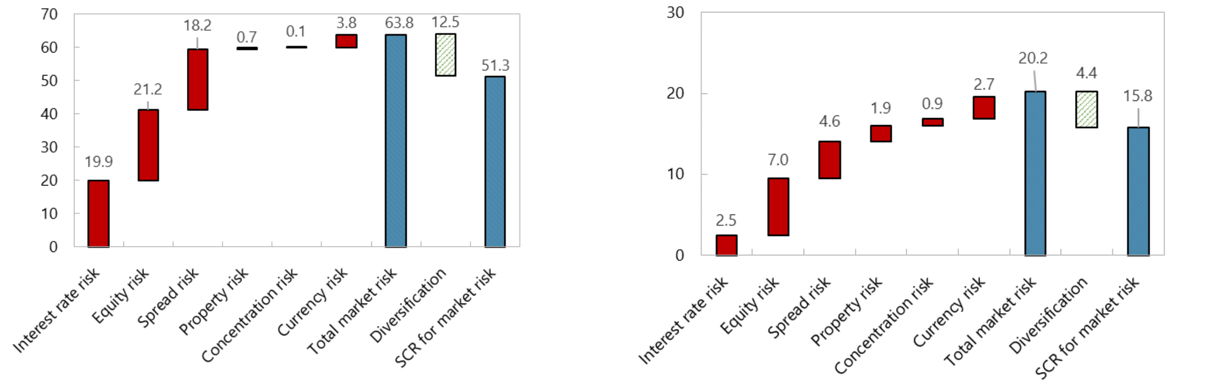
Source: Finanstilsynet.

13. **Norwegian insurers are important financial market players, but their investments reflect the particularities of a comparatively small capital market.** The small size of the capital market is reflected in the insurers' asset allocation, which shows on average lower investments in government bonds in comparison to other European jurisdictions but considerable investments in equities and mortgages and loans. Around 61 percent of total investments are made in bonds. Equities (22 percent) and loans and mortgages (10 percent) are the other main investments. Three quarters of Norwegian bond investments are in corporate bonds. Bonds with longer maturities are mainly issued in foreign markets. In comparison, on a European average, the share of government bonds to corporate bonds is about 50:50.

14. **Although direct investments in property are comparatively low with 0.5 percent of total investments, property exposure nevertheless is one of the highest in Europe.** The property investments primarily comprise property-related equities managed through subsidiaries and related undertakings. A large proportion is also in bonds issued by property companies. Loans also constitute a significant share.

Figure 2. Norway: Market Risk Exposure Expressed as Capital Requirement

Market Risk Life (In billions of NOK) | **Market Risk non-Life** (In billions of NOK)



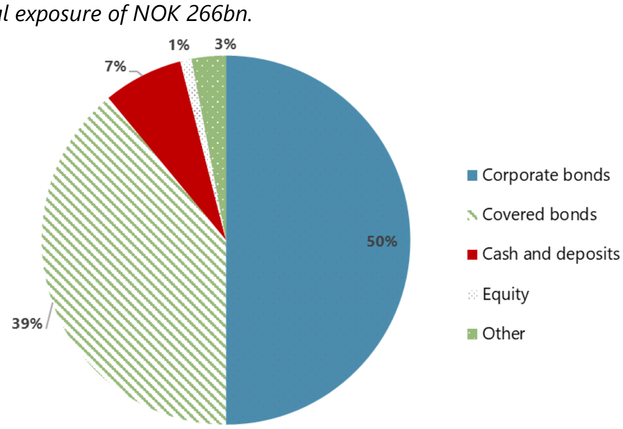
Source: Finanstilsynet.

15. Norwegian insurers' asset side exposure to banks is significant relative to most other EEA peers. In 2018, it represented more than 20 percent of total investments and also represents a significant but stable funding source for banks. To a limited extent, these are intra-conglomerate exposures. The level of bank exposure puts Norway on the upper end of the third quartile of EU and EEA member countries, according to the financial stability report published by the EIOPA in June 2019. The exposure can be broken down into deposits, equity, fixed income securities, consisting mainly of corporate and covered bonds, and a small category of other investments. The main exposure is in bonds (90 percent for life insurers and 82 percent for nonlife insurers). Deposits represent about eight percent in life insurance and seven percent in nonlife. Undertakings for collective investments in transferable securities (UCITS), which are 9 percent of nonlife insurers' exposure to banks, play a negligible role for life insurers and overall.

16. However, bank's direct exposures to insurers are negligible. Only about 0.01 percent of banks' total loans are to insurance companies. 0.14 percent of banks' investments in securities are in insurance companies.

Figure 3. Norway: Insurers' Exposure to Banking Sector

The majority of the exposure towards the banking sector is in the form of corporate and covered bonds. Together they cover 89 percent of the total exposure of NOK 266bn.



Source: Finanstilsynet.

17. Limited investment opportunities in Norway require considerable diversification into other currencies. Foreign currency exposures make up 16 percent of overall exposures, 40 percent thereof being in U.S. dollars. Most of these foreign exposures are in fixed income assets. Due to the lack of long-dated Norwegian securities, foreign currency assets are used to support insurers' asset-liability-management policy. To hedge against currency risk, Norwegian insurers use derivatives, thus keeping the currency exposure comparatively limited (cf. Figure 2). They face roll-over risks as the derivatives have typically maturities of one to three months but a considerable share of foreign denominated assets is of long maturity (cf. Figure 4). In the first quarter of 2019, the notional amount of derivative contracts by all insurers was NOK 744 billion, almost 80 percent of the underlying assets were in foreign currency. Most of the remainder were interest rates derivatives. Only one insurer reported FX swap exposure to a related bank. In all other cases, the bank counterparties were not related entities.

18. Norwegian insurers' capital resources are characterized by a comparatively higher portion of lower quality capital. Norwegian insurers have a higher share of tier 2 capital than insurers in other EEA countries. Tier 2 capital is either not available or cannot be called upon to fully absorb losses in a going concern basis. But it is available in the case of winding-up to absorb losses until all other obligations are met. In the Norwegian case, it includes the risk equalization reserve and natural damage capital. A considerable share belongs to subordinated loans, whose amounts have increased in the period prior and after the introduction of Solvency II. The issuance is linked to a capital optimization strategy, given the lower cost of debt. In other words, insurers intend to reduce the overall cost of capital by issuing subordinated debt with an interest rate that is lower than their target return on equity.

C. Risks and Vulnerabilities

19. The prolonged low interest rate environment remains a challenge, particularly for life insurers with paid-up policies. In 2008, for occupational pension schemes, profit sharing in arrears was replaced by a premium paid in advance to cover costs and risk, including the interest rate guarantee. This return guarantee can be revised on an annual basis. However, the customer, i.e., the employer, has the option of terminating the scheme in order to switch to a defined contribution pension plan. In such a case, the obligations are converted into paid-up policies, where the insurer cannot charge for the interest rate guarantee. The significant increase of the paid-up policies in Norway are testament to the fact that existing private defined benefit schemes are increasingly being wound down. As profit-sharing was retained for paid-up policies, insurers receive up to 20 percent of the excess return. But this is of little value in a low interest rate environment.

20. Life insurers have either ceased to offer products with interest rate guarantees or considerably reduced the guaranteed rates. Unit and index-linked products have considerably increased over the years. Those products usually do not provide interest rate guarantees. A small share of unit linked products (two percent) guarantee no loss of capital, i.e., the policyholder receives at least his investment.

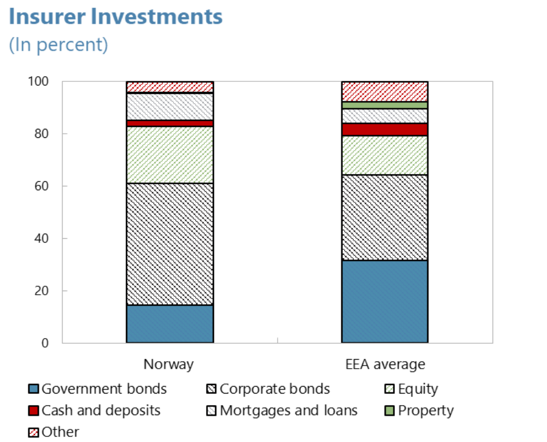
21. For some life insurers, the legacy business that carries interest guarantees still imposes a drain on profitability. Insurers with a high proportion of paid-up policies are particularly exposed to falling interest rates, as they cannot compensate for the fall in interest rates by charging higher premiums. More than 50 percent of products with an interest rate guarantee are provided for life. EIOPA[2] estimates the average time period, for which the interest rate guarantee applies is about 23 years for products in run-off. For products that are still sold, the average guarantee is considerably lower. The guarantee for commercialized business is about 1.8 percent in comparison to about 2.7 percent for all products. At the end of 2018, the average guaranteed rate of return in the collective portfolio was 2.6 percent for life insurers. The book return in the collective portfolio, which will cover the annual guaranteed rate of return, was 3.6 percent in 2018, which is slightly lower than in 2017.

