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FINANSDEPARTEMENT

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EFTA Surveillance Authority

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Your ref	Our ref	Date
Case No: 80996	17/3573 -	11.06.2020

Response to the reasoned opinion concerning the authorisation of financial undertakings

Reference is made to the reasoned opinion of 11 March 2020 from the EFTA Surveillance Authority ("the Authority") concerning the authorisation of financial undertakings. In the reasoned opinion, the Authority concludes that:

> *"by maintaining in force an administrative practice whereby no single shareholder is, as a main rule, allowed to own more than 20-25 percent of the total shares in financial undertakings, as well as a rule according to which three quarters of the share capital in a bank or an insurance company shall be subscribed by capital increase without any preferential rights for shareholders or others, such as the rule in Section 3-3 second paragraph of the Financial Undertakings Act, Norway has failed to fulfil its obligations arising from Articles 31 and 40 of the EEA Agreement".*

The Norwegian Government maintains that the national measure in question does not breach the EEA agreement, and therefore disputes the Authority's conclusion.

1. INTRODUCTION

The infringement proceedings against Norway concern the issue rule in Section 3-3 second paragraph of the Financial Undertakings Act and the administrative practice whereby no single shareholder is, as a main rule, allowed to own more than 20-25 percent of the total shares. The Authority has rightfully viewed these as a whole, as they are an integrated part of the ownership control regime.[1] In the following, the issue

[1] Reference is made to the letter of 11 June 2019 and the letter of 20 March 2018.

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rule and the administrative practise will be referred to as "the measure" or "the dispersed ownership rule."

It is undisputed that the dispersed ownership rule does not violate any secondary legislation. The Authority's view is however that it constitutes an unlawful restriction on the freedom of establishment under Article 31 EEA or, as the case may be, on the free movement of capital under Article 40 EEA.

The Authority opened its case in the light of the Advisory Opinion in *Netfonds Holdings* (E-8/16) from the EFTA Court.[2]

On 8 June 2018, *Oslo tingrett* found that the measure, i.e. the issue rule and administrative practise, constituted an unlawful restriction on the freedom of establishment in EEA Article 31. Both parties have appealed the case. The Government considers that the judgment by *Oslo tingrett* is vitiated with fundamental errors of law and fact, several of which are replicated by the Authority in its letter of formal notice and reasoned opinion. The hearing in the appeal case before *Borgarting lagmannsrett* is due on 19 January to 3 February 2021.

Further, on 12 December 2018, the Ministry appointed professor Tarjei Bekkedal to make an independent expert assessment of whether in particular the dispersed ownership policy was compatible with EEA law.[3] In his report from April 2019, professor Bekkedal concludes that the administrative practise whereby no single shareholder can own more than 20-25 percent of the total shares *does not* violate EEA law, as interpreted by the EFTA Court in case E-8/16 *Netfonds Holding*. Many of the arguments now advocated by the Authority contradicts professor Bekkedal's view. This will be further elaborated below.

The Norwegian Government continues to loyally follow up the Advisory Opinion from the EFTA Court in *Netfonds Holding* in the proceedings before national courts. The Government has appealed the judgment from *Oslo tingrett*, as has Netfonds Holding, and the hearing in the appeal case is due in approximately 6 months.

On this background, the Government considers it unfortunate that the Authority has decided to pursue the infringement procedure against Norway. Even more so as all the issues that are being raised by the Authority in its letter of formal notice and the reasoned opinion are also part of the national proceedings that the Government are in the midst of.

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[2] The EFTA Court answered questions referred to it by Oslo District Court concerning the interpretation of Articles 31, 36 and 40 of the EEA Agreement.

[3] The mandate (in Norwegian) can be accessed here: https://www.regjeringen.no/no/aktuelt/dep/fin/nyheter/2018/utformingen-av-eierkontrollreglene-skal-utredes/mandat-for-utredning-om-regelverket-for-kontroll-av-finansforetaks-eierstruktur-og-potensielle-eieres-egnethet/id2622430/

In *Netfonds Holding* the EFTA Court found that the dispersed ownership rule pursued objectives reflected in the general interest, see paragraph 116. The aims pursued were accordingly legitimate. The EFTA Court provided guidance on the interpretation of the EEA law, but in line with the preliminary reference proceedings it left it to the national courts to examine the evidence and conclude whether the measure in fact is suitable and necessary.

A substantial part of the hearing before *Oslo tingrett* concerned the examination of the evidence on the appropriateness and necessity of the measure. That will also be the main issue before *Borgarting lagmannsrett* between 19 January to 3 February 2021. It is difficult to provide an equally comprehensive examination of all the evidence within the framework of the present proceedings initiated by the Authority. The Government is, however, left with no choice but to do its utmost to provide the Authority with our view of the correct application of EEA law and the relevant facts of the case, inter alia to correct what we see as the failures of *Oslo tingrett*.

2. OVERVIEW

According to established case law, a national measure that hinders the freedom of establishment or the free movement of capital can be justified by overriding reasons in the public interest, if the measure is appropriate to attain the objectives pursued and does not go beyond what is necessary in order to attain the level of protection sought.

In the view of the Authority, the dispersed ownership rule constitutes a restriction on the freedom of establishment or, as the case may be, on the free movement of capital that cannot be considered suitable nor, in any event, necessary. The Authority therefore concludes that Norway has failed to fulfil its obligations arising from Articles 31 and 40 of the EEA Agreement.[4]

The Government acknowledges that the measure in general[5] may constitute a restriction on the freedom of establishment in EEA Article 31.[6] The Government maintains, however, that it is justified by overriding reasons of general public interest.

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[4] Reference is made to the letter of formal notice 10 April 2019 paragraph 54. Although the Authority's concerns relate to both freedoms, the Authority's focus is on Article 31 EEA, "[a]s the measures at issue touch at least prima facie upon the freedom of establishment.

[5] With regard to the restriction assessment, the Government would like to add, for the sake of clarity and in order to not cause any misunderstandings as regards the position of the Government in the pending national case, that in that particular case there is either no cross-border restriction, as all the relevant facts of the case is wholly internal, or there is only a limited and severable part of the facts of the case could be seen as involving relevant cross-border elements. Any claim for damage on the basis of a breach of EEA law is also accordingly at most confined to the limited and severable circumstance that a restriction on the freedom of establishment may be found. As this is of no relevance to the present infringement proceedings, concerning the dispersed ownership rules as such, the Government will not further outline this in the following.

[6] The Government will also focus on the freedom of establishment in Article 31 EEA.

Concerning the justification of the dispersed ownership rule, the Government notes that it is uncontested that the measure pursues objectives reflecting overriding reasons of public interest. The Authority accordingly acknowledges that the dispersed ownership rule is pursuing legitimate aims.

With regard to the suitability requirement, the Authority's view is essentially that i) it doubts the premise that small shareholdings contribute to the financial stability of the market, ii) the rules are inconsistent, as they cannot apply to subsequent acquisitions, and iii) the rules are inconsistent, as they do not apply in situations where a financial undertaking acquires control of another financial undertaking.

Regarding the necessity test, the Authority's view is that the Norwegian rules are not necessary, as it appears to the Authority to be alternative means of obtaining the objectives pursued, which are less restrictive while at the same equally effective.[7] The Authority further states that the Norwegian Government has not provided any concrete arguments as to why the alternatives referred to by the Authority would not entail an equally high level of protection as that achieved by the Norwegian rules.

In section 3, the Government will briefly recall the objectives pursued by the measure and the overriding reasons reflected by those objectives. While it is uncontested that the measure pursues legitimate aims, the Authority has not applied those objectives to the assessment of the suitability and necessity of the measure. The point of departure for the proportionality assessment is therefore incorrect, which also has affected the outcome of the proportionality analysis.

In section 4, the Government will demonstrate that the Authority's assessment of the suitability and consistency of the measure is vitiated with several factual and legal errors, and that the Authority's view therefore cannot be upheld. In the Government's view, the measure is suitable to attain its objectives, and there is no relevant inconsistency rendering the measure to be considered not appropriate.

Section 5 contains the Government's view on why the measure is necessary and thus also the specific reasons that the alternatives proposed would not be considered equally effective in order to secure the level of protection sought.

It is on this background that the Government respectfully submits that the dispersed ownership rules is justified on the basis of overriding reasons of public interest and in that regard also complies with the proportionality principle.

[7] Reference is made to the letter of formal notice dated 10 April 2019 part 5.3.3, and the reasoned opinion dated 11 March 2020 paragraph 32.

3. OBJECTIVES REFLECTING OVERRIDING REASONS OF PUBLIC INTEREST

3.1 Introduction

In order for a restrictive measure to be justified, the measure must pursue an objective reflecting overriding reasons in the general interest, i.e. the measure must be based on legitimate aims.

While some cases are rather straightforward in the sense that the measure in question pursue a single objective, in many cases, the measure pursues several objectives, some of which may be more or less integrated, while others may in fact be somewhat contradictory, leaving the national authorities with the task of striking a reasonable balance.

The requirement of legitimate objectives does not require an analysis of all the objectives pursued and the relevant overriding reasons reflected by those objectives. It suffices to identify *one* objective reflecting an overriding reason in the general interest. However, the proportionality test requires a more careful examination of *all* the objectives pursued and the overriding reasons reflected by those objectives. In that latter sense, it is therefore essential to clearly identify the objectives at play, so that the point of departure when examining the appropriateness and necessity of the measure is correct.

3.2 Undisputed that the measure pursues objectives reflecting overriding reasons in the general interest

The Government understands that it is undisputed that the dispersed ownership rule fulfils the first requirement of the proportionality principle, which is to pursue an objective reflecting an overriding reason in the general interest.[8] This was also the position of the EFTA Court in its advisory opinion in *Netfonds Holdings*.[9] *Oslo tingrett* also found that the measure pursued legitimate aims.

Moreover, the Government also understands it to be undisputed that the dispersed ownership rule pursues *several* objectives reflecting somewhat different overriding reasons of general interest. In paragraph 62 of the letter of formal notice, the Authority "acknowledges that the objectives of the Norwegian measure may in principle reflect overriding reasons in the general interest, but it must still comply with the principle of proportionality, i. e. be suitable and necessary."

Although, accordingly, there seems to be no disagreement on the *identification* of the objectives pursued and the overriding reasons that they reflect, the Authority does not actually *apply* those objectives when undertaking the proportionality assessment.

[8] Reference is made to the letter of formal notice paragraphs 59-62 and the reasoned opinion paragraph 19.

[9] See *Netfonds Holdings* paragraph 116.

3.3 The Authority does not apply all the objectives identified in its proportionality assessment

With regard to the requirement of suitability/consistency, it is sufficient for the fulfilment of that requirement that the measure is appropriate to attain at least *one* of the objectives. An argument that the measure does not comply with the suitability/consistency requirement, presupposes therefore a finding that the measure is not suitable to attain *any* of the legitimate objectives pursued.

However, the Authority is of the view that the suitability requirement is not fulfilled simply because there are doubts concerning the attainment of the objective to reduce the excessive risk-incentives inherent in financial institutions with concentrated ownership structures. The Authority does not consider for instance whether the measure may nevertheless be suitable to reduce the risk of misuse of ownership power. This is further addressed in section 4 below.

Similarly, in order for the measure to be necessary, it suffices that it is necessary for the achievement of the level of protection sought with regard to *one* of the objectives pursued. For the measure to be considered not necessary, the alternative measures accordingly need to be equally effective to secure the level of protection sought with regard to *all* legitimate objectives sought.

The Authority is however of the view that the dispersed ownership rule is not necessary simply because the alternative measures could equally attain the objective of reducing the risk of misuse of ownership power. The Authority does not consider for instance whether the measure may nevertheless be necessary to attain the objective to reduce the risk of misuse of ownership power. This is further addressed in section 5 below.

This incorrect point of departure for the suitability and necessity assessment has affected the outcome of the Authority's view. Moreover, the sole objective considered by the Authority is not even the same objective in the suitability assessment as in the necessity assessment.

On that background, the Government will further elaborate on the objectives pursued and why it is important and necessary to actually integrate them into the examination of the suitability and necessity test.

3.4 The objectives pursued by the measure

In the view of the Government, there are <u>two main objectives</u> of the measure; i) to reduce the risk of misuse of ownership power and ii) to reduce the excessive risk-incentives inherent in financial institutions with concentrated ownership structures.

Indeed, both objectives concern the objective of reducing *risk* in the financial sector. They are however directed at different forms of risk. The first objective solely concerns the risk of different forms of misuse of ownership power, e.g. certain illegal forms of transactions to the personal benefit of the owner or related persons/businesses, while the second relates to the excessive risk-incentives affecting all business actions.

