



THE NEW NORWEGIAN COVERED BOND LEGISLATION

Stein Sjølie and Tor Hvidsten
Norwegian Financial Services Association

7th Central European
Covered Bond Conference
Berlin, 13th – 14th October 2003

BACKGROUND

The Norwegian Market

The housing market

- Size: 1x GDP (mainland)
- High level of individual ownership
- Turn-over 6% yearly

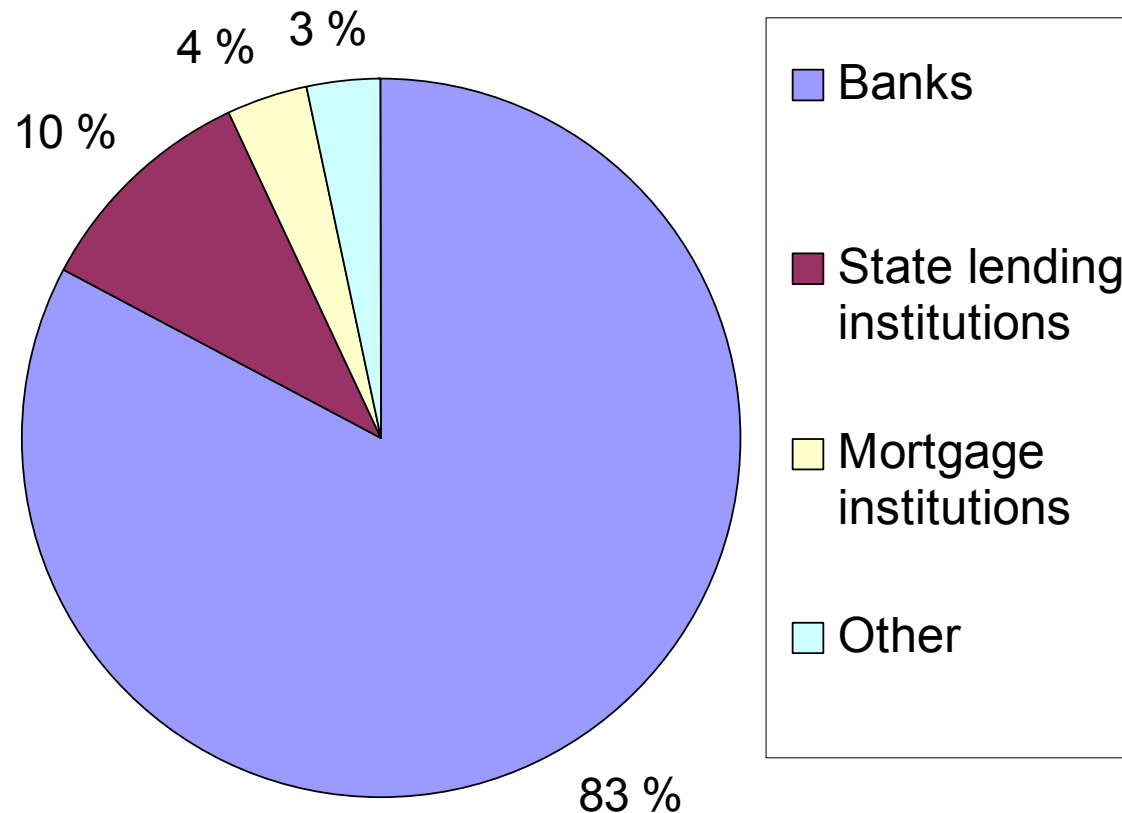
The credit market

- Personal debt
- Housing collateral
- Frequent refinancing
- Banks dominating
- Tradition for adjustable interest rates
- Funding through deposits insufficient