22. There is a relative shortage of longer-dated assets in Norway to back long-term liabilities. The tenure of (sufficiently liquid) fixed income assets in Norway is considerably shorter than the average duration of liabilities for insurers, particularly life insurers providing pension products. It is typically less than five years, while the life insurance obligations are on average 15 years. As a consequence, life insurers face considerable asset liability mismatches, making them particularly vulnerable to reinvestment risk but also to interest risk more in general. Investments in foreign long-term fixed income securities can partly compensate for the duration gap but incur currency risk. An increase of interest rates from 2017 to 2018, led to a moderation of interest rate risk. But interest rates remain at a low level. The trend from defined benefit to defined contribution private group pension contracts will reduce the exposure to the duration gap in the long run.

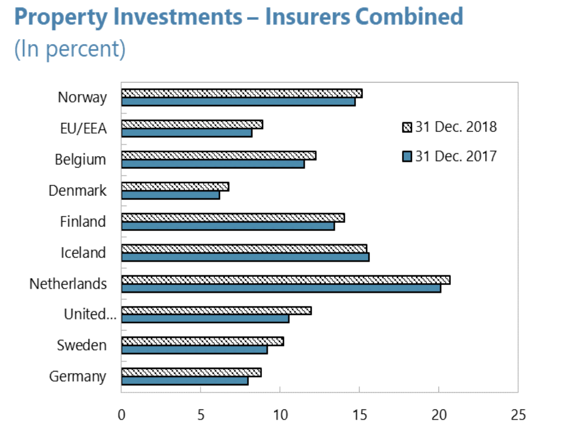
[2] Cf. EIOPA (2018): Report on long-term guarantees measures and measures on equity risk 2018, available under: https://eiopa.europa.eu/Publications/Reports/2018-12-18%20_LTG%20AnnualReport2018.pdf

Figure 4. Norway: Insurers' Investments

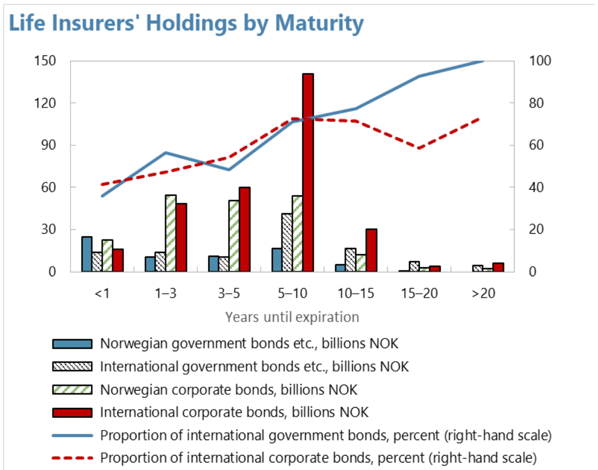
Norwegian insurers' investments are characterized by high shares of corporate bonds, equities and mortgages and loans.



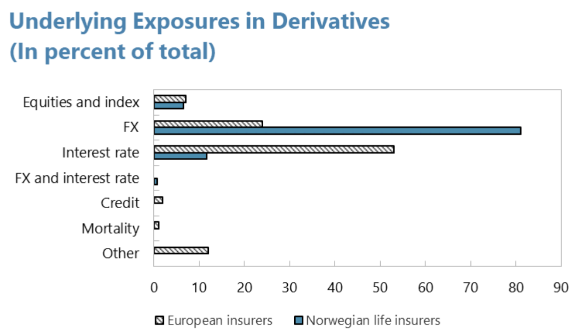
Although direct investments in properties are low, property exposure is comparatively high, mainly due to related equity investments.



Norwegian insurers' foreign currency exposure in their bond holding is determined by the shortage of longer-dated Norwegian bonds.



Derivatives mainly serve the purpose of mitigating foreign currency exposure.

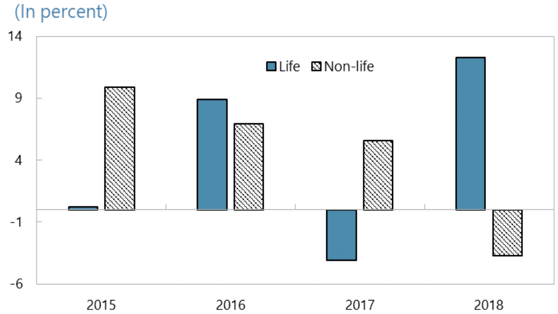


Source: EIOPA, Financial Stability Report, June 2019; Finanstilsynet, risk outlook December 2018.

Figure 5. Norway: Profitability Indicators for the Insurance Sector

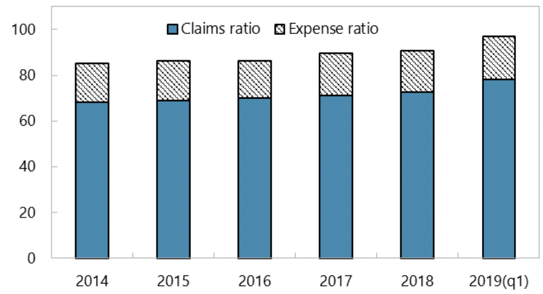
Insurance premiums have grown by about 18 percent for life and 19.5 percent for nonlife since 2014. But growth rates have been volatile over the years.

Change in Gross Written Premiums
(In percent)



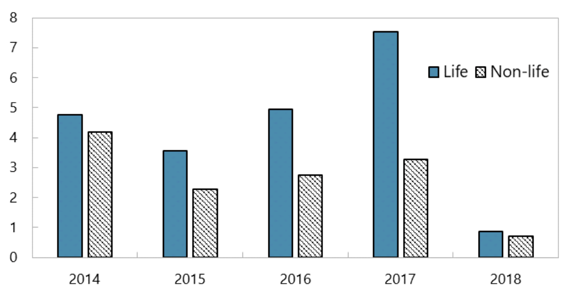
Combined ratios have been increasing over the last few years, thus reducing underwriting profits.

Combined Ratios
(In percent)



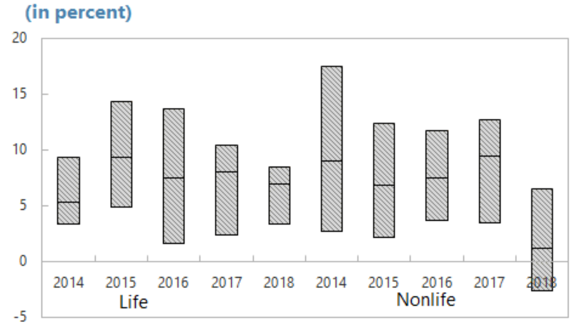
Investment yields have been consistently higher in life insurance than in nonlife insurance. With the exception of 2018 life insurers' average investment yield has been higher than the average guaranteed rate.

Investment Yield
(In percent)



The interquartile range shows that RoEs vary substantially across insurers.

Return on Equity
(in percent)



Source: Finanstilsynet.

23. Nonlife insurance, being mostly short-tailed business, is less affected by the low interest rate environment in terms of a duration mismatch between assets and liabilities. The return on their investment portfolio has been low over the last few years but their underwriting profitability is healthy. Combined ratios have increased somewhat over the years and stood at 90 percent in 2018. The latest figures of the third quarter of 2019 show a combined ratio of 92 percent. The share of losses to expenses in this ratio is about four to one. The market average masks, however, that there is a considerable number of mostly smaller nonlife insurers that make an underwriting loss. The FSA's June 2019 risk outlook highlights that a number of nonlife insurers made extensive weather-related claims payments. At the same time, investment yields have fallen from 4.2 percent in 2014 to 0.7 percent in 2018. Investment yields have been consistently below the yields earned by life insurers.