With regard to the suitability test, it is evident that *even if* – as the Authority claims, but which the Government disputes – the measure is not suitable to reduce the excessive risk-incentives inherent in financial institutions with concentrated ownership structures, the measure may *nevertheless* be considered suitable to reduce the risk of misuse of ownership power.

Similarly, with regard to the necessity test, the Authority's assessment is also vitiated with the same error of law. Indeed, *even if* – as the Authority claims, but which the Government disputes – the measure is not necessary in order to reduce the risk of misuse of ownership power, the measure may *nevertheless* be considered necessary to reduce the risk the excessive risk-incentives inherent in financial institutions with concentrated ownership structures. The alternative measures proposed to reduce the risk of misuse of ownership power – e.g. special conditions prohibiting certain transactions, such as to prevent the granting of favourable loans, guarantees or any comparable transactions for the benefit of large owners or their related parties – have no or little effect on the objective to reduce the excessive risk-incentives inherent in financial institutions with concentrated ownership structures.

Moreover, having rules that prevent owners from being too dominant also ensure independence in relation to other businesses and industries, and in relation to owners that could conceivably use their influence for their own benefit or for the benefit of other closely related, thus preventing conflicts of interest. Preventing conflict of interests and ensuring independence are recognised as legitimate objectives in itself by the CJEU and the EFTA Court.[10]

In Proposition No. 50 (2002-2003) the following is stated in section 4.2.4:

> *"At the outset, the Ministry would like to stress the important function that financial institutions have for the general economy. The special legal requirements that apply to financial institutions in all countries that hove a well-developed economy, must be seen in light of this. Such regulation is intended partly to safeguard the institutions' relationship with their customers and partly to safeguard the role of these institutions generally in economic life. One special aspect of the role*

[10] See e.g. case E-9/11 ESA v Norway paragraph 84: "The applicant and the defendant submit that the objectives of the contested measures are to promote the well-functioning and efficiency of the financial markets by creating safeguards against conflicts of interests and covert misuse of powers in infrastructure institutions such as the ones at issue as well as to ensure the independence, neutrality and integrity of these important financial infrastructure institutions in the market. They agree that those aims pursued are overriding reasons in the general interest capable of justifying national measures restricting the freedoms established by Articles 31 and 40 EEA."

of these institutions in the general economy is their function as managers of savings and other capital assets. Both banks and insurance companies manage large assets, and therefore have a big influence on the rest of the economy. Such influence is exercised through the institutions' "ownership power" as well as through their granting of credit.

[...]

In addition, the Ministry believes that the regulations should ensure the financial institutions' independence in relation to other business and industry and in relation to owners that could conceivably use their influence for their own benefit or for the benefit of their business or private associates by granting favourable loans, guorantees etc. Having control of, for example, a large financial group confers great influence in relation to other business and industry. One should therefore continue to seek to prevent non-financial owners from gaining a disproportionately big influence on other business and industry through holding significant ownership interests in Norwegian financial institutions, as this will entail a risk of actions being motivated by extraneous considerations. One must also continue to seek to prevent nonfinancial owners from using their position for the benefit of themselves or their business or private associates (for example, cheap credit, including credit that would otherwise not have been extended on account of the risk involved being too high). Such conflicts of interest are also an incentive to imposing particularly stringent conditions on customers who, for example, compete with the business of the influential owner in question. If dealings are not based on purely commercial considerations, this can be to the detriment of other customers of the financial institution in question and the profitability of the financial institution, and hence also to the detriment of the other owners. In the worst case scenario, the financial institutions will have to be bailed out by others. Moreover, the general economy may suffer a loss if the funds are not channelled to the most well-founded projects". [11]

The objective of reducing the excessive risk-incentives due to a concentrated ownership structure, relates also to the more general objective of strengthening the corporate governance structure of the financial undertakings. This is further outlined in section 4.5.6 below. Strengthening the corporate governance structure has also been recognised as an objective in itself.[12]

Furthermore, it is also important to recognise the *additional* benefits of the measure which also forms part of the *general* objectives of the Norwegian authorities in financial market regulation.[13] These also underpin the preference of the dispersed ownership rule over the other alternative measures proposed. These additional benefits relate to iii) contributing to a sound capital situation for the financial institution, iv) the

[11] Unofficial translation of Ot.prp. nr. 50 (2002-2003).

[12] See e.g. case E-9/11 ESA v Norway paragraph 84 quoted above.

[13] These are further described in section 4.5.7.

promotion of compliance with regulations, v) the facilitation of supervision and enforcement of such regulations, and vi) the increase in the confidence of investors and creditors in the Norwegian financial market.

With regard to iii) contributing to a sound capital situation for the financial institution, the aim is to strike to reasonable balance. On the one hand, the Government seeks to have financial institutions that is not too dependent on the financial situation of a single or only very few shareholders, a situation which is unfortunate not only because of its inherent dependency on the decisions of one or only very few shareholders, but also because of the increased risk that large shareholders may prevent further capital injections into the financial institution due to fear of diluting their ownership power. On the other hand, the dispersed ownership rule should allow for sufficiently large shareholders that are more likely to be willing to follow up on their investment with further capital injections, if need be.

Although not the main reason behind the dispersed ownership rule, the Government is not neutral. It clearly prefers a measure that contributes to a sound capital situation for the financial institution over a measure that does not. Thus, it *supports* the dispersed ownership rule over other alternative measures, as it strengthens the well-functioning of the financial market[14] and thus contributes to a higher overall level of protection.

With regard to iv) the promotion of compliance with regulations, it is also clear that the Norwegian authorities prefer measures that promotes compliance with regulations over those that does not promote such compliance. Recent studies demonstrate that the impact of bank regulations on bank risk depends critically on each bank's ownership structure. For instance, the stabilizing effects of capital regulations diminish when the bank has a large owner with the incentives and power to increase bank risk, and with a sufficiently large owner, capital regulations will indeed increase risk. In that sense, ensuring a dispersed ownership structure also contributes to strengthening the effect of other regulatory measures.[15]

All else equal, a measure that promotes compliance with other regulations ensures a higher level of protection overall. Ensuring compliance with financial regulation is clearly an important part of the general objectives of the Norwegian authorities, and is also recognised as a legitimate objective in itself.[16] It thus also supports the dispersed ownership rule over other alternative measures, as it contributes to a higher overall level of protection.

[14] See e.g. *Netfonds Holding* paragraph 113

[15] See more on this in section 4.5.7

[16] See e.g. E-02/01 *Pucher* paragraph 32: "… The Court also acknowledges that securing compliance with national legislation, assisting the administration of justice, facilitating the execution of civil judgments, and enforcing administrative and criminal sanctions are important elements in order to achieve that objective…."

Concerning v) the facilitation of supervision and enforcement of financial regulations, it is also evident that the Norwegian authorities, all else equal, would prefer a measure that facilitates supervision and enforcement of financial regulation compared to the alternative measure that does not, or at least not to the same degree. It certainly is an important part of the general objectives of the Norwegian authorities with financial regulation, and is also recognised as a legitimate objective in itself.[17] It thus also supports the dispersed ownership rule over other alternative measures, as it contributes to a higher overall level of protection.

Finally, with regard to vi) the increase in the confidence of investors and creditors in the Norwegian financial market, this constitutes very much an essential part of the Norwegian authorities' rationale behind all financial regulation. This aspect renders it even more important to build a robust and solid structure in the market, which not only directly protects the consumers, but also contributes to the integrity and the stability of the financial market. Because of the important function in the society that these institutions have, it is essential for the integrity and the stability of the financial market to prevent private financier activities and to ensure that these institutions' power is dispersed among several interests, which in turn strengthens the confidence in them.

All else equal, the Norwegian authorities clearly prefer the measure that ensures the greatest confidence in the Norwegian financial market, as that would ensure a higher overall level of protection. It certainly is an important part of the *general* objectives of the Norwegian authorities with financial regulation, and the importance of it is also recognised in case law.[18] It thus also *supports* the dispersed ownership rule over other alternative measures, as it contributes to a higher overall level of protection.

On this background, the Government maintains that all these objectives – both the main specific objectives of the measure itself and the additional benefits of the measure strengthening the general objectives of the financial regulation – have to be examined specifically under the suitability and necessity test.

The Authority's assessment of the appropriateness and necessity of the measure is unfortunately vitiated with precisely this error of law, as it has not clearly identified the objectives and overriding reasons at play. The incorrect point of departure has also affected the outcome of the Authority's view.

When it comes to regulating banks and insurance companies, special concern arises concerning financial stability. The societal costs of financial market turbulence and crises can be large and persistent. In particular, the interaction between the banking sector and the rest of the economy may result in the build-up of financial imbalances, and trigger turmoil and deep economic setbacks. In *Netfonds Holdings* the EFTA Court

[17] See e.g. E-02/01 *Pucher* paragraph 32, E-08/04 *ESA v Liechtenstein* paragraphs 24-26, and C-441/93, Panogis Pafitis paragraph 49

[18] See e.g. C-384/93 *Alpine Invest* paragraphs 42-44

emphasised that soundly regulated and safe financial institutions are of decisive importance for financial stability in the EEA, mainly due to the particular function of banks and insurance companies for the economy as a whole.[19]

This is not something to simply pay lip-service to. The importance of banks and insurance companies for the economy as a whole, and the consequences for the general economy as a whole upon failures of those institutions, warrants additional and more robust regulation than for ordinary businesses. However, when examining the necessity of the dispersed ownership policy, the Authority makes no mentioning of these particular facts.

The Government acknowledge that different countries may have a different take on the acceptable risk in the financial sector. To some extent, there may also possibly be a certain trade-off between regulations entailing lower level of risk to the financial stability and growth ambitions in the sector, adding to variations in regulatory approach between countries. Accordingly, in non-harmonised areas of EEA law, different countries may have sought to ensure different sets of objectives and a different level of protection. However, the measure must be assessed solely by reference to the objectives pursued by the EEA State concerned and the level of protection that it seeks to ensure.[20]

This is also not something to just pay lip service to. Different objectives and different levels of protection call for different regulatory tools. So when the Authority simply resort to the general regulatory tools as suggestions of alternative measures, cf. section 5 below on the necessity test, the Authority fails to take due account the characteristics of the financial sector.

The Government has sought to explain and demonstrate that Norway has a very low level of acceptance for banking failures, mainly due to its experience with a banking crisis in the 90s. Following the banking crisis, the Norwegian financial regulation was strengthened in order to have a sound and consistent regime, where preventing new financial crises and new costly bank failures were the main objectives. As a result, the Norwegian Government has also in many cases opted for a financial regulation stricter than the minimum requirements following EU/EEA-regulations. For example, in the Financial Markets Report for 2015, the Ministry of Finance stated:

> *"[t]he acceptable levels of stability and quality in the provision of financial services may vary from country to country, based on factors such as adopted priorities and risk tolerance. Views may also differ on how best to achieve a given level of stability and quality in service provision. Norwegian financial market policy is designed to secure a high level of stability and quality through requirements relating to solvency and the conduct of financial undertakings, which are frequently stricter than*

[19] *Netfonds Holdings* paragraph 132
[20] *Netfonds Holdings* paragraph 131

> *international minimum requirements. Norwegian policy emphasises confidence, security and long term growth."*[21]

There were no bank failures in Norway during the international financial crisis autumn 2008, largely because of the robust and consistent financial regulation covering all financial sectors. According to an OECD report after the crisis (Financial Market Trends 2/2009) on the subject of measures introduced during the financial crisis, Norway was the only EU/EEA country in OECD in which it was not necessary to issue State guarantees for borrowings or lendings or to expand the deposit guarantee coverage.

3.5 Conclusion

The Government maintains – and this does not seem contested by the Authority– that the dispersed ownership rule pursues several objectives which reflect overriding reasons in the general interest. Further, the Government has emphasised the importance of carefully identifying the relevant objectives and overriding reasons at play, as that constitutes the point of departure for the analysis of the proportionality principle.

4. SUITABILITY

4.1 Overview

In order for the national measure to be justified on the basis of overriding reasons in the public interest, it is also required that the measure is suitable to attain the objectives pursued.

The Authority contest that the measure is suitable. Three arguments are invoked, all of which are claimed to be sufficient on its own to find that the measure is unsuitable. First, the Authority states that it has doubts that small shareholdings contribute to the financial stability of the market, and therefore argues that the measure is not suitable. Second, the Authority claims that the measure is inconsistent as it cannot apply to subsequent acquisitions. Third, the Authority claims that the measure is inconsistent as it does not apply in situations where a financial undertaking acquires control of another financial undertaking.

The Government maintains that the measure is suitable. In the Governments view, the Authority's view cannot be upheld, as demonstrated below.