BACKGROUND

Loans with mortgage on dwelling. July 2003

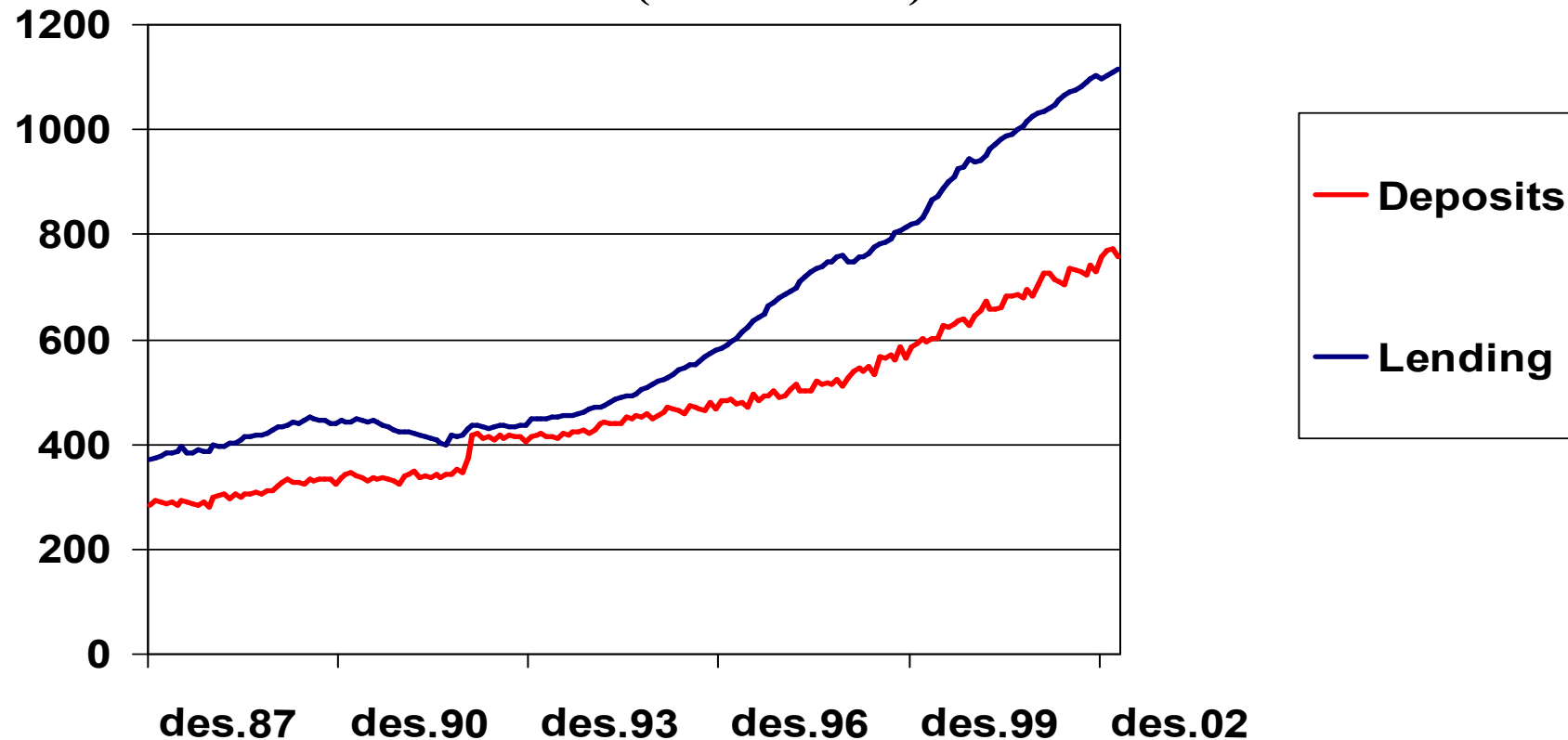


Source: Norges Bank



BACKGROUND

Banks lending and deposits to the public (billion NOK)



BACKGROUND

Objectives of New Legislation

Reduce the funding gap of the banking system

- Reliance on short term funding
- Substitute short term inter-bank deposits by long term bonds

Enhance competition

- Norwegian mortgage market
- Norwegian operators' competitiveness

Stimulate use of fixed interest rates in housing finance

Enlarge and improve depth of domestic bond market



NEW INSTRUMENTS

Covered Bonds (Mortgage Bonds)

- Specialised mortgage institution only
- Bank's subsidiary eligible

Securitisation

- Special purpose vehicle (SPV)
- Arm's length from bank
 - Basel II



COVERED BONDS

Objectives in creating legislation for covered bonds

- **Dedicated, specialised credit institution with low risk**
- **High credit quality bond:**
 - **UCITS Directive art. 22 (4):** 25% of mutual fund's assets
 - **Insurance companies' placements:** 20% of insurance reserves
 - **Banks' capital adequacy:** 10% risk weight
 - **International rating:** Top rating



TIME SCHEDULE

Proposal from Norwegian Bankers' Association	1997
Report from Banking Law Commission	2001
White Paper from Government	Summer 2002
Adoption of New Law Provisions	End 2002
Regulations under preparation	2003
New Regulations enter into force	2004



LEGISLATION

Legislation on Norwegian covered bonds

- **Act on Financing Activity and Financial Institutions**
- sections 2-25 to 2-33, bonds secured on a loan portfolio
- **Regulation on mortgage credit institutions that issue bonds secured on a loan portfolio, still to be adopted**

Further regulation of covered bonds

- Articles of association
- Bond holder agreement (trustee)



THE COVERED BONDS

Features of the covered bonds

- Enforceable first priority pledge over cover assets
- Cover assets at least equal the residual value of the bond issue at all times
- Maximum 5 % of cover assets can be related to single borrower
- Liquidity reserve for each bond issue
- No acceleration in case of public administration or bankruptcy



COVER ASSETS

Good quality cover assets:

- **Residential mortgages**
 - maximum LTV 60%
 - **Commercial mortgages**
 - maximum LTV 60%
 - **Public sector loans**
 - Interest rate and currency derivatives for hedging purposes
 - Substitution assets
- Separate portfolios of cover assets for covered bonds secured on residential mortgages and public sector loans

THE MORTGAGE CREDIT INSTITUTION

Credit institution established under

- *General requirements* relating to credit institutions
 - EU + additional national requirements
- *Special requirements* relating to Mortgage Credit Institutions issuing Covered Bonds

The special requirements relate to

- restrictions on other lending and funding activities
- risk management
- supervision
- proceedings in regard to bankruptcy or public administration



RESTRICTIONS ON ACTIVITIES

Stringent statement of mission must be laid down in the articles of association:

- Limit *lending activities* to granting or acquiring loans that are eligible for inclusion in cover assets
- Limit *funding activities* primarily to issuance of covered bonds

The statement of mission may not be changed without the consent of the supervisor.



RISK MANAGEMENT

Requirements on risk management include

Asset-and-liability management

- Balance principle

Limits on

- Currency risk
- Interest rate risk
- Liquidity risk



SUPERVISION AND BANKRUPTCY

Supervision

- Institution is under supervision of national supervisor
- Specially appointed accountant supervise fulfilment of eligibility criteria in regard to each bond issue

Bankruptcy / public administration

- Estate must respect bond contracts and continue to service bonds from the proceeds of cover assets or liquidity reserve
- No acceleration of claims from bond holders or counterparts as long as cover assets are sufficient to cover the bond debt