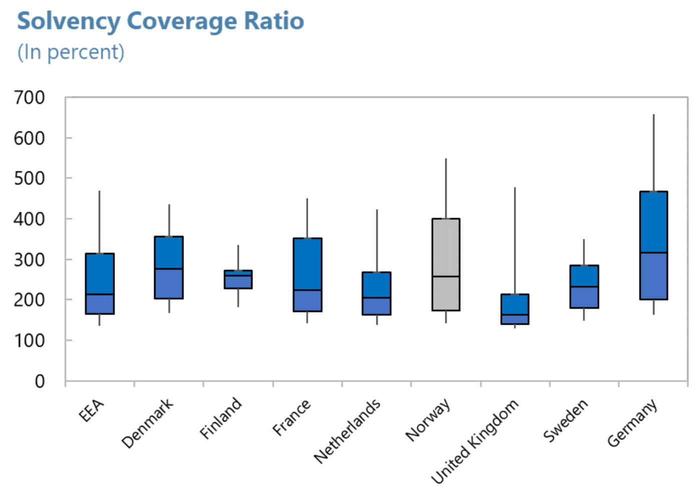
24. Eligible own funds (EoF) clearly exceed the solvency capital requirement (SCR). This ratio has increased over the last years. According to the FSA the ratio has been bolstered through the accumulation of reserves through profit retention, aligning investment risk to their risk-bearing capacity, and increasing capital (including subordinated loans). Nevertheless, the ratio varies substantially across undertakings. Including the long-term guarantees (LTG) measures (cf. Box 1), which are applied by some life insurers, on average, the solvency coverage ratio stands at 219 percent (225 percent for life insurers and 208 percent for nonlife insurers). The lower 25th percentile still reaches a ratio of 184 percent.

25. Norwegian insurers are well-capitalized now. The SCR ratio measured relative to only unrestricted tier 1 is at 179 percent. Under current conditions, they do not have to resort to their tier 2 capital with lower loss absorbency to cover regulatory solvency requirements. It is noted though that the share of subordinated debt has been increasing over the last years, thus reducing the loss absorption in stressed scenarios.

26. However, solvency coverage ratios are considerably lower without the application of transitional measures and the application of a discount rate adjustment for insurance liabilities. This is a consequence of the generally lower technical provisions and capital requirements that result from the application of the so-called LTG measures (see Box 1). Currently, six insurers apply the transitional measure on technical provisions (TTP); a measure that allows a gradual adjustment to the higher technical provisions under Solvency II. In terms of market share, this corresponds to around 90 percent of all Solvency II technical provisions in Norway. The volatility adjustment to the discount rate is applied by eight life insurers, with a similar share of technical provisions (for details on the role and mechanics of those measures refer to Box 1). Those two measures are not mutually exclusive. Not applying the TTP means that the overall SCR ratio falls to 208 percent from 226 percent in 2018. Without the application of the volatility adjustment, the overall solvency ratio for all insurers at end 2018 would fall further from 208 percent to 181 percent. The possible effect, however, varies at different times. Furthermore, the maximum deduction that can be applied to the difference between Solvency II and Solvency I technical provisions is gradually reduced and will be zero in 2032.

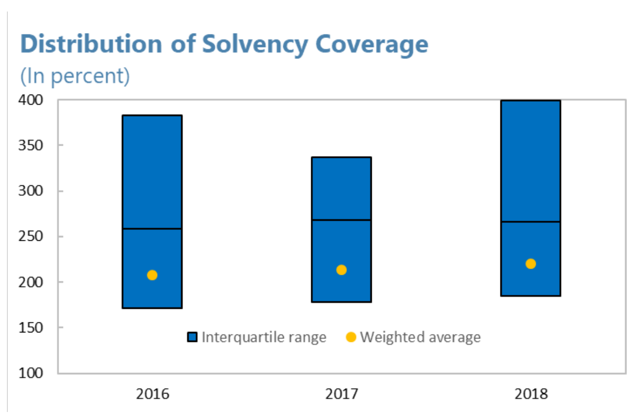
Figure 6. Norway: Solvency Coverage Ratio

The box plots show the solvency coverage ratios (including long-term guarantees measures) for Norway and several per countries and the EEA average. The whiskers represent the 10th and 90th percentile respectively. The boxes represent the interquartile range and the line represents the mean. Insurers tend to be well capitalized, but the dispersion is high.



Source: Finanstilsynet Risk Outlook June 2019, based on EIOPA data.

Several insurers have strengthened their solvency position over the last years. The weighted average solvency coverage ratio has increased from 208 to 221 percent. The 25th percentile has increased by 13.3 percentage points and was at 184.6 percent in 2018. The median was at 265.9 percent, up by 7.5 percentage points.



Source: Finanstilsynet data.

Box 1. Long-Term Guarantees Measures

The LTG measures were introduced in the Solvency II Directive[1] through the Omnibus II Directive.[2] Specifically, the aim is to smooth the impact of short-term volatility in financial markets on insurers' balance sheets, to smooth the transition from Solvency I to Solvency II and to allow for flexible supervisory actions in exceptional adverse circumstances. Those measures have been introduced as a response to the findings of quantitative impact studies in the run-up to Solvency II. They showed a significant number of insurers undercapitalized without the application of these measures.

The LTG measures mainly consist of measures that adjust the calculation of the technical provisions under Solvency II. But the changes to technical provisions can also have an impact on other items of the balance sheet and on the capital requirements and own funds.

Six Norwegian insurers currently apply the transitional on technical provisions (TTP) and eight insurers apply the volatility adjustment (VA). The application of the transitional measures, the volatility adjustment and the matching adjustment is optional, subject to conditions laid out in the Solvency II Directive and Regulations. As these measures have mainly been designed for long-term products, they are mostly applied by life insurers. The two measures are not mutually exclusive and in fact, those Norwegian insurers that apply the TTP, use both measures. Originally, eight insurers applied for the application of the transitional. The number has fallen because the transitional had no effect on some of these insurers' technical provisions, i.e., the new requirements under Solvency II were lower than the Solvency I requirements.

Transitional measure on technical provisions: For a period of 16 years after the start of Solvency II, insurers may apply the TTP. Under this measure, insurers apply a transitional deduction to the technical provisions for their insurance and reinsurance obligations. This deduction is based on the difference between the technical provisions under Solvency I and the technical provisions under Solvency II. The maximum portion of the adjustment is decreasing linearly over the transition period. At year-end 2016, the maximum portion that could be applied was 100 percent, in 2018 it would have been 87.5 percent. The TTP requires supervisory approval and can be set at lower levels than the maximum permissible. Insurers that are reliant on the TTP to cover the SCR are required to submit a phasing-in plan, including different options such as retaining profits, ceasing or reducing the amount of new business written, reducing expenses, raising additional capital, etc. These phasing-in plans need to be followed by progress reports.

Volatility adjustment: Recital 32 of the Omnibus II Directive states that in order to prevent pro-cyclical investment behavior, insurance and reinsurance undertakings should be allowed to adjust the relevant risk-free interest rate term structure to mitigate the effect of over-stated bond spreads. For that purpose, insurers can apply a volatility adjustment to the risk-free term structure. The VA is based on 65 percent of the risk-corrected spread between the interest rate that could be earned from a reference portfolio of assets and the risk-free interest rates without any adjustment. The reference portfolio is representative for the assets which insurers are invested in to cover their insurance obligations. The VA is derived per currency. In July 2019, the VA was 38 basis points (bp) for the Norwegian kroner, compared to 6bp for the euro or 19bp for the British pound. The comparatively high figure, which is used for adjusting the risk-free term structure, is the result of comparatively high investments in corporate bonds relative to government bonds in Norway.

Box 1. Long-Term Guarantees Measures (Concluded)

The Solvency II Directive requires EIOPA to review the LTG measures (and measures on equity risk) until January 1, 2021. Annual reports on the impact of these measures are sent to the European Parliament, Council and Commission and are made publicly available on the EIOPA website.

National supervisory authorities are required to provide the following information to EIOPA on an annual basis:

- the availability of long-term guarantees in insurance products and the behavior of insurers as long-term investors;
- the number of insurers applying the measures;
- the impact on the financial position and investment behavior; and
- compliance with phasing-in for those insurers that apply the transitional measures.

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[1] Directive 2009/138/EC of November 25, 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, December 17, 2019.