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[21] Unofficial translation. In Norwegian original: «Hva som er et akseptabelt nivå av stabilitet og kvalitet i tilbudet av finansielle tjenester, vil kunne variere fra land til land, ut fra bl.a. prioriteringer og risikotoleranse. Videre kan det være ulike synspunkter på hvordan en best oppnår et gitt nivå av stabilitet og kvalitet i tjenestetilbudet. Den norske finansmarkedspolitikken er innrettet for å gi et høyt nivå av stabilitet og kvalitet, gjennom krav til soliditet og atferd i finansforetakene som ofte er strengere enn internasjonale minstekrav.»

4.2 The suitability test requires an assessment of *all* the objectives pursued, not merely one of them

The Government submits that it is legally incorrect to conclude that the measure is unsuitable *solely* on the basis of a finding that it is not appropriate to attain the specific objective of contributing to financial stability by reducing the inherent risk appetite by large shareholders. The Authority's assessment of the suitability of the measure falls short, however, to what is required by the suitability test. Indeed, the Authority has acknowledged that the measure pursues several objectives reflecting overriding reasons of public interest, cf. section 3.2 above. Neither the letter of formal notice nor the reasoned opinion contains, however, an examination of whether the measure may be appropriate to attain any of the other relevant objectives identified.

The Authority has not considered whether the dispersed ownership rule is suitable for the attainment of the objective of reducing the risk of different forms of misuse of ownership power for personal gains. Nor has the Authority considered whether the alternative measures would be equally effective as the ownership rules with a view to achieve the level of protection sought with regard to the general reduction of the risk-appetite following from a concentrated ownership structure. And the Authority has not taken into account all the additional benefits which also forms part of the objectives pursued by the Norwegian financial regulation.

Since the point of departure is not clearly identified, the Authority seems to be freely "shopping" objectives as the relevant yardstick against which the appropriateness and necessity of the measure are assessed against. A logically consistent approach from the Authority would however have led to a different outcome.

It is for instance difficult to see how the dispersed ownership rule could ever be considered not appropriate to reduce the risk of different forms of misuse of ownership power. The measure clearly limits the possibility of a single shareholder *to exert dominant and possibly undue influence* over the financial institutions. In that sense, the measure goes straight to the root of problem, constituting a barrier to different forms of misuse of shareholder power.

Indeed, the Norwegian legislation *also* contains the more traditional regulation of unwanted behaviour through the use of prohibitions and sanctions, together with an *ex ante* assessment of the suitability of the owner. The dispersed ownership rule constitutes an *additional and more effective barrier* to exert dominant and possibly undue influence. It further reduces the risk of such misuse of ownership power. The use of an additional barrier is, from the Norwegian authorities' perspective, warranted because of the significant negative consequences of such misuse in the financial sector compared to more traditional business. The greater the negative consequences are if a certain risk materialises, the lower level of risk tolerance is acceptable.

4.3 The relevant test is *not* whether the Government has provided conclusive evidence and eliminated all doubts

The Government also submits that it is legally incorrect to conclude that a measure is not suitable to attain an objective simply on the basis of the existence of "doubts" or a failure by the EEA State to present "conclusive" evidence.[22]

In the Governments view, there is no basis in case law for adopting a threshold according to which the EEA State is required to eliminate *all* doubts and accordingly to present *conclusive* evidence in order for it to be suitable. The fact that *Oslo tingrett* – to which the Authority refers – has also made the same legal errors in its suitability analysis is not relevant. From an EEA legal methodology perspective, the Government questions the weight of a single judgment from *Oslo tingrett*, which moreover is under appeal, precisely partly because of that error.

As noted in the Ministry's reply to the letter of formal notice section 2.3 first paragraph, the Government is of the opinion that the relevant test when considering the suitability of a measure is *whether it may be reasonable to assume* that the national measure will have some effect on the attainment of the objectives pursued.[23]

The Authority claims in paragraph 26 of the reasoned opinion that it already in the letter of formal notice sufficiently addressed the arguments set out by the Government in its letter of 20 March 2018. However, neither in its letter of formal notice, nor in its reasoned opinion, has the Authority provided any explanation for the use of its novel test.

The Government maintains that the "no doubt"- or "conclusive evidence"-standard used by the Authority is incorrect. And any conclusion derived from the use of that threshold of compliance will be vitiated with an error in law. While the Government maintains that the relevant test is whether it is reasonable to assume that the measure has an effect on the objectives pursued, it is in any event sufficient for the Government to demonstrate that a given measure is likely to be appropriate. The Government is of the view that applying a correct standard of review would have led to a different outcome than the Authority's position.

4.4 The measure is suitable to attain the objective of preventing conflicts of interest, ensuring independence and accordingly to reduce the risk of misuse of ownership power

The Authority has not disputed the existence of the risk of misuse of ownership power, nor has the Authority ever disputed the legitimacy of the objective to reduce such risk through the prevention of conflicts of interest. Nevertheless, the Authority has not considered whether the measure is appropriate to attain these objectives.

[22] See the letter of formal notice paragraphs 62-73, cf. the reasoned opinion paragraphs 26-30.

[23] See e.g. Case E-16/10, Phillip Morris, paragraph 83.

The appropriateness of the measure to attain these objectives should be undisputed given that the EFTA Court in *Netfonds Holding* paragraph 122 explicitly stated that "[t]he administrative practice [whereby] individuals and legal … are not authorised to own more than 20 to 25 per cent of the shares in financial institutions … appears suitable to achieve the legitimate objective that has been identified by the Court." It is recalled that in paragraph 116 the EFTA Court concluded that "the objective of reducing excessive risk incentives of owners of banks or insurance companies, particularly in relation to the risk of misuse of power, reflects overriding reasons in the general interest capable of justifying national measures which restrict the freedom of establishment as guaranteed by Article 31 EEA."[24]

That the dispersed ownership rule is suitable to attain the objective of preventing the emergence of conflicts of interest and hence to reduce the misuse of ownership power, is furthermore supported by case E-09/11, in which the EFTA Court confirmed in paragraphs 84-86 that the ownership limitations were suitable for ensuring inter alia the independence, neutrality and integrity of financial infrastructure institutions.

Moreover, in case C-89/09 *Commission v France*, the CJEU found that national provisions prohibiting non-biologists from holding more than 25 percent of the shares, hence of the voting rights, in undertakings operating biomedical analysis laboratories was appropriate in order to attain the public health objectives pursued, see paragraphs 54-65.

The Government submits therefore that the measure is suitable to attain the objective of preventing the emergence of conflicts of interest and to reduce the risk of misuse of ownership power. This finding is moreover in itself sufficient to conclude that the suitability requirement is fulfilled, regardless of whether the measure is or is not appropriate to attain other objectives as well.

4.5 The measure is suitable to attain the objective of reducing the excessive risk-incentives from concentrated ownership structures

4.5.1 Overview

The Government submits that it is at least reasonable to assume that the dispersed ownership rule is also suitable to attain the objective of reducing the excessive risk-incentives from concentrated ownership structures.

In section 4.3 above, the Government has argued that the Authority's standard of review – the no doubt-test – is legally incorrect. Here, the Government will also demonstrate

[24] For the sake of completeness, the Government notes that the observations by the EFTA Court in paragraph 123 concerns the alleged inconsistency of the measure, an issue to which the Government will return in section 4.6 below. They do not, however, affect the issue of whether the measure as such is suitable to attain the objective, which is considered here.

that the more specific arguments as to *why* the Authority has doubts concerning the appropriateness of the measure are also vitiated with several errors, and that the Authority's view cannot therefore in any event be upheld.

The Government observes that the main doubts pointed to by the Authority does not concern whether the measure actually has an effect on the objective, i.e. whether the measure is able to tackle the problem identified. Instead, the Authority's main doubts relate to the objective itself, i.e. *whether the alleged concern really is a concern*.

More specifically, the Authority firstly doubts that concentrated ownership structure in financial institutions at all creates excessive risk-incentives. In that regard, the Authority has raised special concerns due to the Danish experience and literature. This will be addressed in section 4.5.3 below. Secondly, the Authority doubts that the Norwegian authorities are genuinely concerned with the objective of reducing the excessive risk-incentives from concentrated ownership structures. This is addressed in section 4.5.4 below.

Thirdly, the Authority questions how the risk-incentives possibly created by a concentrated ownership structure could be a problem *per se* since not all levels of risk are negative. This is addressed in section 4.5.5 below. Fourth, in section 4.5.6 the Government will further outline that the measure is appropriate to attain the objective of reducing the excessive risk-incentives from concentrated ownership structures and to strengthen the corporate governance structures. Fifth, in section 4.5.6 the Government will present some evidence to support the additional benefits of the measure described in section 3.3 above. Sixth, the Authority has doubts concerning the specific level of concentration that the excessive-risk incentives are created. This is addressed in section 4.5.7 below.

In section 4.5.2 below, the Government will first make some general remarks on the level of scrutiny of the subject matter in the present case.

4.5.2 The relevance of the subject matter when examining the suitability

When examining the evidence concerning the suitability of a measure, due account has to be taken of the subject matter examined. In some cases, the risks associated with a certain factor and the effect of certain measures may be rather straightforward to identify, e.g. whether high-speeding on a narrow street passing a kindergarten actually poses a public health risk, and if so whether the introduction of speed limits is capable of reducing the public health risk, and whether a speed limit of 30 or 20 km/h would be appropriate in that regard. Other cases are by way of nature far more complex.

In the Governments view, it is difficult to imagine a more complex matter than financial market regulation. And the issue of whether *concentrated ownership structure* in the financial sector entails excessive risk-incentives and thus also a negative effect on the stability of the financial market, is definitely among one of several complex issues within financial regulation.

Moreover, difficulties of measuring the impact or effectiveness of a given measure may differ depending on whether it is the only measure addressing the objective or whether it merely forms (an important) part of a regulatory mix consisting of several measures all addressing the same objective.

The Government submits, perhaps not so controversially, that the EEA law is not immune or irresponsive to the reality. When considering whether the evidence and analysis presented passes the burden of proof and standard of review applicable, the subject matter examined – and the issues described above – is taken into account.[25]

4.5.3 The Danish experience

In paragraph 67 of the letter of formal notice, the Authority refers to Denmark where there has been a debate concerning whether too *small* shareholdings pose a bank risk. The Authority states that the Government has neither provided the Authority with any assessment of this fact nor its analysis in the scientific literature, nor any explanation of why the aim of ownership limitation should be given more weight than, for example, the aim of ensuring sufficient ownership allowing to influence the decision making.

Indeed, there are critical voices in Denmark suggesting that the ownership influence is too marginalised and that the management of the financial institutions have been afforded too much power as a result, which is also claimed to be negative for the well-functioning of the financial market.[26] Others have argued that the problem is not too much power in the hands of the management, but rather emphasised the problems with large shareholders for the well-functioning of the financial market.[27]

The Government will return in more detail to the issue of why concentrated ownership is detrimental to the stability of the financial market in section 4.5.6 below. In the present section, the main focus is to address the criticism raised against the Danish rules. And before one seeks to extrapolate those critical voices and apply them by analogy to the Norwegian ownership rules, it is important to have a clear view of the Danish rules. As far as the Government understands, they differ fundamentally from the Norwegian ownership rule.

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[25] Reference could for instance be made to case C-333/14 *Scotch Whisky* concerning the introduction of a minimum price on alcohol, see CJEU's judgment paragraph 36, cf. AG Bot's Opinion paragraph 82-88 AND 127.

[26] For instance Bechmann & Raaballe, *Danske banker og finanskrisen* (2008), Bechmann & Raaballe *Manglende bremseklodser i danske banker* (2009), Bechmann & Raaballe *Danske bankdirektørers aflønning – Incitamentsaflønning eller tag selv bord?* (2009) and Bechmann & Raaballe *Stemme- og ejerbegrænsninger i danske banker – en replik* (2010).

[27] For instance Rose, Caspar, *Kritikken af pengeinstitutternes ejer og stemmelofter hviler på et alt for spinkelt grundlag* (2010), Østrup *Konsekvenser af ejerstrukturen i danske pengeinstitutter* (2013)

First, the ownership requirements in Denmark are usually 10 pct., although they may also in some cases either be 5 pct. or 15 pct.[28] It is recalled that in Norway, the administrative practice prevents as a main rule single shareholders from obtaining more than 20-25 percent ownership. Second, most of the listed financial institutions in Denmark also had imitations on the voting rights, of which the most common limit in 2009 was a ceiling on voting rights on less than 0,05 pct. The median was 0,03 pct. of the votes. Rules limiting the voting rights are virtually non-existent in Denmark for other listed companies than financial institutions, but the three listed (non-financial) companies that did have such limits, capped the voting rights on 7.5 pct., 10 pct. and 20 pct.[29] The limitations on voting rights for owners of financial institutions in Denmark are accordingly relatively strict.