[2] Directive 2014/51/EU of the European Parliament and the Council of April 16, 2014 amending Directives 2003/71/EC and 2009/138/EC And Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority), OJ L153, May 22, 2014.

27. **Another strain on reserves results from the growing life expectancy.** According to World Bank world development indicator statistics, life expectancy at birth in Norway was 84.2 for females and 80.9 for males, which is one of the highest life expectancies in the world, similar to the other Nordic countries. It has also increased substantially over the years, growing by 1.5 years for females and 2.7 years for males over the last ten years. New mortality tables were introduced from 2008 but were soon regarded as insufficient. In 2013, new, dynamic, mortality tariffs were therefore worked out. Pension institutions were permitted to devote policyholder surpluses to meeting up to 80 percent of the increased need for provisioning and to apply for a provisioning period of seven years. Pension institutions' provisioning is now generally in line with the mortality basis established in 2013.

28. **Life insurance policies can be surrendered with a time restraint of more than one month.** No penalties are applied to those surrenders. Over the previous years, surrender rates in life insurance have been modest; around one percent in terms of volume. Liquidity risk arises as a result of an imbalance between liquidity sources and needs. Norwegian insurers' considerable investments in loans and mortgages increases the exposure to liquidity risk in stressed conditions but the time restraint for policy surrenders mitigates the risk.

29. **Norway's exposure to climate-related physical risk has been small in comparison to most other countries but risks are increasing.** Climate risk is particularly relevant for nonlife insurer, life insurers are mostly exposed through their investments in properties. The cumulated reserves in the Natural Perils Pool amount to three to four times the largest yearly claims costs (adjusted for inflation) related to natural catastrophes experienced over the last 30 to 35 years. To address climate related risks, the FSA engages in various initiatives, e.g., it set up a cross-sectoral

group to build competence on climate risk and its review of insurers' Own Risk and Solvency Assessment reports has a special focus on companies' assessment of climate related risks in 2019.

D. Overview—Institutional Setting

30. The Financial Supervision Act identifies Finanstilsynet as the integrated supervisor for the Norwegian financial market; covering a wide array of regulatory responsibilities. Finanstilsynet (FSA) is responsible for the supervision of banks, finance companies, mortgage companies, insurance companies, pension funds, investment firms, securities fund management and market conduct in the securities market, stock exchanges and authorized market places, settlement centers and securities registers, estate agencies, debt collection agencies, external accountants and auditors. The Ministry of Finance (MoF) supervises the Public Service Pension Fund[3] (Statens Pensionskasse) for public sector employees, the pension scheme for pharmacists (Pensjonsordning for apotekvirksomhet), a contractual early retirement pension scheme and a pension scheme for medical practitioners (Sykehjelps- og pensjonsordning for leger).

31. The FSA is governed by a Board of five members, which is appointed by the MoF for a period of four years. It consists of a chairman, a vice-chairman and three members; not including two alternates. The Norges Bank has an observer on the Board, who is entitled to speak but not to vote. The observer (and the alternate) are appointed for a period of four years by the ministry following a proposal by the Norges Bank. Two members are elected by and from among the employees to supplement the Board when it deals with administrative business.

32. The day-to-day management is in the hands of the Director General, who is appointed by the King in Council for a period of six years at a time. The Director General confers with a management team consisting of the directors of the supervisory departments and the Administration Department, the General Counsel and the Communications Director. The three supervisory departments are organized into a banking and insurance supervision department, a capital market supervision department and a digitalization and analysis department.

33. Section 3 of the Financial Supervision Act clearly identifies the FSA's objectives. It requires the FSA to ensure that the institutions it supervises operate in an appropriate and proper manner in accordance with law and provisions laid down pursuant to law and with the intentions underlying the establishment of the institution, its purpose and articles of association. It shall ensure that the institutions it supervises attend to consumer interests and rights in their activities.

34. Financial stability is identified as a purpose in the Financial Institutions Act. In addition, the FSA's mission, as presented on the website, explicitly says: "Through its supervision of enterprises and markets, Finanstilsynet strives to promote financial stability and orderly market conditions and to instill confidence that financial contracts will be honored and services performed as intended."

[3] The Public Service Pension Fund consists of 1,089,000 members, including active members, deferred members and beneficiaries. It is financed through annual state budget. It is the main provider of public occupational pensions.

35. The guarantee scheme for nonlife insurance is a legal entity in its own right. It is mainly regulated in the Financial Institutions Act, chapter 20A and further substantiated in the Financial Institutions Regulations. The Guarantee Scheme is headed by a board of directors consisting of five members with personal deputies, all of which are appointed by the MoF. The FSA provides the secretariat to the board of directors. Insurance undertakings, which are granted a license to carry on direct nonlife insurance in Norway must be members of the guarantee scheme. This includes Norwegian branches of a nonlife insurance undertaking with head offices in another EEA member state, unless the undertaking is a member of a guarantee scheme in its home state and the branch provides evidence that the scheme covers insurances coming under the Norwegian guarantee scheme to virtually the same extent. Life insurers have no guarantee scheme (life insurer resolution is covered in more detail in a later section).

REGULATORY AND SUPERVISORY OVERSIGHT

A. Supervisory Powers, Independence, and Resources

36. In constitutional terms, the FSA is part of the MoF. It acts under delegated authority from the ministry and as such is not an independent authority even if in the normal course of events it can be considered operationally autonomous. There have been cases where the MoF overruled decisions taken by the FSA. One recent example in insurance relates to a case where the authorities disagreed on the question of granting a delay to becoming Solvency II compliant for a particular company. Another previous example dates back to pre-Solvency II regulation. Under the previous regulation, the FSA set the maximum guaranteed rate that pension providers can accept and consequently use in the calculation of premiums and insurance provisions. After 2011, the FSA consistently reduced the maximum guaranteed rate with considerable resistance from the industry. In 2013 the Ministry of Finance overruled the FSA's decision due to pending other regulatory processes in the pension area.

37. The MoF issues prudential regulations and keeps responsibility for certain tasks considered of importance. These responsibilities include in particular the licensing and withdrawal of licenses, the transfer of a company's insurance portfolio and some other nonstandard supervisory decisions. The FSA is responsible for day to day supervision. The MoF sets goals for the FSA and may give operational instructions. As the ministry retains overall responsibility for financial market regulation, the division of duties is not always entirely transparent, specifically as the FSA generally acts under delegated authority.

38. The FSA issues circulars that provide guidance on financial services regulation. The decision to issue a circular may arise from different circumstances. In addition to providing guidance to a new law or regulations, it may also result from findings in the FSA's supervisory activities.

39. Formal decisions of the FSA can be appealed to the MoF and ultimately to the court. This set-up and the fact that the MoF is ultimately making the final decisions may create an environment where stakeholders could potentially try to leverage off perceived differences in positions between the two authorities.

40. The FSA's budget is approved by Parliament but financed through levies to the supervised institutions. The Parliament can set limits on total resources as part of total government budget. The apportionment of the overall levy among the various institutional groups is based on budgeted expenditure for the year and follows detailed rules set out in regulations on the levying of expenses for supervision. The levying is carried out by the FSA. The MoF can allocate FSA resources to specific projects, thereby affecting the resources that are available for supervisory purposes, given budget constraints.

41. Compared to other regulators, the turnover overall is generally relatively low. In 2018, the FSA had 302 employees, including short-term appointments. An equivalent of 40 full time staff is allocated to insurance. According to the 2018 annual report, overall staff turnover was comparatively low at 6.8 percent, down from 9.4 percent in 2017 but in line with the years before. The turnover is considerably lower than in several other peer countries but also in comparison with several Norwegian public agencies. As in other markets recruiting specialized staff, such as nonlife actuaries can be a challenge.

42. The Civil Service Act provides FSA employees with legal protection for any action in good faith. Any compensation claims by third parties must be aimed at the FSA and not directly against the employees, meaning the FSA is liable for the actions of its employees.

Recommendations

43. The formal autonomy of the FSA should be strengthened. In particular, the FSA should be given powers to issue binding regulations. In addition, the powers given to the MoF to issue instructions and decide on appeals to supervisory decisions should be removed since they could impair the ability of the FSA to effectively fulfill its supervisory mandate.

44. The FSA should also get more autonomy in determining its budget. The supervisory levies that already determine the budget of the FSA should be charged directly by the FSA.

B. Capital and Investment

45. As a Member of the EEA, Norway's financial sector rules are closely aligned with norms of the European Union. The EU legislation in the financial area is incorporated into the EEA Agreement and implemented in Norwegian laws or regulations. The Solvency II Directive[4] was transposed into the Financial Institutions Act, effective from January 1, 2016. Solvency II is a

[4] For a detailed description of the workings of the Solvency II regulation and in particular the calculation of the SCR, refer to the 2018 Technical Note on Insurance, Investment Firm, and Macroprudential Oversight for the euro area (IMF Country Report No. 18/23). Norwegian insurers apply the standard formula for the calculation of the SCR. However, two nonlife insurers apply a partial internal model.

maximum harmonization directive, which does not leave much room for national discretion for insurance regulation.

46. When the delegated regulation 2015/35, which supplements the Solvency II Directive, was incorporated into the EEA agreement, two material adaptations were made. The first adaptation allows the supervisory authority to determine that exposures to unrated regional governments and local authorities shall be treated as exposures with a one-step lower credit quality step than the credit quality step assigned to the rating of the central government of the jurisdiction in which they are established. The second adaptation allows the supervisory authority to set a higher value than zero as a floor for the loss-given-default. The intention is to ensure an overall capital charge for the mortgage loan exposure in line with the capital charge for such exposures held by credit institutions, as stipulated in Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

47. Pension funds are subject to a new national solvency requirement from January 1, 2019. As the revised Institutions for Occupational Retirement Provision (IORPs) Directive (Directive (EU) 2016/2341) is a minimum harmonization directive, it allows a stricter transposition into Norwegian law. In Norway, the requirement is a simplified version of Solvency II, based on former specifications of stress tests for pension funds in Norway. Examples for adjustments to Solvency II are simplified risk modules and the waiving of the requirement to use stochastic simulation to calculate technical provisions and the reporting requirements. But with this reform, the capital requirements in Norway are now largely aligned with those for life insurers. Whether the simplifications may lead to an unlevel playing field in the long term, needs to be monitored. But currently life insurers do not see pension funds as competitors in their market.

48. Several of the mainly larger institutions apply adjustments to the technical provisions, permitted under Solvency II, the so called LTG measures (cf. Box 1). Typically, those measures lead to higher solvency ratios. But they entail a number of risk management requirements, such as the setting up of a liquidity plan or sensitivity assessments when using the VA. Until 2021, EIOPA annually assesses the use of the LTG measures, inter alia, to analyze any differences in behavior of those insurers that apply them. The application is discretionary for both the VA and TTP but the TTP is subject to supervisory approval. In contrast, the application of the VA, which is a permanent measure, does not require supervisory approval. The VA is generally relatively high in Norway. This is the result of Norwegian insurers' higher share of corporate bonds as part of their fixed income investments. As the market is very concentrated, the largest firms through their size influence the country-specific portfolio, which determines the volatility adjustment.

49. So far, the FSA has not experienced any differences in investment behavior and product design between insurers that apply LTG measures and transitional. The FSA expects the undertakings to establish capital targets based on the solvency ratio without transitional rules and apply those targets in their risk management system. Discussions with industry participants indicate that own intervention levels are generally determined based on solvency levels calculated without the allowed adjustments.

50. With regard to investments, Solvency II takes a principles-based approach. No explicit restrictions or limits are applied. Investments should follow the prudent person principle, which states that the insurer shall only invest in assets and instruments whose risks it can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs. Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the insurance liabilities.

51. In on-site inspections, the FSA's main focus is on the system of governance when assessing insurers' asset management. They assess insurers' strategy and policies, the organization and responsibilities, the measurement of risk, the monitoring and reporting routines and the independent controls. Individual investments are generally not the focus of such inspections.

52. The FSA developed a supervisory module for market and credit risk, which it published on its website. It provides guidelines for the supervisory assessment of the risk management and control of market and credit risk. The assessment steps are based on legal requirements related to Solvency II, recommendations from EIOPA, relevant aspects of the ICPs on corporate governance and risk management and internal controls, as well as experience from supervision.

C. Supervisory Review and Reporting

53. The FSA takes a risk-based approach to supervision. At the core of the supervisory review process is the early warning system. It is informed by a risk and impact classification, which is essentially based on each institution's solvency coverage and the size of its business. The impact and the risk classifications consist of four steps, each. Step four is the highest classification. Based on the classification of the insurers, supervisory work is prioritized. The risk classification, essentially an insurer's solvency coverage determines whether any intervention is needed and what form it may take (increase of capital, dividend restrictions, etc.). At quarterly early warning meetings, representatives of the different involved units discuss the companies' situation and any needs for supervisory measures. These meetings are run separately for life, nonlife and pension funds.

54. The risk and the impact classification are the main determinant for the inspection program. The date of the last inspection and complaints on the institution are further determinants for the inspection program. Several units are involved in the supervision of insurance undertakings, but the unit for Insurance Supervision has the main responsibility, unless a thematic review takes place on a specialized topic, such as IT or money laundering, where the respective sections take the lead.

55. The main focus of the on-site inspection is the assessment of the system of governance. Risk and capitalization of an institution is to a larger degree assessed off-site. Determinants for the scope of the inspection include the early-warning system, the assessment of the responsible supervisor or the priorities of the supervisory plan.

56. There is no formally stated minimum frequency for on-site inspections, but important undertakings should normally be covered every second year. Importance is largely a function of market share within the life or nonlife insurance sector and as such size becomes the dominant determinant for the prioritization in the inspection program. At the end of 2018, three life insurers and one nonlife insurers fell into the highest impact category.

57. Typically, a total of 3–4 on-site inspections per year take place in life insurance, and due to the higher number of entities about twice as many in nonlife insurance. On-site inspections involve an extensive process over several months, starting with a detailed notification letter and ends with a final report. The process includes a meeting with the undertaking. The length of the meeting is a function of type and size of the institution. On-site inspections in smaller insurance companies are usually full inspections carried out over two days. On-site inspections in larger insurance companies are theme-based inspections, carried out in one or over two days. Based on the findings, the inspection team prepares a preliminary report. This preliminary report is sent to the Board for comments before it is concluded. The final report is sent to the Board, with a request for a copy of the minutes of the Board meeting, where the issues highlighted in the report are treated. In particular cases, the FSA may request status reports. Final reports covering the findings of the inspection are published on the FSA's website.

58. Regularly, the FSA undertakes thematic reviews. In the second half of 2016 and the first half of 2017, the focus was on the calculation and validation of technical provisions and capital requirements, including related systems of governance. In 2018, the FSA carried out a survey on information and advice provided to the members of defined contribution schemes and owners of pension capital certificates. In 2019, it will review all received ORSA (Own Risk and Solvency Assessment) reports, with a particular emphasis on insurers' capital targets and the assessment of climate risk.

59. The FSA has semi-annual meetings with the top management of the most important, i.e., largest, insurers. These meetings are separate from the on-site inspection program. In addition, the FSA can request ad-hoc meetings, when needed. At these meetings the insurers present their latest financial results and developments in key risk factors. In addition, updates are given on the markets in which the insurers operate, on organizational matters and on strategic issues at the individual insurer.

60. Desk-based, off-site supervision is risk based as well. That means that the analyses of the insurers within the highest impact category should be analyzed in more detail. However, these formal analyses have not been performed in the last two years. The starting point of the assessment is the detailed quarterly and annual Solvency II reporting. Other sources are the yearly ORSA and Solvency and Financial Condition reports. In addition, insurers are required to file quarterly accounting data. Customer complaints information is also collected from companies. If required, the FSA also has the power to request ad-hoc information from companies. The findings feed into the quarterly early warning reports for both life and nonlife insurance. As part of the established early warning system, representatives of various units meet at least quarterly to discuss, separately for life and nonlife, the undertakings' situation and any needs for supervisory measures.

61. Currently macroprudential surveillance and supervision in insurance plays a subordinated role. The FSA undertakes aggregate analyses of investment and other Solvency II data and publishes biannually its Risk Outlook. But supervision is focused to the largest extent on individual insurers and a system-wide view is still limited. Generally, the FSA follows developments at EIOPA but only takes little own initiatives with regard to macroprudential supervision.