In the *Rangvid-report*, the main critique against the Danish rules was that the management were given too much power and that shareholders may have been prevented from exercising professional control.[30] This was based on the *combination* of ownership limitation (at usually 10 percent) and the cap on voting right (at usually 0,03 pct.).

However, the incentives to exercise professional control is stronger for a shareholder of e.g. 20 percent with no voting rights than a shareholder of 5-10 percent with a cap on voting rights of 0,03 pct. The Danish rules are not comparable to the Norwegian administrative practice. If it is the case that the Danish rules combined have led to a pulverization of the shareholder influence that is not expedient from a corporate governance perspective, that does not however apply to the Norwegian rule whereby no single shareholder as a main rule is authorised to own more than 20-25 percent and with no limits on the voting rights.

In the Danish studies on differences in risk-taking between shareholder controlled banks and manager-controlled banks, the definition usually applied is that shareholder-controlled banks exist where there is shareholder with more than 5 percent ownership and which is independent from the manager. This is different from international studies which usually define large shareholder (concentrated ownership structure) as above 10 or 20 percent voting rights.[31] Moreover, it is recalled that strict voting rights are also widespread in Danish financial institutions. Accordingly, a financial institution with a 5 percent shareholding position, but with a cap on voting right of 0,03 pct would still, as far as the Government understands, be classified as a large shareholder and the bank thus as a shareholder-controlled bank. Moreover, a bank with a shareholder with for

[28] *Rangvid-rapporten, Den finansielle krise i Danmark – årsak, konsekvenser og læring* (2013) p. 281.

[29] *Rangvid-rapporten, Den finansielle krise i Danmark – årsak, konsekvenser og læring* (2013) p. 280.

[30] Page 43: "Det er udvalgets vurdering, at ejer- og stemmeretsbegrænsninger kan have udgjort en hindring for sikringen af en professionel ledelse af visse mindre og mellemstore institutter forud for den finansielle krise. Det er således udvalgets opfattelse at så vel lovbestemte som vedtægtsbestemte ejer- og stemmeretsbegrænsninger kan have den effekt, at de beskytter en bestyrelse i et institut, som ellers ville kunne blive afsat af ejerne...»

[31] Laeven & Levine *Bank governance, regulation and risk taking* (2008) on page 261.

instance 40 percent shareholding position, but which are not independent from the manager, will be considered as manager-controlled bank.[32]

The limited applicability of international studies on the risk-incentives in financial institutions with concentrated or dispersed ownership to the situation in Denmark (and vice versa) has also been recognise in the scientific literature on Denmark. For instance, Sørensen refers to international studies finding a positive correlation between large shareholders/concentrated ownership structure[33] and risk taking, but then argues that those international studies are not relevant to Denmark due to the specific rules ownership and voting rights applicable there.[34]

It is also incorrect to state, as the Authority does, that "the aim of ownership limitation in financial undertakings should be given more weight than, for example, the aim of ensuring sufficient ownership allowing to influence the decision making."

The Government does not accept the premise that there is an absolute contradiction between objectives pursued by the dispersed ownership rule and the aim of ensuring sufficient ownership allowing to influence the decision making. As observed above, the Danish rules are not comparable to the dispersed ownership rule in Norway which evidently allows for more ownership influence than provided by the Danish rules. In any event, when considering the shareholder influence, it is important to take into account the special corporate governance structures for financial institutions, see section 4.5.6 below.

Finally, if one were to accept the merits of the criticism raised against the Danish rules, the solution to a situation that possibly may afford too much power to the management would not, in any event, be to simply repeal those rules and to grant too much power to the shareholders. The solution would rather have to be a reasonable balance. Thus, the reference to the situation in Denmark does not in any event suggest that the dispersed ownership rule in Norway should be removed.

To sum up, the Governments view is that the Danish rules and scientific literature is of no or limited relevance to the dispersed ownership rule in Norway, and that critique raised against the Danish rules in any event does not call for the removal of the all ownership limitations.

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[32] See for instance Østrup Konsekvenser af ejerstrukturen i danske pengeinstitutter (2014) on page 6 and 7.

[33] Large shareholder is defined as an owner of more than 10 percent of the total shares and concentrated ownership exists where there is at least one large shareholder.

[34] *Har ejerstrukturen betydning for sandsynligheden for at blive nødlidende?* (2014), Sørensen, an appendix to Finanskrisekommissionen Kraka: Den danske finanskrise – kan det ske igjen? (2014).
In his study, Sørensen applies a similar definition of large shareholders as that adopted by Østrup, Konsekvenser af ejerstrukturen i danske pengeinstitutter (2014). This is also the definition adopted in most of the existing Danish literature, see for instance also Bechmann og Raaballe Manglende bremseklodser i danske banker (2009) and Bechmann og Raaballe Stemme- og ejerbegrænsninger i danske banker – en replik (2010).

4.5.4 The Government is genuinely concerned with the issue, and there is no requirement that the scientific literature relied on existed at the time the measure was adopted

In paragraph 68-69 of the letter of formal notice, the Authority suggest that the measure may not genuinely reflect a concern that concentrated ownership may lead to an increase of risk appetite to the detriment of the stability of the financial market. The reason given is that the ownership regulation historically was based on some other objectives and that the studies relied on are relatively recent (dating from 2009 to 2013).

The Government recalls that a finding that the measure is not suitable simply by examining the appropriateness of the measure against one of the objectives pursued, is legally flawed, cf. section 3.1 and 3.3.

Even if merely considering the objective of reducing the inherent risk-appetite in concentrated ownership structures, the Government submits that the Authority's line of reasoning is flawed for several reasons.

It follows from the CJEUs judgement in *Finalarte* that the national court had to consider *the actual and objective effects* of the measure, irrespective of the subjective statements on the aim of the measure (which was, moreover, illegal). This was also followed up in *Portugaia* – another case concerning the protection of posted workers. The CJEU reiterated that the national court had to determine whether, *viewed objectively*, the rules at issue in that case promoted the protection of posted workers. The existence or not of certain statements in the preparatory work is therefore of no or only limited importance when considering the objectives pursued by the measure.

With regard to *Dickinger*, the Government fails to see the relevance. The case concerned a gambling case on whether the German authorities actually was concerned with reducing opportunities for gambling, on the basis of an alleged expansionist and commercially aggressive policy by the monopoly holder. If confirmed by the evidence, it is fair to say that a commercially aggressive monopoly holder cannot (no longer) rely on the objective to reduce gaming activities. The conduct is thus *irreconcilable* with the purported objective. By contrast, there is nothing to suggest in the present case that Norway has either acted detrimental to the objectives relied on or even failed to take reasonable actions with a view to attain those objectives. Quite the contrary, particularly due to its experience with a banking crisis on the 1990s, Norway has consistently sought to strengthen the financial stability.

To ensure stability of the financial market is and has for a long time been a main objective of the Norwegian financial regulation. Norway has also for a long time sought to ensure a high level of protection in that regard.[35] The Government submits that the emergence of new evidence supporting the justification of an existing measure *also* by

[35] EFTA Court *Netfonds Holdings* paragraph 130, cf. 132.

virtue of its contribution to the financial stability naturally then forms part of the measure's *raison d'être*.

In section 3.3, reference was made to Meld. St. 29 (2015–2016) – Finansmarkedsmeldingen 2015, from which it follows that "Norwegian financial market policy is designed to provide a high level of stability."[36]

The importance of ensuring the stability of the financial markets in Norway had also been emphasised in for instance Meld. St. 30 (2012–2013) – Finansmarkedsmeldinga 2012, from which it follows on page 7 that:

> *"Preventing crises in the financial system is often less demanding than mitigating the negative consequences of a financial crises. <u>Facilitating financial stability is therefore a very important task</u> for the governing authorities."*[37]

The Norwegian financial market policy is accordingly designed to achieve a high level of stability in order to prevent financial crisis.

Norway has also been successful in that regard, as it was less affected by the financial crisis in 2007-2008 than other countries. In Innst. 360 S (2011–2012), the Finance committee emphasised the robust financial regulation in Norway as a major explanatory factor, referring to the valuable (although costly) experiences learned from Norway's own bank crisis some twenty years ago at that time.

Financial stability in Norway has accordingly been of utmost importance, the financial regulation has been designed to achieve financial stability, and the experience from the financial crisis suggest that Norway has been successful.

Moreover, the Norwegian authorities have also in fact explicitly referred to *the excessive risk-incentives* as a fundamental cause of the financial crisis. From Meld. St. 12 (2009–2010) – Finansmarknadsmeldinga 2009, it follows:

> "*Generally, it seems to be a broad consensus that excessive risk-appetite among important operators, and inadequate and partly non-existent regulation in some important countries, are important causes of the financial crisis."*[38]

This further shows that the Norwegian authorities have been *genuinely* concerned with the emergence of an excessive risk-appetite in the financial sector. And, when new evidence pinpoints the excessive risk-appetite to concentrated ownership structures, it

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[36] Reference can also be made to inter alia Meld. St. 34 (2016-2017) – Finansmarkedsmeldingen 2016-2017 p.54.

[37] Unofficial translation. In Norwegian original: «Å førebyggja kriser i finanssystemet er ofte mindre ressurskrevjande enn å motverka utslaga av finanskriser. Å leggja til rette for finansiell stabilitet er difor ei svært viktig oppgåve for styresmaktene».

[38] Unofficial translation. In Norwegian, original: "Generelt ser det ut til å vere brei semje om at for stor risikotaking hos viktige aktørar, og mangelfulle og dels fråverande reguleringar i sentrale enkeltland, er viktige årsaker til finanskrisa.»

is evident that the Norwegian authorities are also genuinely concerned with that particular cause of the excessive risk-appetite, particularly when there already is a broad agreement in the Parliament behind the dispersed ownership rule.[39]

The Government submits therefore that there is no basis for calling into question that the Norwegian authorities are *genuinely* concerned with the stability of the financial market, and in that regard also excessive risk-incentives as a major cause of financial instability, including the emergence of evidence on those excessive risk-incentives stemming from concentrated ownership structures in financial institutions.

4.5.5 The suitability condition does not require the establishment of an optimal risk level and the demonstration of a risk level exceeding that yardstick

In paragraph 71 in the letter of formal notice, the Authority refers to the judgment by *Oslo tingrett* and states that bank activity will always entail risk.

The Authority seem to question how risk-incentives possibly created by a concentrated ownership structure could be a problem *per se*, as banking activities entail by necessity some level of risk and not all levels of risk can thus be considered to constitute a problem (to be addressed by restrictive measures).

First, the acceptable level of risk depends on the level of protection sought in each EEA State, which the EFTA Court has found to be a high level of protection.[40]

Second, if the Authority's argument is to be understood to the effect that it is impossible to claim the existence of *excessive* risk-incentives as a justification for a restrictive measure if not compared to a yardstick of optimal or acceptable risk level, the Government submits that this is another example of a novel test being proposed by the Authority for which there are no support in case law and moreover would have unforeseen consequences for regulatory measure in the financial sector.

Third, and in any event, the Government submits that the evidence presented is sufficient to prove that it is reasonable to assume or even likely that the increased risk-incentives created by concentrated ownership structures are so high that it has a *negative* affect the stability of the market and increases the likelihood of financial crisis if not addressed in an appropriate manner. Reference is made to section 4.5.6 where this is further outlined.

Based on the above, the Government submits that the Authority's view is vitiated with errors of law and fact.

[39] See e.g. Meld. St. 21 (2013–014) – Finansmarknadsmeldinga 2013 on page 50.
[40] *Netfonds Holding* paragraph 113.

4.5.6 It is at least reasonable to assume the existence of excessive-risk incentives due to concentrated ownership in financial institutions and that the dispersed ownership rule will strengthen the corporate governance

The Government submits that in addition to being appropriate to prevent conflicts of interest, ensure independence and to reduce the risk of misuse of ownership power (see section 4.4 above), the dispersed ownership rule is also suitable to attain the objective of reducing the excessive-risk incentives due to concentrated ownership in financial institutions and to strengthen the corporate governance in financial institutions.