62. The FSA participates in the bi-annual stress tests organized by EIOPA. In line with recital 42 of European regulation number 1094/2010 (regulation on the establishment of the European Insurance and Occupational Pensions Authority), EIOPA initiates and coordinates Union-wide stress tests to assess the resilience of financial institutions to adverse market developments. Since the introduction of Solvency II in 2016, Norway participates in these exercises with two to three of its largest insurers. EIOPA uses bottom-up stress tests to assess the resilience of the European industry against a number of pre-defined stress scenarios. The FSA does not run its own market-wide stress test exercises.

63. Section 4 of the Financial Supervision Act enables the FSA to take preventive or corrective actions. The FSA may (inter alia) order an institution to maintain a capital ratio in excess of the minimum, to rectify matters when there has been a breach of license conditions, a failure to comply with law, regulations or articles of association, or to rectify an inappropriate investment. If the FSA learns about payment difficulties at an institution, further powers apply. In consultation with the institution, the FSA clarifies any remedial actions. If such actions are not taken, the FSA may convene the general meeting at short notice, order an alteration of the governing bodies, implement the necessary measures, and require an audited statement of financial position. Further powers are conferred on the FSA when an entity is put under public administration (cf. section in this TN on resolution and insurance guarantee scheme).

64. Generally, the supervisory measures that the FSA has at its disposal appear adequate, but challenges may arise where the FSA's position diverges from the MoF. The different objectives of the two authorities may lead to supervisory action that may deviate from one that is purely taken on supervisory or prudential grounds (cf. section on supervisory powers, independence and resources).

65. The FSA issues quarterly press releases summarizing the results of the analyses undertaken. Overall assessments of the situation in the financial sector and of various risks faced by Norwegian financial institutions are published twice a year in the FSA's risk outlook.

Recommendations

66. Generally, early warning meetings and reports should be further strengthened, as they are the main determinants of the supervisory program. They ultimately affect the allocation of scarce supervisory resources. This can be achieved in a number of ways:

- Enhance the detail of the assessment that goes into the early warning report.

- Include regular data-based analysis as a standing item in the report and the meetings. This provides a complement to the more governance focused inspections and may identify potential weaknesses of individual firms or the entire sector. It may also give rise to thematic reviews.

- Expand the group perspective in the early warning reports.

67. The FSA should give a higher priority to desk-based analysis. The authority has access to highly granular regulatory and accounting information, which should be used to further inform the current risk/impact matrix that prioritizes the supervisory program and is tilted towards the size category. In this context, the early warning report should be enhanced by establishing a broader risk dashboard for key risks, such as market risk, credit risk, solvency, profitability and liquidity, which are analyzed across the whole sector, including both levels and trends of risks over time. Such a dashboard should also cover an assessment of the quality of risk management and governance processes in mitigating the aforementioned risks. The stronger focus on the probability side of risks should enhance a forward-looking, pre-emptive approach to supervision and make it less reactive. It should build on the work that is already being done in this field. Efficiency gains will be achieved by internalizing analysis that forms part of the reporting to EIOPA, such as the quarterly risk dashboard.

68. A specific focus in the regular supervisory program should be dedicated to aspects related to financial conglomerates and other cross-cutting aspects of insurers and banks. Most of the insurance business in Norway comes from entities within a group or financial conglomerate structure. Therefore, an additional focus should be on aspects such as group risk management, including group liquidity risk management, intra-group transactions and large exposures. Another aspect is the interconnectedness between banks and insurers through financial instruments holding (cf. Figure 3). EIOPA, in its December 2018 financial stability report, highlights the need to monitor potential increases in bail-in bonds, particularly non-preferred senior bonds in the future. These group-specific aspects can be organized within the current early warning framework or as a separate module.

69. The early warning reports should, at least on an annual basis, include an assessment of the insurance sector's exposure to macroeconomic shocks or general market movements. This assessment should also include analyses on insurance sector trends that could potentially result in externalities to the wider financial system and/or adversely impact the insurance sector. Such analyses may include the assessment of asset and liability concentrations with regard to specific counterparties, markets or sectors and the assessment of possible liquidity mismatches. Insurers have a significant exposure to the banking sector. With 20 percent of total investment, shocks in the banking sector could have a significant impact on the insurers. This is in line with the identified strategy, which, according to the FSA's 2018 annual report, will give special priority—inter alia—to macroprudential supervision during the strategy period 2019 to 2022 as part of its broader goal to promote financial stability and well-functioning markets. The current early warning reports, which inform supervisory decisions, have a microprudential focus.

70. The early warning reports should, at least once a year, include a detailed assessment of insurers' investment portfolio allocation. These assessments should cover levels and trends in asset allocation over time with the objective to monitor potential procyclicality and search for yield in insurers' investment choices. It can build on and consolidate information collected for other reports, such as the risk outlook.

71. The FSA should run its own focused, market-wide sensitivity or stress tests for insurers. These assessments should be run on a bi-annual basis and organized such that the timing does not overlap with EIOPA stress tests. EIOPA will generally test European-wide concerns, as such focuses predominantly on the largest institutions within a jurisdiction. In a concentrated insurance market like Norway, 2–3 participants will provide a good coverage of the market, but those firms may not necessarily be representative of the whole sector, as the large variation in SCR coverage ratios indicate. An FSA-run stress test can better take account of specificities of the Norwegian insurance market, such as the comparatively high equity and loan exposures or the high duration gap between liabilities and assets in life insurance, as described in the background section of this note. Stress tests are resource-intensive exercises for both the supervisor and the participating firms. It, therefore, makes sense to consider how best to coordinate or combine the assessment with other thematic reviews, which the FSA undertakes in a given year. The stress test could also be narrower than the EIOPA stress tests, focusing on a specific concern.

72. The FSA has a thorough on-site inspection process but should consider extending the duration of the on-site inspection meetings. This would allow for more detailed discussions of findings with both senior management and relevant experts. It is also recommended to follow up with the inspected entity after the inspection has concluded and the report has been published. On-site inspections involve an extensive process and detailed preparations on both sides. In this context, meetings that last less than two days appear too short to cover relevant aspects in sufficient detail and to allow for in-depth discussions with the relevant experts and responsible persons. In particular non-procedural aspects are better captured in detailed discussions than in written documentation. Without such in-depth discussions, there is a risk of the inspection becoming a high-level compliance exercise.

D. Corporate Governance, Risk Management, and Internal Controls

73. The Financial Institutions Act covers in detail the role of the general meeting, the structure of the Board of Directors and the duties of the individual members. Section 8 of the Act also covers the role and tasks of the general manager. These aspects are to a lesser degree covered in Solvency II. Risk management and internal controls requirements are covered in Solvency II. The Directive is transposed into the Financial Institutions Act and the corresponding delegated regulation (EU) 2015/35 is directly applicable. The FSA also applies EIOPA's guidelines on the system of governance and the ORSA

74. The supervision of governance structures, internal control systems and insurer's own risk management is a regular feature in the FSA's inspection program. Given the prominence of the system of governance in the overall on-site inspection, the FSA has published guidelines for the assessment. Typically, supervisors request and assess information on aspects, such as: the insurer's business and risk management strategy and related guidelines, the organization of the company, including the roles and reporting lines of the respective functions; in particular the internal audit, compliance, risk management and actuarial function, outsourcing, measurement and monitoring of risks and reporting. In addition, to the management and control of an insurer, the inspection also assesses the asset management and insurance operations, including the calculation and validation of technical provisions and capital requirements.

75. In their yearly ORSA, insurers are expected to assess—in a forward-looking manner—risks that are inadequately covered in statutory capital requirements. Specifically, insurers need to assess whether there is a need to set aside capital for any such risks. As part of this exercise, insurers are required to regularly perform stress tests/scenario analyses as an integral part of their risk management system. The FSA evaluates the ORSA reports. In its June 2019 risk outlook, it states that it will place increasing emphasis on insurers' assessment of risks related to climate change. The FSA notes that these own assessments have developed over time but still need improvement, including assessment of less quantifiable risks, such as operational risk, including cyber risk, and potential risks connected to climate change.

76. In its opinion on the 2020 review of Solvency II, EIOPA recommends the introduction of pre-emptive recovery plans for a very significant share of the national insurance markets. Those recovery plans, that are established in normal times rather than under stressed conditions, should apply at both group and solo level and be regularly reviewed. In Norway, currently insurers are not required to develop pre-emptive recovery plans. The requirements set out in section 20-5 in the Financial Institutions Act and the EU Banking Recovery and Resolution Directive (BRRD) applies only to banks, mortgage companies, parent companies and holding companies in the financial group and finance companies included in the financial group. The plan covers the entire group's operations, but the focus of the plan is on the group's activities and strategies to recover in specific scenarios rather than the individual entity. Several insurers use some form of recovery planning, but it is usually restricted to parts of their risk management, such as the portfolio management.