Traditional corporate governance theory suggests that shareholder and manager interests should be aligned to reduce agency costs. However, there are several differences between non-financial firms and financial institutions that renders the traditional corporate governance inappropriate for banks. There is an increase amount of literature emphasising that *pro-shareholder banks were guilty of excessive risk-taking prior to the financial crisis.*

In *Principles of Financial Regulation* (2016), Armour et. al. states that:"Unfortunately, tightening the linkage between shareholders and managers in banks had the adverse effect of encouraging bank managers to test the limits of regulatory controls and take excessive risks. As we describe in this chapter, <u>the banks that had the most 'pro-shareholder' boards</u> and the closest alignment between executive returns and the stock price were those that <u>took the greatest risk prior to, and suffered the greatest loss during, the crisis</u>."[41]

Further, to the same effect, Armour et. al states that:

> *"An emerging body of literature reports that the bank executives subject to the strongest incentives to maximize the value of their shares – as reflected in stock-based compensation, oversight by independent directors, and <u>shareholder power</u> – worked at banks that took the greatest risks and suffered the greatest losses. In other words, financial firms that had the 'best' governance mechanisms, as conventionally understood before the crisis, actually did worst during the crises."*[42]

Armour et. al. then explains why banks are different from non-financial firms. The Government quotes the reasoning (almost) in full:

> *"The first difference is that banks are <u>highly leveraged</u>… As a result, shareholders may stand to benefit at creditor's expense from changes in the bank's investment projects that increase the risk and associated return. If things go well, the shareholders keep the increased returns,*

[41] Page 371.
[42] Page 376.

whereas if things go badly, the creditor suffer losses. Perversely, mechanisms that succeed in tying executives to the interests of shareholders may actually exacerbate those financial agency costs. Creditors should therefore satisfy themselves that there are strong checks in place to ensure that the riskiness of the bank's activities is kept within acceptable limits. However, depositors usually have only modest amounts at stake and are widely dispersed, so they do not wish to, or feel able to, monitor" bank lending effectively."

"The second difference is that bank failure imposes greater costs on society. A bank failure can trigger contagion in other parts of the financial system, and, by impeding the operation of the financial system, can harm the ability of business to obtain finance… Moreover, as the source of contagion is usually the failure of a financial firm, governments have incentives to throw money at troubled firms to avert such failure… The implicit government guarantee means that such firms enjoy a lower cost of credit and that creditor's incentives to monitor the firms' performance is undermined. What this does is to morph the creditor's problem described in the previous paragraph into a problem for society more generally, through the implicit subsidy that creditors receive.

The third difference is that certain types of financial assets are hard to observe and measure. The rationale for bank lending … is that banks may be able to collect information on borrowers that is not available to others. Hence, the value of their loan portfolio may not readily be subject to external scrutiny by shareholders as well as potential bidders and creditors themselves.

As a result of the first and second of these differences, regulators – in lieu of creditors – are tasked with monitoring and controlling bank risk-taking. However, the very difficulty of monitoring financial assets. The third difference described above – makes it particularly challenging for regulators, as well as investors, to perform this task effectively. And the efficiency of regulatory control is further compromised by very intense managerial incentives to maximize the share price. Managers may, therefore, seek to avoid regulation and to minimize the costs of regulation by influencing regulators, rather than taking desired actions and precautions to minimize risks of failure."[43]

Further, Armour et. al., states in section 17.5 that:

[43] Page 374-375.

> *"As shareholders enjoy limited liability, in the presence of imperfectly priced deposit insurance, or the expectation of a bail-out for 'too big to fail' firms, we might think they would have incentives to encourage firms to take more risk than is socially desirable. Consistently with this, Ferreira et al report that US banks in which shareholders enjoy objectively greater power – in terms of shareholder rights and ability to control management. were more likely to be bailed out during the financial crisis.*
>
> *We might expect this concern to be ameliorated where investors hold shares in banks as part of a diversified portfolio. Such investors will internalize a large part of the costs to society of bank failure through the losses to their other portfolio firms. On the other hand, the problems will be exacerbated by the presence of controlling shareholders, who will be in a position to make more of a difference to the control of the firm than dispersed shareholders, and who will be less diversified and so care less about impacts on other firms."*[44]

Similarly, in *Short-Termism: Why Corporate Governance for Banks is Different* (2016), Østrup & Oxelheim argues that:

> *"[There is a] substantial difference between financial institutions and non-financial companies in the way managements react to the pressures from short-term shareholders. As a response to short-term shareholders, bank management is inclined to increase lending to capture a short-term increase in earnings while costs, in the form of subsequent losses, appear much later. Management of non-financial firms, on the other hand, have incentives not to expand business activities as this requires a reduction in short-term earnings, implying a rise in the risk for managements of being fired. Thus, while the purpose of corporate governance in non-financial firms is to push managements into risk taking, corporate governance in banks should aim at restraining managements from taking excessive risks."*[45]

Furthermore, in *Konsekvenser av ejerstrukturen i danske pengeinstitutter* (2013)[46], Østrup states:

> *"In credit institutions, short-term shareholders can have more serious consequences as it entails a pressure on an expansion of loans and thereby increases the risk of a subsequent collapse in the credit institution.*

[44] Page 388.
[45] Page 1, abstract.
[46] In English: Consequences of the ownership structure of Danish banks.

This viewpoint can be explained as follows. An expansion of lending in a credit institution will mean that earnings will be generated in the short term, while the costs - in the event of any losses on the loans granted - will only appear in the longer term. Therefore, in view of the desire to create satisfaction among shareholders with a short time horizon, the management of credit institutions has an incentive to expand lending, which increases the risk of a subsequent crisis. In view of the need to avoid crises in credit institutions, it is therefore advantageous to isolate management from the influence of the stock market.[47]

…

In view of reducing the negative societal costs of collapse in credit institutions, it is desirable that credit institutions have a less expansionary strategy than the strategy involving maximizing profits. This public concern is sought through financial regulation aimed at reducing risk taking in the credit institution. However, it is possible that financial regulation is not sufficient. It could thus be a public interest to organize the management of a credit institution in such a way as to limit risk taking. This could suggest limiting shareholder influence."[48] *(unofficial translation)*

The above clearly suggest that financial firms with controlling shareholders take on excessive risk – more than socially desirable – and that traditional regulation is not sufficient. This suggest a regulatory approach whereby the shareholder influence itself is limited. Furthermore, as the Government will revert to in section 4.5.7 below, not only may financial regulation be insufficient to address this concern, as argued above, in combination with controlling shareholders it may even further increase the excessive risk-incentives.

[47] Page 2. In Danish, original text: «"I kreditinstitutter kan en kort tidshorisont hos aktionærerne have mere alvorlige konsekvenser, idet den medfører pres for en ekspansion aflån og derved øger risikoen for et senere sammenbrud i kreditinstituttet. Synspunktet kan forklares på følgende måde. En udvidelse af udlånene i et kreditinstitut vil indebære, at der på kort sigt skahes en indtjening, mens omkostningerne - i form af eventuelle tab på de bevilgede udlån - først viser sig på længere sigt. Set ud fra ønsket om at skabe tilfredshed blandt aktionærer med en kort tidshorisont har ledelser i kreditinstitutter derfor en tilskyndelse til at ekspandere udlånene, hvilket øger risikoen for en senere krise. Set ud fra hensynet til at undgå kriser i kreditinstitutter er det derfor en fordel at isolere ledelsen fra aktiemarkedets påvirkning.»

[48] Page 3. In Danish, original text: «Ud fra hensynet til at mindske de negative samfundsmæssige omkostninger, der er ved sammenbrud i kreditinstitutter, er det ønskeligt, at der i kreditinstitutter føres en mindre ekspansiv strategi end den strategi, der indebærer maksimering af overskuddet. Dette samfundsmæssige hensyn søges tilgodesegennem finansiel regulering, som sigter mod at mindske risikotagningen i kreditinstituttet. Det er imidlertid muligt, at den finansielle regulering ikke er tilstrækkelig. Det kunne herved være en samfundsmæssig interesse at indrette ledelsen i et kreditinstitut på en sådan måde, at risikotagningen begrænses. Dette kunne tale for at begrænse aktionærernes indflydelse."

As noted by Armour et. al., the view that financial firms with controlling shareholders take on excessive risk is moreover not only something that is suggested in economic theory. There is an increasing amount of evidence underpinning this, some of which are briefly mentioned here.

In *Ownership Structure, Deregulation, and Bank Risk Taking* (1990) Saunders et. al. found support for the hypothesis that stockholder controlled banks have incentives to take higher risk than managerially controlled banks. The paper concluded that the "results have an important implication as far as bank failure avoidance is concerned."

Further, in *Bank governance, regulation and risk taking* (2009), Levine et. al. showed that bank risk taking varies positively with the comparative power of shareholders[49] within the corporate governance structure of each bank.[50] The paper found that banks with more powerful owners tend to take greater risks. The paper concluded:

> *"We find that banks with more powerful owners tend to take greater risks. This is consistent with theories predicting that equity holders have stronger incentives to increase risk than nonshareholding managers and debt holders and that large owners with substantial cash flows have the power and incentives to induce the bank's managers to increase risk taking."*[51]

Further, in *Bank CEO incentives and the credit crisis (2009)*, Fahlenbrach et al. found no evidence that banks with CEOs whose incentives were better aligned with the interests of their shareholders performed better during the crisis and some evidence that these banks actually performed worse, in contrast to what traditional corporate governance theory would suggest. It is stated that:

> *"A possible explanation for our results is that CEOs with better incentives to maximize shareholder wealth took risks that other CEOs did not. Ex ante, these risks looked profitable for shareholders. Ex post, these risks had unexpected poor outcomes. These poor outcomes are not evidence of CEOs acting in their own interest at the expense of shareholder wealth."*[52]

In *Why did some banks perform better during the credit crisis?* (2009), Beltratti et. al., found inter alia that:

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[49] The paper defined a bank having a large owner if the shareholder has direct and indirect voting rights that sum to 10% or more. If no shareholder holds 10% of the voting rights, the bank is classified as widely held. The paper's results hold when using a 20% cutoff to define a large owner.
[50] The paper also showed that the same regulation (capital regulations, deposit insurance policies, and restrictions on bank activities) has different effects on bank risk taking depending on the bank's corporate governance structure. This latter aspect is commented upon in section 4.5.7.
[51] Page 273.
[52] Page 13.

"There is no evidence that banks with better governance, when governance is measured with data used in the well-known Corporate Governance Quotient (CGQ score) perform better during the crisis. Strikingly, banks with more pro-shareholder boards performed worse during the crisis. Such a result does not mean that good governance is bad. Rather, it is consistent with the view that banks that were pushed by their boards to maximize shareholder wealth before the crisis took risks that were understood to create shareholder wealth, but were costly ex post because of outcomes that were not expected when the risks were taken."[53]

In *Strong boards, CEO power and bank risk-taking* (2009), Pathan stated that a strong bank board is expected to better monitor bank managers for shareholders, but that in the presence of 'moral hazard problem', since bank shareholders have incentives for more risk, strong bank boards can be expected to associated with bank risk-taking positively. Pathan stated that

"The consequences of such risk-taking by financial institutions via imprudent lending activities are far reaching. Therefore, studying bank risk-taking behavior is far more important today than ever before.[54]

Pathan's study found that strong bank boards (boards reflecting more of bank shareholders interest) positively affect bank risk-taking, but that, in contrast, CEO power (CEO's ability to control board decision) negatively affected bank risk-taking.[55]

In *Bank Owners or Bank Managers: Who is keen on Risk? Evidence from the Financial Crisis* (2010), Gropp et al., analysed whether bank owners or bank managers were the driving force behind the risks incurred in the wake of the financial crisis of 2007/2008. Gropp et al showed that owner controlled banks had higher profits in the years before the crisis, incurred larger losses and were more likely to require government assistance during the crisis compared to manager controlled banks. The paper concluded that:

"The results in this paper suggest that owner controlled banks experienced higher profits before the crisis and larger losses during the crisis. Both imply that owner controlled banks incurred greater risks compared to manager controlled banks. Economically these effects are large. The profits of banks owned by a majority shareholder operating in a country with strong shareholder rights declined about five times as much during the recent crisis compared to widely held banks operating in countries with weak shareholder rights. These effects are robust to including a wide variety of regulatory, bank specific and country specific variables. We also

[53] Page 3.

[54] Page 1340.

[55] The term 'strong boards' is to explain boards' effectiveness in monitoring bank managers for their shareholders. Similarly, the term 'CEO power' refers to bank CEO's ability to influence board decisions.

> *find that the probability of owner controlled banks to receive government assistance during the crisis is significantly higher than that of manager controlled banks.*[56]
>
> …
>
> *[The results] do not support the idea that aligning the interests of management better with shareholders will reduce risk taking of banks. Instead they suggest the opposite. If management is better controlled by shareholders, banks may increase their risk taking. Indeed, one may be able to interpret the observed compensation schemes before the crisis as attempts by shareholders to induce management to increase their risk taking in line with the preferences of shareholders. At the same time, weakening the control of shareholders over management would not only reduce risk, but may entail significant efficiency costs for banks. Privately optimal management compensation schemes may not be socially optimal, as they do not take the externality of a higher probability of bank failure into account."*[57]

On the basis of the above, the Government maintains that limiting the shareholder power through the dispersed ownership rule is appropriate to attain the objective of reducing the excessive risk-incentives stemming from a concentrated ownership structure, and in that regard also strengthen the corporate governance structure in financial institutions.

4.5.7 Additional benefits from the dispersed ownership rule, forming part of the overall objectives of the Norwegian financial regulation

The Government also holds that the dispersed ownership rule has several additional benefits which evidently also form part of objectives of the Norwegian financial regulation, including the dispersed ownership rule.

First, the Government submits that a dispersed ownership structure strengthens the effect of other regulatory measures, such as capital requirements, activity restrictions, etc., in contrast to concentrated ownership structures that will have a negative impact on the effect of the same regulatory measures.

In *Bank governance, regulation and risk taking* (2009), Levine et. al. showed that the same regulation (capital regulations, deposit insurance policies, and restrictions on bank activities) has different effects on bank risk taking depending on the bank's corporate governance structure. It follows from the paper that:

[56] Page 21.
[57] Page 22.

"The paper found that the relation between risk and regulation depends critically on each bank's ownership structure, such that the relation between regulation and bank risk can change sign depending on ownership structure. For example, the results suggest that deposit insurance is associated with an increase in risk only when the bank has a large equity holder with sufficient power to act on the additional risk-taking incentives created by deposit insurance. The data also suggest that owners seek to compensate for the utility loss from capital regulations and activity restrictions by increasing bank risk. Stricter capital regulations and more stringent activity restrictions are associated with greater risk when the bank has a sufficiently powerful owner, but stricter capital regulations have the opposite effect in widely held banks. Ignoring bank governance leads to erroneous conclusions about the risk taking effects of banking regulations."[58]

…

"Furthermore, the impact of bank regulations on bank risk depends critically on each bank's ownership structure. The effect of the same regulation on a bank's risk taking can be positive or negative depending on the bank's ownership structure. Consistent with theory, we find that ignoring ownership structure leads to incomplete and sometimes erroneous conclusions about the impact of capital regulations, deposit insurance, and activity restriction on bank risk taking."[59]

Accordingly, the effectiveness of other financial regulation "depends critically" on the ownership structure. The existence of capital regulations, deposit insurance policies and restrictions on bank activities actually increase the already excessive risk-incentives stemming from the concentrated ownership structure as identified above in section 4.5.6, whereas there is no significant impact if the bank is widely-held.

In *The role of ownership structure and regulatory environment in bank corporate governance* (2010), Westman confirmed the findings of Levine et. al., as described above, that a generous deposit insurance system induces risk-taking (only) in banks with a blockholder owner.[60] Westman states therefore "that it is crucial to examine the joint impact of ownership characteristics and regulatory environment features rather than only the impact of individual corporate governance mechanisms."[61]

[58] Journal of Financial Economics 93 (2009) 259–275 on page 261.
[59] Page 273.
[60] Page 1 and 2.
[61] Page 2.

Finally, Westman also argues that "the combinations of ownership structure and regulatory environment … are associated with higher risk in the pre-crisis period and a greater and a greater impact on variables measuring the level of severity of the financial crisis",[62] and moreover that "bank corporate governance, ranging from regulatory mechanisms to bank ownership structure and the incentives these create, has played a significant role in the development of the current financial crisis."[63]

Moreover, the measure also contributes to a sound capital situation, allowing for the financial institution to not be too dependent on the financial situation of a single or only very few shareholders, but at the same time allowing for sufficiently large shareholders that are more likely to be willing to follow up on their investment with further capital injections, if need be. Moreover, in *Konsekvenser av ejerstrukturen i danske pengeinstitutter* (2013)[64], Østrup argues that:

> *"Considering the need to ensure an efficient handling of crises in credit institutions, it may be inappropriate to have large shareholders in credit institutions. It is conceivable that large shareholders will oppose the recapitalization of a credit institution by new equity capital, as the inflow of new equity capital will dilute the large shareholder's ownership interest. Alternatively, the major shareholder may prefer to reduce the credit institution's lending in a situation where there is a risk of non-compliance with solvency requirements."*[65]

Moreover, an excessively large concentration of ownership power may reduce the effectiveness of the supervision. It is recalled that in *Principles of Financial Regulation* (2016), Armour et. al. emphasises the particularly difficult task of regulators to monitor financial institutions properly. Moreover, "the efficiency of regulatory control is further compromised by very intense managerial incentives to maximize the share price. Managers may, therefore, seek to avoid regulation and to minimize the costs of regulation by influencing regulators, rather than taking desired actions and precautions to minimize risks of failure."[66]

Concrete examples of this are recalled in the report from the Special Investigation Commission a concrete example of this is mentioned:

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[62] Page 37.
[63] Page 35.
[64] In English: Consequences of the ownership structure of Danish banks.
[65] Page 3. In Danish, original: "Set ud fra hensynet til at sikre en effektiv håndtering afkriser i kreditinstitutter kan det være uhensigtsmæssigt med storaktionærer i kreditinstitutter. Det kan således tænkes, at storaktionærer vil modsætte sig en rekapitalisering af et kreditinstitut gennem tilførsel afny ejerkapital, idet tilførslen af ny ejerkapital vil udvande storaktionærens ejerandel. Som et alternativ kan storaktionæren foretrække at nedskære kreditinstituttets udlån i en situation, hvor der er risiko for en ikke-overholdelse af solvenskrav."
[66] Page 374-375.

> *"It is worth reiterating that loans, that are too big, to one customer and related parties are not beneficial to the banks. There is, at the same time, increased risk that a bank will suffer serious reversals of fortune if the customer goes bankrupt and, not least, there is a risk that the balance of power between the bank and the customer will be disrupted, as discussed above. Therefore, the Special Investigation Commission is of the opinion that the objective of the management teams of the banks and their risk management teams should have been not to permit individual exposures to become too large. Instead, <u>there is evidence that the banks themselves had taken part in trying to bypass rules on large exposures</u>. The Investigation Commission finds this reproachable. <u>Numerous examples are mentioned in the report</u>, such as a Joan from Glitnir to Svarthafur ehf. This resulted in significantly increasing the concentration risk within the banks."*[67]

Another concrete example of the insufficiency of traditional regulatory measures, is the fall of the Banco Espirito Santo, further outlined in section 5 below. As it follows there, according to an article from Reuters, the bank's chief executive "ignored a directive from Portugal's central bank that [he] stop mixing the lender's affairs with the family business". In addition, the banks' auditor, KPMG, found that the bank "had either not recorded or had under-reported financial liabilities and risks, had grossly overvalued its assets, and had scant evidence for its reported transactions." The article further describes that some of these transactions were made "through an opaque transatlantic ping pong".

These examples illustrate that objective and simple rules reducing the very position from which to exert undue influence would contribute to a more efficient supervision from the regulatory authorities.

Finally, large shareholders having excessive risk-incentives would weaken the trust and confidence in the financial sector. Unambiguous and objective requirements may contribute to a stronger trust among the customers and creditors than alternative measures that are less effective and less transparent.

4.5.8 The level of 20-25 percent is an appropriate level in order to attain the objectives pursued

In the letter of formal notice paragraph 70, the Authority claims that the Norwegian Government has not explained why it has chosen in particular ownerships not exceeding 20-25 percent of shares of a financial undertaking.

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[67] Chapter 21, page 13.

First, the maximum level of 20-25 percent is set on the basis of the experience that in the banking and insurance sector, such holding may *de facto* suffice to exert negative control, due to *inter alia* a fragmented ownership structure and low attending rates at the general assembly, cf. also case-law.[68] The Government submits therefore that this level is appropriate to attain the objective of reducing risk of misuse of ownership power.

Second, according to scientific literature, the excessive risk-incentives associated with concentrated ownership have been observed where voting rights exceed 10 and 20 percent. Therefore, that the maximum level of 20-25 percent is also appropriate to attain the objective of reducing the excessive risk incentives stemming from concentrated ownership.

Third, as noted above in section 4.5.3 the maximum level of 20-25 percent is sufficient to allow for sufficient ownership influence over the decision making, in contrast to the Danish rules.

Fourth, the level of 20-25 contributes to ensure a sound capital situation allowing for the financial institution to not be too dependent on the financial situation of a single or only very few shareholders, but at the same time allowing for sufficiently large shareholders that are more likely to be willing to follow up on their investment with further capital injections, if need be.

On that basis, the Government submits that the level of 20-25 percent is appropriate in order to attain the objectives pursued and to ensure a reasonable balances approach.

4.6 The Authority's claim that the measure is inconsistent

4.6.1 Even according to the Authority's understanding of the secondary law, there is no inconsistency in an EEA law regard

The Government does not agree with the Authority's view on the relevant secondary law. This is further analysed in section 4.6.2 below. However, even according to the Authority's understanding of the secondary law, the Government submits that the alleged inconsistencies would not constitute an inconsistency in an EEA law sense capable of rendering the measure unsuitable to attain the objectives.

First, the Authority's view contradicts the findings of the EFTA Court in *Netfonds Holding*. From paragraph 122 it clearly follows that the EFTA Court considered the administrative practice as suitable to attain the objectives pursued, and despite the EFTA Courts view on the secondary law in paragraph 123, it states in the concluding paragraph 124 that "the administrative practice … appears suitable to achieve that objective <u>to the extent that</u> it applies to applications for authorisation as a bank or an

[68] See e.g. C-89/09 *Commission v France*, paragraph 68, and Case E-09/11, *EFTA Surveillance Authority v Norway*, paragraph 81.

insurance company and not to secondary acquisitions after the granting of authorisation."

Second, the Authority's inconsistency-argument relies on an incorrect understanding of the consistency requirement. It follows from case law that the consistency test requires that "*a State* must not take, facilitate or tolerate measures that would run counter to the achievement of the stated objectives of a given national measure" (emphasis added).[69] The issue is w*hether the conduct by the EEA State itself* contradicts the objectives pursued by the measure.

The test is not concerned with measures taken or accepted by the EEA State as a direct result of an EEA law obligation. That is not "hypocrisy" on the part of the EEA State capable of calling into question the *real* objective of the measure, but simply the legal consequences arising from the EEA law. Those consequences are attributable to the degree of harmonization sought by the secondary law, [70] not any conduct on the part of the Norwegian authorities.

The Government also refers to the expert report by Professor Bekkedal. Indeed, professor Bekkedal was of the view that the secondary law prevented the application of the dispersed ownership rule to subsequent acquisitions, as the Authority also argues, but he nevertheless found that this did not and could not entail any inconsistency in an EEA law sense.[71]

The Government submits therefore that even if the Authority's understanding of the secondary law is correct, in the sense that the dispersed ownership rule may not apply to subsequent acquisitions, that does not entail that the dispersed ownership rule is inconsistent when applied to the initial authorisation.

4.6.2 The Authority's understanding of the secondary law is incorrect

It is undisputed that directive 2000/12/EC, directive 2006/48/EC and directive 2002/83/EC, as amended by the QHD, does not address the level of harmonisation governing the prudential conditions for initial authorisation of banks and insurance companies. Reference is made to *Netfonds Holding* paragraph 101.

Consequently, as the EFTA Court states in *Netfonds Holding* paragraph 102, the QHD "did not prevent the EEA States from maintaining stricter rules concerning the procedure for the authorisation of banks and insurance companies."

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[69] See e.g. EFTA Courts judgment in E-1/6 Gaming Machines paragraph 43 and its advisory opinion in case E-3/6 Ladbrokes paragraph 51.

[70] See also in this regard CJEUs judgment in case C-11/92 Imperial Tobacco paragraphs 20 and 22, and C-128/94 Hönig paragraphs 16-17.

[71] Bekkedal's report *Egnethetsprøving av store eiere i finansforetak*, section 7.3.3.

Since the QHD merely sought the lay down harmonised rules on the procedure for and prudential assessment of subsequent acquisition of qualifying holdings, but did not address the level of harmonisation governing the prudential conditions for initial authorisation of banks and insurance companies, it was an *unavoidable (and acknowledged) matter of fact* that regulatory differences could emerge.