Recommendations

77. The FSA should require its larger insurers to establish pre-emptive recovery plans as part of their ORSA. While the FSA already expects insurers to cover capital targets and contingency plans in their ORSA, these expectations should be formalized through the requirement to establish a pre-emptive recovery plan. As a minimum, this should include all insurers that are highly important according to the FSA's risk assessment (i.e., rating class four insurers). The development of a recovery plan forces a company to critically review and better understand its own organization, which, in return, helps them to better manage a crisis situation, even if such a crisis turns out to materialize differently than envisaged in the plan.

E. Conduct of Business

78. Section 13.5 of the Financial Institutions Act stresses the requirement to conduct business with integrity and in accordance with good business practice. Section 16 of the Act provides general provisions on the relationship to clients, marketing, etc. It includes the requirement to establish the customer service in a manner that ensures the availability of the necessary competence within the undertaking, having the necessary systems and procedures to satisfy information obligations, and having arrangements to identify and mitigate conflicts of interest between the institution and its clients. Section 16 also covers the financial institution's obligation to data confidentiality.

79. The Insurance Contracts Act provides more specific provisions to insurers on the duty to provide information to the policyholder. In 2016, the FSA published circular 14/2016 on information and advice when selling life insurance products with investment choice. The circular summarizes and clarifies FSA's earlier statements in this regard. It specifically refers to Section 16-1 (3) of the Financial Institutions Act of 2015, which stipulates for financial institutions providing saving and capital products that it shall be ensured that customers are in a satisfactory manner made aware of the degree of risk, cost responsibility and expected net return that are associated with the products, and of the rules governing lock-in period, termination and payment and disbursement arrangements that will apply. The information provided must be clear, relevant and understandable, taking into account the policyholder's experience. To avoid potential conflicts of interest, the insurer needs to disclose if they receive commissions from investment management companies and how much. Insurance companies must have clear guidelines for the choice of assets and changing portfolios.

80. As a consequence of the experience in the low interest rate environment, many insurers changed the products they offer to customers. Life insurers have de-facto ceased to sell products with interest rate guarantees. At the same time, the share of unit- and index-linked products has increased. The policyholder bears the risk in these products, which highlights the importance of effective conduct of business supervision.

81. The conversion from defined-benefit pension paid-up policies to unit-linked paid-up policies became the focus of attention for the FSA. This is due to the inherent conflict of interest between the insurance company and the costumer. The FSA has reviewed customer documentation related to agreements on conversion and the insurers basis for its recommendations.

82. The FSA can withdraw an intermediary's authorization if it no longer fulfils the requirements in the Insurance Intermediation Act. The FSA may also withdraw an authorization if an insurance intermediary undertaking seriously or repeatedly has contravened its duties pursuant to the law or regulations. Over the last three years, the FSA has imposed cumulative fines on five insurance intermediaries for the failure to comply with reporting requirements. Further, in one case the FSA has withdrawn the insurance intermediary's licence. In other four cases the insurance intermediaries handed in their licence after serious or repeated infringements of the acts and regulations.

83. Insurance undertakings that are part of a bank-dominated financial group, distribute and market their insurance products mainly through the bank channel. Insurance-dominated groups also increasingly rely on the personalized marketing through the bank channel. This is considered an ancillary function of the banks. They are not considered as agents, and as such, currently no related data from the banks is collected by the FSA. However, the FSA can access information through the insurer and can that way assess whether information and advice is provided in line with policies and regulation. With the implementation of the Insurance Distribution Directive, banks will fulfil their service as regular agents. This means that the FSA will have the same level of information as in the context of brokers and insurance agents.

84. The FSA does not handle complaints from customers with the view that supervision of financial institutions and complaints handling should not be handled by the same institution. Circular 4/2019, however, covers detailed guidelines for complaints processing. It requires insurers to have a written procedure for dealing with complaints. The complaints handling procedures shall ensure that all complaints are investigated thoroughly and that any conflict of interest are identified and delineated. All complaints must be registered and reported quarterly to the FSA. Their continuous analysis should help reveal any systematic or fundamental problems. The complaints handling procedure should be publicly available.

85. The Norwegian Financial Services Complaints Board (FSCB) deals with disputes that arise between finance companies and their customers. The FSCB is a voluntary body, which most insurers in Norway are members of. It serves as an independent ombudsman. Its decisions are advisory. If an insurer has not accepted a decision against it, the undertaking is obliged to cover the counterparty's costs in court proceedings. For the FSCB to become involved in a dispute, the insurer must be a member and customer complaints have already been handled by the insurer or the agent. It will not act in parallel or after a case has bene brought to court.

Recommendations

86. Conduct of business should be a standing item on the agenda in early warning meetings. An increase in customer complaints, the mishandling of potential conflicts of interest and other poor conduct may require a deeper assessment of the insurer. The underlying issue may be rooted in a company's financial position.

F. Group-wide and Financial Conglomerate Supervision

87. The FSA follows the definition of group and the rules for application of group supervision provided by the Solvency II Directive. The Financial Institutions Act defines a financial group as a group in which at least one entity that is not the parent company is a financial institution. A financial institution is an entity carrying on business as a bank, mortgage credit institution, finance company, insurance undertaking, pension undertaking or holding company of a financial group. A group is also considered a financial group if it is established by collaborative agreement between mutual insurance undertakings or between a savings bank and a mutual insurance undertaking to the effect that the entities shall have a joint board of directors and in the event other joint bodies. A financial group in Norway may only be established under the authorization of the MoF. Based on this definition, the FSA is group supervisor of insurance groups. Two groups thereof, Storebrand and Gjensidige, have supervisory colleges due to their international business.

88. To establish capital adequacy and other prudential and solvency requirements, generally full consolidation is applied to subsidiaries. For participations in another institution that is not a subsidiary proportional consolidation is applied. To determine whether own funds requirements are met at the group level, the transferability of own funds needs to be considered.

89. Transactions between institutions of a financial group have to be at arm's length. A financial institution that is the subsidiary of a financial group may not provide funding to another subsidiary of the group. Unless otherwise stated in its articles of association, a life insurance undertaking cannot provide funding to other group institutions. An insurance undertaking may not without consent from the MoF provide a loan or guarantee to another institution in the same group, unless the loan is to a wholly-owned subsidiary whose business is confined to that which the insurance undertaking itself is entitled to pursue. Generally, any flow of capital out of the insurance undertaking, to support other undertakings in a conglomerate, is subject to supervisory approval. A company that applies the Solvency II transitional, may not be granted supervisory approval. Intra-group transactions and risk concentrations are reported to the FSA. The same applies to dividends above 50 percent of financial year result and any outsourcing agreements.

90. Measures are in place to limit the risk of double or multiple gearing in a group. Insurance undertakings are not allowed to issue debt, with the exception of subordinated debt in accordance with the criteria for tier 2 or tier 3 capital under Solvency II. Insurance holding undertakings are allowed to issue regular debt, but are subject to group solvency requirements on a consolidated basis at the insurance group level, where the gearing effect of capital is eliminated. For many Norwegian insurers, also the Financial Conglomerates Directive applies. However, this Directive does not address differences in capital requirements. The sectoral rules are applied in the consolidation of the overall requirement. That is, the Solvency II rules are applied for exposures held by insurance undertakings.

91. The FSA is concerned that different regulatory treatments between the European Capital Requirements Directive IV and Solvency II may lead to capital arbitrage. In recent years, the largest life insurers have taken over portfolios of residential mortgages (predominantly those with fixed interest rates) from banks in the same conglomerate. Currently mortgage loans amount to 2.4 percent of insurer's total assets or NOK 42 billion. This corresponds to 1.4 percent of total mortgage loans provided in Norway. They already cover the largest share of the available fixed rate mortgage loans, as these products are attractive investments for the purpose of cash flow hedging. But in a market with limited long-term investment opportunities, insurers may potentially also increase their share in floating rate notes. The case is very comparable to the situation in Belgium, where the market is also dominated by financial conglomerates. As highlighted in the December 2019 EIOPA Financial Stability Report, the Belgian regulator addressed the issue through the development of a comprehensive monitoring and reporting framework for the risks arising from mortgage lending by insurers.