The Government is of the view that the rules on subsequent acquisitions of qualifying holdings cannot be (mis)used as a basis to circumvent the (stricter) conditions by which the financial institution is already obliged on the basis of its initial business authorisation. This is supported not only by the partly harmonising character of the QHD, but also more explicitly by recital 3 of the QHD, which reads: "The Directive <u>prevents the circumvention</u> of the initial conditions for authorisation by acquiring a qualifying holding in the target entity in which the acquisition is proposed." Moreover, it is also supported by recital 4 of the QHD.[72]

Neither the letter of formal notice nor the reasoned opinion contain any arguments concerning recital 3, despite being emphasised by the Government in previous correspondence.

Instead, the Authority argues i) that recital 4 is designed to cover other circumstances, notably prudential requirements imposed by the directives in the financial sector such as capital requirements, and ii) that the contested measure is based on the suitability assessment of the owners of financial undertakings, which has been fully harmonised at the EEA level in Directive 2006/48/EC, as amended by Directive 2007/44/EC, and Solvency II, and that the relevant provisions in those directives would become devoid of their purpose if the Government's view would prevail.

First, with regard to recital 4 (and recital 3), the Government submits that there is no basis for the Authority's narrow understanding to the effect that only conditions *imposed* by the directive would be covered as initial conditions, as opposed to those conditions attached by the national authorities to the granting of initial business authorisation *in accordance with* the directive.

Second, it is misleading to claim that the dispersed ownership rule is based on the suitability assessment of the owners of financial undertakings, and incorrect to claim that the assessment of the owners has been fully harmonised.

It is recalled that the dispersed ownership rule consists of two parts – the issue rule and the administrative practice – which are considered as a whole. The national legal basis for the issue rule is section 3-3 second paragraph first sentence of the Financial Undertakings Act, while the administrative practise whereby no single shareholder is,

[72] "The prudential assessment of a proposed acquisition should not in any way suspend or supersede the requirements of on-going prudential supervision and other relevant provisions to which the target entity has been subject since its own initial authorisation."

as a main rule, allowed to own more than 20-25 percent of the total shares in financial undertakings, is legally based on section 3-2 first paragraph second sentence, according to which conditions may be set for the authorisation.

The suitability assessment of the owners is moreover *not* fully harmonised with regard to the initial authorisation, cf. e.g. article 7 of directive 2000/12 from which it follows that the competent authorities shall refuse authorisation if, taking into account the need to ensure the sound and prudent management of a credit institution, they are not satisfied as to the suitability of the abovementioned shareholders or members. Nor are the suitability criteria fully harmonised in CRD IV, cf. below.

Third, the Authority's argument that the relevant provisions in the secondary law would become devoid of their purpose if the Government's view would prevail, is also incorrect.

It is recalled that the QHD was adopted on the backdrop of the Commission's finding that the level of cross-border acquisitions in the financial market was sub-optimal, and moreover that differing national rules applicable to acquisitions constitutes a major hinder to an increased cross-border acquisitions. On that basis, it follows from recital 2 of the QHD that "[a] clarification of the criteria and the process of prudential assessment is needed to provide the necessary legal certainty, clarity and predictability with regard to the assessment process, as well as to the result thereof."

Since the adoption of the QHD, the possibilities for national authorities to introduce new criteria or apply other criteria than those following from QHD to a proposed acquisition is limited. That in turn "increases <u>legal certainty, clarity and predictability with regard to the assessment process</u>", as mentioned in recital 2 of the QHD, and it may thus also contribute to an increase in cross-border acquisitions in the financial EEA market.

The Government is of the opinion that the purpose of achieving the necessary legal certainty, clarity and predictability in order to increase cross-border transactions in the financial market will also be achieved with the Government's view.
Potential acquirers of a qualifying holding in a financial institution in another country will usually perform some sort of Due Diligence of the target entity, both economic and legal. It is not unusual to consider the target entity's authorisations, including the conditions attached to those authorisations. This does not contradict the QHD's purpose of achieving the necessary legal certainty, clarity and predictability with regard to subsequent acquisitions, as this is part of the normal transaction procedure.

At the same time, the fact that the conditions are attached to the initial authorisation also effectively limits the possibility for the EEA State to suddenly attach *new* conditions to a given proposed transaction, under the guise of seemingly legitimate aims. It prevents the EEA States from acting arbitrarily in the case of a proposed cross-border acquisition.

While the Authority is concerned with an alleged circumvention by EEA States of the requirements of QHD to subsequent acquisitions through the use of stricter conditions for the initial authorisation, the QHD is more concerned with the circumvention by potential acquirers of qualifying holdings of the initial conditions to which the target entity has been subject to through the use of the harmonised rules on subsequent acquisitions. The latter is prevented, cf. recital 3.

The Authority's view would entail that the harmonised rules on the procedure for and prudential assessment of subsequent acquisition of qualifying holdings would always prevail over the initial conditions attached to the business authorisation in the event of conflict. If accepted, it would entail a *de facto* harmonising directive also with regard to the initial authorisation procedure and assessment, which is difficult to reconcile with the partly harmonising character of the QHD.

Further, reference is made to Case C-18/14, in which the CJEU had the opportunity to interpret directive 92/49/EEC, which regulated the sector of direct insurance other than life assurance, as amended by the QHD. CJEU was called upon to decide whether the introduction by the QHD of the limited set of prudential criteria for the assessment of acquisitions of qualifying holdings, prevented the competent authorities from imposing a condition for the approval of such acquisition that at least half of the members of the supervisory boards of the target undertakings, including the chairs, should be independent of the shareholders.

The CJEU nevertheless found that member states were entitled to attach conditions to the authorisation of such acquisitions, provided that they sought to satisfy the prudential assessment criteria, and did not go beyond what was necessary in doing so.[73] Moreover, the CJEU held that the directive did not prevent the specific conditions concerning the composition and structure of the supervisory boards of the target companies. These conditions could legitimately be imposed on the basis of Article 15(1)(2) of Directive 92/49, as amended, which, according to the CJEU, allowed for conditions "relating to the ability of the insurance undertaking ... to comply and continue to comply with the prudential requirements based inter alia on that directive ... "[74]

Advocate General Mengozzi stated in his Opinion that Article 15(1)(d) of directive 92/49 "provides that the competent authorities are to ensure the 'suitability' of the undertaking to 'comply and continue to comply' with its prudential obligations", and moreover that that provision concerned the "protection … against the undue influence

[73] Case C-18/14 paragraphs 50-55.
[74] Case C-18/14 paragraph 56, cf. paragraph 49.

of the proposed acquirer. [75] " Next, Advocate General Mengozzi held that the "condition aimed at ensuring the independence of the supervisory board … appears to me to be appropriate to preclude the undue influence of the proposed acquirer."[76]
lf, on the other hand, the proposed acquirer would have been able to appoint the majority of the members of the management board, "there would be nothing to prevent it taking decisions contrary to the 'sound and prudent management' required by Article 15b{1) of Directive 92/49, as amended ..." [77]

In the view of the Government, therefore, the QHD does not prevent the competent authorities from imposing requirements on the ownership structure, as a condition for the approval of acquisitions of qualifying holdings, in order to prevent the undue influence of the proposed acquirer, thereby contributing to the sound and prudent management of the financial institution.

Finally, with regard to the Authority's reference in paragraph 79 of the letter of formal notice, while it is correct that the same assessment criteria are applicable to the authorisation to commence the activity of a credit institution as regards the suitability of the shareholders or members, it clearly follows from the wording of Article 14 paragraph 2 that other assessment criteria is not excluded as such, cf. the fact that authorisation shall be refused "in particular where the criteria set out in Article 23(1) are not met".

4.6.3 Conclusion

The ownership control regime creates safeguards against misuse of power and reduces the excessive risk incentives that large owners have, as the rules prevent a single shareholder from owning more than 20-25 pct. of the total shares in a financial undertaking.

On this basis, the Government contends that it is at least reasonable to assume that dispersed ownership rule have an effect on the attainment of the objectives pursued, cf. section 3.3.

5. NECESSITY

5.1 Overview

The necessity test consists of an assessment of whether the national measure is needed in order to achieve the legitimate objectives at the level of protection sought, or whether this could equally well be obtained through other, less restrictive means.[78]

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[75] Paragraph 66 of his Opinion in case C-18/14.
[76] Paragraph 68 of his Opinion in case C-18/14.
[77] Paragraph 68 of his Opinion in case C-18/14
[78] Reference is made to E-03/06 paragraph 58.

According to case law, inter alia *Netfonds Holdings,* EEA States are free to define in detail the level of protection sought. In the reasoned opinion, the Authority states that "a chosen level of protection does not release an EEA State from the burden of demonstrating that the national measures are indeed proportionate." This is not disputed. However, it is important to recall that the national measure must be assessed *solely by reference to the objectives pursued by the EEA State concerned and the level of protection that it seeks to ensure*.[79] As a consequence, the mere fact that an EEA State has opted for a system of protection which differs from that adopted by another EEA State cannot affect the assessment of the proportionality.

The Government submits that the Authority has failed to assess the dispersed ownership rule (and the alternative measures) against the objectives pursued and the level of protection sought. The only specific reason given for the Authority's view that the measure is not necessary, is that the Government has not allegedly provided "any concrete arguments as to why the alternatives referred to by the Authority in paragraphs 87 and 88 of the letter of formal notice would not entail an equally high level of protection as that achieved by the Norwegian rules."

The alternatives referred to in paragraph 87 are i) the introduction of special conditions aimed at preventing the risk of misuse of power, i.e. conditions that prevent the granting of favourable loans, guarantees or any comparable transactions for the benefit of large owners or their related parties, and ii) a suitability assessment of potentially large shareholders. According to the Authority, these two alternatives would "address the excessive incentives related to the risk of misuse of power while still being less restrictive than the contested measures."

Moreover, in paragraph 88 the Authority simply refers to the judgment by *Oslo tingrett* which in turn on a superficial and summarily level merely observes the existence of several other regulatory means, control mechanisms and supervisory powers, without any concrete assessment.

The Government disputes the Authority's findings and reasoning. In section 5.2, the Government will demonstrate that the Authority's assessment of the necessity test is vitiated with several errors of law and fact. In section 5.3, the Government will further outline why the dispersed ownership policy is necessary. The conclusion is drawn in section 5.4.

[79] Reference is made to paragraph 130-131.

5.2 The Authority's assessment of the necessity test is vitiated with several errors of law and fact

5.2.1 The Authority has solely examined the necessity of the measure against *one* of the objectives pursued due to an incorrect point of departure

The first error of law is that the Authority solely refers to the objective of reducing the risk of misuse of power when examining the necessity of the measure. As noted above in 3, the necessity test requires an assessment of *all* the legitimate objectives pursued.

In E-1/6 *Gaming Machines* the EFTA Court held that the monopoly on gaming machines could not be considered necessary with regard to the objective of reducing crime and malpractice, but nevertheless found that the monopoly was necessary in order to attain the objective of fighting gambling addiction to the level of protection sought.[80]

This failure has impacted the outcome of the assessment. For instance, it is irrelevant to consider special conditions preventing different forms of misuse of power as an alternative to strengthening the cooperate governance and to reduce the excessive risk-incentives stemming from concentrated ownership. Nor would a suitability assessment of the owners be relevant. The root cause of the excessive risk-appetite is the concentrated ownership, not whether the large shareholder has e.g. previously laundered money.

5.2.2 The Authority has not made any assessment of the level of protection

The second error of law is that the Authority's assessment of the necessity of the measure is devoid of any consideration of the level of protection. The Authority confines itself to observe that the alternatives would "address" the excessive incentives related to the risk of misuse of power and that they "appear" to achieve an equally high level of protection in that regard.[81]

First, merely to observe that the alternatives would "address" the same objective (or, to be precise, one of the objectives) pursued by the contested measure falls short of what is required. It is not sufficient that the alternative measures pursue the same objective(s) or are suitable to attain the legitimate aims, rather they have to be equally effective as the contested measure.

Second, the Authority confines itself to claim that the alternative measures "appear" to attain an equally high level of protection. The phrase is reminiscent of the EFTA Court's Advisory Opinion in *Netfonds Holding*.[82] In the context of infringement proceedings, that is not sufficient.

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[80] See paragraphs 50-52.
[81] See letter of formal notice paragraph 87.
[82] See paragraphs 133-134.

The Government acknowledge that at the outset the national authorities have the burden of proof with regard to demonstrating the necessity of the measure.

The CJEU has however clarified that the burden of proof "cannot be so extensive as to require the Member State to prove, positively, that no other conceivable measure could enable that objective to be attained under the same conditions."[83] By just listing a number of alternative measures, adding without any concrete argument or evidence presented, that the alternative measures "address" the same objective and "appear" to be equally effective, and thereafter calling upon the rules on the burden of proof to reject the justification of the measure, the Authority has essentially required the Government to prove, positively, that no other conceivable measure could enable that objective to be attained under the same conditions, as quoted above.