92. On 29 March 2019, the FSA sent a consultation document to the MoF, proposing changes to the provisions concerning capital requirements for residential mortgages. The aim is to prevent arbitrage-motivated transfers of residential mortgages. Those changes, and hence deviations from Solvency II, are in line with the EEA Agreement, which allows the FSA to set a higher value than zero as a floor for the loss-given-default. Concretely, the public consultation proposed a floor of 4.5 percent as capital requirement for counterparty default risk for loan-to-value ratios smaller than 60 percent. The aim is to harmonize capital requirements for residential mortgages for insurers and banks to the extent possible given different regulatory regimes.

Recommendations

93. The MoF should implement the proposed increase in capital requirements for counterparty default risk of insurers to align the requirements with those on the banking side. Following the example of the Belgian supervisor, the authorities should consider collecting detailed information on the development of the real estate market and the risks arising from insurers' mortgage lending. In addition, the FSA should continue to assess trends of business moving from one financial sector (within or beyond the same financial group) to the other, and where applicable, address potential arbitrage opportunities between banking and insurance. It should be noted, however, that comparisons are not straightforward. The valuation differs between banks and insurers. Furthermore, Solvency II takes a total balance sheet approach, meaning that applying specific shocks affects both sides of the balance sheet and the capital requirement will, thus include capital for both asset and liability risks. At the same time, the different risk modules are aggregated taking diversification at several levels into account. Also, the necessary quality of capital to meet the solvency requirement needs to be accounted for.[5]

G. Resolution and Insurance Guarantee Scheme

94. If the FSA has reason to believe that an institution is unable to meet its liabilities it advises the MoF on the need to place the institution under public administration. The MoF may then decide to order the resolution of an insurer, by placing it under public administration. This also applies Norwegian branches of institutions with head offices in a foreign state. The Financial Institutions Act stipulates that when an institution is put under public administration its former bodies become inoperative and an administration board assumes the authority vested in those bodies. The administration board comprises at least three members with personal deputies, and functions as the institution's board of directors for a period of up to one year. In effect, the FSA—through the administration board—achieves full control of the insurer: The law stipulates that decisions of material significance to the institution shall be approved by the FSA before they are implemented. The institution may not incur new or expand previous exposures without FSA's approval, and payments to creditors may not take place without FSA's approval. The administration board shall endeavor as rapidly as possible to draw up arrangements enabling the continued operation of the institution's activities on an adequate financial basis, or to bring about a merger with, or have its activities transferred to, other institutions, or wind up the institution.

95. The administration board must either find basis for a resumption of ordinary operations, or it must wind up the insurer. Policyholders have priority in liquidation. Where an insurance undertaking is under public administration, any claim emanating from a direct insurance contract, including interest, shall be paid before other claims, except preferential claims. The preferential right for life insurance claims applies to an overall amount corresponding at least to the

[5] The MoF has adopted a regulation following the proposal from the FSA, with effect from 31 December 2019.

undertaking's technical provisions. Three months after a public administration order is made, all nonlife insurance contracts become void.

96. Upon winding up a life insurance undertaking the administration board shall endeavor to have the entire insurance portfolio taken over by one or more life insurance undertakings. If transfer of the insurance portfolio is not achieved, the MoF fixes a final reduction of the insurance amounts in accordance with the settlement carried out and calls a general meeting of policyholders to form a mutual undertaking.

97. In 2017, the resolution framework has been tested for the first time. It was an example of a successful resolution of an insurance company. Silver Pensjonsforsikring AS was the first life insurer in Norway that was placed into public administration. (cf. Box 2 for a detail description). The company was eventually resolved and the insurance book was sold to a competitor, Storebrand.

Box 2. The Public Administration of Silver Pensjonsforsikring

Silver Pensjonsforsikring AS was placed into public administration in February 2017. Silver Pensjonsforsikring was granted a life insurer's license on June 30, 2005. Silver's business consisted in the management and administration of insurance contracts emanating from collective pension schemes (paid-up policies and pension rights certificates), and paid-up individual pension agreements. By taking over paid-up policies from other life insurers, Silver assumed commitments to pay lifelong future benefits.

The increase in technical provisions that was required from life insurers in 2014 to address the population's increased longevity, together with the company's profitability prospects put it under considerable strain. In July 2015 Silver applied for dispensation from the forthcoming capital requirements of the Financial Institutions Act. The Ministry of Finance allowed Silver one year's grace as from January 1, 2016. The period of grace was subsequently extended to February 15, 2017. On the same date the Ministry of Finance rejected Silver's application for extended dispensation from the capital requirements with reference to the institution's failure to present evidence of significant progress towards finding a solution. When the existing dispensation expired, Silver was noncompliant with the capital requirements for insurers, and the Ministry of Finance resolved on February 17, 2017 to place Silver into public administration.

The FSA appointed an administration board on the same date to find a feasible arrangement within the remit of section 21-14 of the Financials Institutions Act. The administration board drew up a recommended solution for Silver's customers based on the assumption that paid-up policies would be strengthened in keeping with the K2013 mortality base, and a maximum guaranteed rate of return of 2.75 percent. The recommendation also required retirement pensions to switch from defined benefit to unit linked. Other pension rights were to remain unchanged.

The solution formed the basis for a bid process, which attracted bids from four Norwegian life insurers, with Storebrand Livsforsikring's bid being accepted by the administration board. Storebrand's consideration of NOK 520 million, together with Silver's book equity and excess value meant that the insurance claims (including interest) to cover retirement pensions were written down by a mere 0.76 percent.

Silver's policyholders were given the opportunity to voice objections to the proposed solution. By the expiry of the deadline only 26 objections had been received from policyholders, far below the statutory threshold of one-fifth. On December 19, 2017 Finanstilsynet gave permission for Silver and Storebrand to formalize the conveyancing contract with accounting effect as from January 1, 2018.

98. If a nonlife insurer fails, policyholders' claims are protected by a guarantee scheme. The Guarantee Scheme is a legal entity in its own right. Its members are all insurers that are granted a license to carry on direct nonlife insurance in Norway. No member has a proprietary right to any portion of the Guarantee Scheme's funds. It is headed by a board of directors consisting of five members. The guarantee scheme only covers claims relating to an insured risk that is situated in Norway. The coverage is restricted to 90 percent of each individual claim with the exception of claims under insurance policies for dwellings and compulsory liability insurance. Those are met in full subject to the maximum coverage of NOK 20 million for each insured for each claim and insured event. The Financial Institutions Regulations explicitly exclude several types of insurance from coverage, such as life insurance, credit insurance, energy insurance, aviation insurance, or insurance claims from public sector bodies.

99. A member's maximum liability to the guarantee scheme is capped. Each year it shall be 1.5 percent of the sum of the member's gross premiums earned in the three financial years immediately preceding the capital call year in the case of direct nonlife insurance covered by the Guarantee Scheme. Each member shall in a separate liability item on their balance sheet each year set aside one percent of the basis for calculation until that member's maximum liability is covered. Thus, there is no annual contributions made to the Guarantee Scheme, and no accumulation of funds being made. The guarantee scheme makes an ex post capital call when there is a need for funds. Capital calls are apportioned on the members on a proportional basis.

100. The Financial Institutions Act includes a provision that enables the set-up of a guarantee scheme for life insurance. A guarantee scheme for life policyholders and claimants has been considered on a number of occasions over the last several years and was subject to a public consultation that concluded in May 2019. The FSA is concerned about the challenging legal questions and the potential cost implications.

101. In principle, the current set up provides protection that is similar to other comparable schemes. No compensation is provided for the losses caused by an insurance failure. But the priority of the public administration board is to find ways of merging the insurer with other financial institutions or transfer insurance contracts, if normal business cannot be resumed. The winding up, where policyholders have preferential treatment, is the ultimate option if other solutions are not available. Thus, potential costs to policyholder are considerably reduced. For larger insurers or in the case of several failures, a transfer or merger may prove more challenging, particularly if other insurers are under stress due to market conditions. In such a case, the introduction of pre-emptive resolution planning for larger insurers, as recommended by EIOPA as part of its opinion on the 2020 review of Solvency II, may help achieve an orderly process of resolution or liquidation, ensuring that the undertakings have sufficient loss absorbency capacity.