Further, the obligation to adduce proof for a certain submission will also typically shift between the parties to a dispute. As noted by Krämer: "[t]he more substantiated the arguments from one side are, the more detailed those from the other side have to be." It is only at the end of this process that the courts are faced with the question of the objective burden of proof.

The Authority has claimed that the Government has not provided "any concrete arguments as to why the alternatives referred to by the Authority … would not entail an equally high level of protection as that achieved by the Norwegian rules."[84] This is incorrect. The allegation should instead be addressed to the Authority itself. Neither the letter of formal notice nor the reasoned opinion contains any statements whatsoever regarding the level of protection sought or the effects of the alternative measure compared to the contested measure. The Government submits that – in line with the typical shift in the burden of proof throughout the process – the Authority cannot simply rely on assumptions on the effect.

The CJEU has also stated in several cases that the Commission may not simply *assume* that the proposed alternative measures can attain the objectives as effectively. Of particular relevance is case C-89/09, *Commission v France*, which concerned national provisions prohibiting non-biologists from holding more than 25 percent of the shares, hence of the voting rights, in undertakings operating biomedical analysis laboratories. The CJEU refuted all the alternative measures proposed by the Commission, and in doing so, it consistently stated that "the Commission has not shown" that the alternative measures would as effectively achieve the level of protection sought by the ownership limitation.[85]

[83] C-111/05 Commission v Italy (Italian trailers) paragraph 66.
[84] See reasoned opinion paragraph 33.
[85] See in particular paragraphs 80-89.

Reference could also be made to *Italian trailers*, in which the CJEU recognised that alternative measures could achieve *a certain* level of protection of road safety, but that it could not be presumed that an alternative measure such as a partial prohibition on the use of trailers by motorcycles would ensure the *same* level of protection as a general prohibition of such use, which the member state had chosen. [86]

Similarly, in *Mickelsson and Roos*, concerning a prohibition on the use of jet -skis on waters other than general navigable waterways, the CJEU acknowledged that alternative measures could achieve a certain level of protection, but in the same vein as *Italian trailers* held that it could not be assumed that less restrictive measures could attain the same level of protection. [87]

The Government submits that the Authority *has not shown* and cannot simply assume that the proposed alternative measures would equally effective attain at least the same level of protection as the dispersed ownership rule. No concrete analysis or arguments have been presented, despite the fact that the Government has presented to the Authority arguments and evidence showing a higher level of protection by the dispersed ownership rule. The alternative measures achieve a *certain* level of protection, but it cannot be assumed that they could attain at least the same level of protection as that achieved by the dispersed ownership rule as well.

Based on the above, the Government maintains that the Authority's approach to the necessity test is vitiated with several errors of law, clearly affecting the outcome of the assessment.

5.2.3 The alleged alternative measures are existing, supplementary measures, not alternatives

The third error of law is that the Authority considers that the proposed measures – i) special conditions preventing certain forms of misuse and ii) a suitability assessment of large owners, and also the wide range of measures simply referred to in paragraph 88 – are actually *alternative* measures.

These measures are however not new measures, which could be adopted instead of the dispersed ownership rule. These measures already exist as important elements in a coherent and diverse regulatory approach in order to ensure the proper and sound management of the institutions, reduce the risk of misuse of powers, and more generally contribute to the stability of the financial market. Accordingly, they exist side by side and in addition to the dispersed ownership rule. They are not genuine alternatives, but rather supplements to the ownership rules, and they are not new, but rather part of the existing regulation.

[86] C-110/05 Commission v Italy (Italian trailers) paragraphs 67-69.
[87] C-142/05, Mickelsson and Roos paragraph 36 and 40.

The regulatory regime proposed by the Authority entails thus nothing but the removal of the ownership rules. The alternative regime consists merely of the *remaining* regulatory regime *after* the removal of the contested measure. Logically, in order for the remaining part of the regime to be as effective as the existing regime including the dispersed ownership rule, one would need to find that either i) the dispersed ownership rule has *no additional effect* on the achievement of the objectives sought or ii) that the level of protection sought is not really so high as to justify a measure such as the dispersed ownership policy, i.e. that the measure actually entails an overprotection beyond what the Norwegian State actually has sought to attain. No assessment has, however, been provided to that effect.

Particularly in a case where the alternative regime proposed does not add anything new to the regulatory mix, but merely entails less of the existing regime, it cannot simply be assumed that the lesser regime would attain an equally high level of protection. This is also the main take away from *Italian trailers* and *Mickelsson and Roos* where the alternative regulatory regime simply consisted of the same measure, but to a lesser degree, i.e. a partial prohibition compared to a total prohibition. As noted above, the alternative measures in those cases could not simply be assumed to attain an equally high level of protection as a total prohibition.

5.3 The dispersed ownership policy is necessary

5.3.1 The measure is necessary to attain the objective of reducing the risk of misuse of power

The Government submits that the dispersed ownership rule is necessary for the achievement of the objective of reducing the risk of misuse of power to the level of protection sought.

The Government acknowledge that the alternatives proposed may entail a *certain* level of protection. They would not, however, ensure at least the same level of protection as sought by the dispersed ownership rule.

The alternative measures are all part of the traditional regulatory tool kit when seeking to discourage unwanted behaviour. As noted in section 4.5, the financial sector is not a traditional sector. The consequences of failures by financial institutions are significantly more troublesome for the society and the general economy than in more traditional industries. The increased risk of abuse and the grave consequences for the financial market and the general economy if those risks were to materialise clearly warrant *additional* regulatory tools beyond those applicable in the traditional regulatory tool box.

In the Government's view it is clear that preventing unwanted behaviour by the misuse of ownership power by adopting additional, *ex ante* structural regulation aimed at preventing the establishment of the very position from which the misuse may arise, would further reduce the risk of such misuse of power.

As an example of such misuses of power, reference is made to the Report of the Special Investigation Commission it follows that:

> "*When it so happens that the biggest owners of a bank, who appoint members to the board of that same bank and exert for that reason strong influence within the bank, are, at the same time, among the bank's biggest borrowers, questions arise as to whether the lending is done on a commercial basis or whether the borrower possibly benefits from being an owner and has easier access to more advantageous loan facilities than others. This is, in reality, a case of transfer of resources to the parties in question from other shareholders and possibly from creditors. <u>Research has shown that where big owners of banks are, at the same time, borrowers, these owners benefit from their position and get abnormally favourable deals.</u>*" [88]

The Special Investigation Commission also found that there were "strong indications" that bank owners tried "in their capacity as owners, to exert undue influence on the bank's management." Furthermore, there were concerns about the owners of the banks running other businesses at the same time as running the banks, and the Report expresses great regret that the supervisory authorities failed to follow up those conflicts of interest. Especially in the later stages of the fall of the Icelandic banks, the bank owners seem to have increased their efforts to obtain advantages. The Report states:

> *"When the banks became constricted as the autumn of 2007 and the year 2008 wore on, it seems that <u>the boundaries between the interests of the banks and the interests of their biggest shareholders were often blurred</u> and that the banks put more emphasis on backing up their owners than can be considered normal. The SIC is of the opinion that <u>the operations of the Icelandic banks were, in many ways, characterised by their maximising the benefit of the bigger shareholders, who held the reins in the banks</u>, rather than by running reliable banks with the interests of all shareholders in mind and showing due responsibility towards creditors"*[89].

Another example of how actions of major shareholders in banks can threaten financial stability is the collapse of Banco Espirito Santo (BES). BES lent money to its controlling shareholders, and the exposure of bad debt of the Espirito Santo family-owned ESI resulted in BES collapse. According to an article from Reuters, the bank's chief executive "consistently blurred the lines between the bank's interests and those of his family". Moreover, the bank's chief executive "ignored a directive from Portugal's central bank that [he] stop mixing the lender's affairs with the family business". In addition, the banks' auditor, KPMG, found that the bank "had either not recorded or had under-reported financial liabilities and risks, had grossly overvalued its assets, and

[88] Chapter 21, page 9.
[89] Chapter 21, page 10.

had scant evidence for its reported transactions." The article further describes that some of these transactions were made "through an opaque transatlantic ping pong".

These cases are examples of the effects of poor corporate governance, multiple forms of conflict of interest, and the possibility of a major shareholder acting in the role as both lender and borrower.

Certainly, in cases concerning misuse of power there may also be other factors impacting the outcome, such as for instance failure by internal control mechanisms and external supervision. Strong internal control mechanisms and external supervision on the highest risk-institutions may be reasonable, cf. also paragraph 88 of the letter of formal notice, in which the Authority refers to the statement by *Oslo tingrett* that intense supervision can be conducted.

In the Government's view, however, removing the possibility for single shareholders to obtain a controlling position from which they may exert dominant influence over the financial institution in order to misuse it for personal gains, will clearly add a regulatory layer to the traditional regulatory tool kit box and thus further reduce the risk of misuse of shareholder power, thereby achieving a higher level of protection. Therefore, the Government maintains that the dispersed ownership policy is necessary to attain the objective of reducing the risk of misuse of power to the level of protection sought.

The Government submits that the examples of the Icelandic financial crisis and the Banco Espirito Santo example clearly *illustrates* the shortcomings of the Authority's "alternatives". There is nothing to suggest that the large bank owners in Iceland described above would be prevented from obtaining or retaining controlling stakes by an assessment of their suitability. There are no indications that the they did not have sufficient repute, or that they had, for instance, in the past, been held guilty of relevant criminal charges. Likewise, there are no indications that the Espirito Santo family would be denied the controlling ownership position they have had for years by an assessment of their suitability. Put simply; a suitability assessment would not have prevented these events from happening. However, if none of those had held controlling shareholding positions in the beginning, that would have been an effective mechanism to prevent the misuse of their shareholder power.

There is also nothing to suggest that provisions prohibiting certain conduct would be sufficient to constrain the actions taken by the Icelandic bank owners and to prevent the fall of the Banco Espirito Santo. The Authority may recall the descriptions on how the regulations were bypassed and how explicit directives were neglected, and how flawed the financial reporting was, in particular as the financial troubles wore on. Again, a dispersed ownership policy would, as an addition to such prohibitions, clearly constitute a more effective regulatory framework in preventing such conduct.

The use of prohibitions with independent supervision and possible sanctions reduces the likelihood of unwanted behavior. However, the excessive risk incentives that large bank owners have, and the grave consequences for the society if those risks materialise, are specific features of the banking and insurance sector warranting additional regulatory tools as the dispersed ownership rule.

5.3.2 The measure is necessary to the attainment of the objective of reducing the excessive risk appetite due to concentrated ownership structure

The Government submits that the dispersed ownership policy is necessary to attain the level of protection sought with regard to the objective of reducing the excessive risk-incentives inherent in financial institutions with a concentrated ownership.

Neither in its letter of formal notice nor in the reasoned opinion has the Authority made any assessment of the necessity of the measure with a view to obtaining this objective. Instead, the Authority has simply argued that the measure is not suitable in that regard.

The suitability of the measure to attain this objective is addressed in section 4.5.6 above. As it follows, the Danish experience and scientific literature by no means invalidate the rationale behind the administrative practise in Norway. Rather, it demonstrates that a balanced approach is warranted. Moreover, it follows that Norway is indeed genuinely concerned with the risk on financial stability caused by excessive risk-incentives, and it is at least reasonable to assume that concentrated ownership structures in financial institutions will entail excessive risk-incentives.

Since the Authority has not examined the *necessity* of the measure with a view to attaining this objective, the Authority has not either assessed the level of protection in this regard.

Still, with regard to the suitability of the measure, the Government recalls the Authority's argument in paragraph 71 of the letter of formal notice, that bank activity will always entail a risk. *Oslo tingrett* claimed moreover that neither the Government nor the scientific literature had demonstrated the "optimal" level of risk, and concluded that by removing the dispersed ownership policy, the risk to the stability of the financial market would still be "acceptable".

As noted in section 4.5.5, the EEA law does not require the identification of an "optimal risk level" before adopting regulatory measures seeking to reduce the risk. How would one go about in *defining* in any concrete terms the "optimal" risk level against which all regulatory risk-measures has to be held up? And how should the necessity of any given provision be assessed against such an abstract and yet concrete level of protection? This is not only practically impossible. It also goes way beyond what the EEA law requires from any EEA State or from the EU legislators itself when regulating the financial sector.

In *Netfonds Holding* the EFTA Court held that he EEA States are free to define the level of protection sought by the objectives pursued. This has also been recognised by several other judgments. That entails a freedom to set the level of protection concerning the stability of the financial market and the level of "acceptable" risk of bank failures, without having to define it in concrete terms and without having to define the optimal level of risk. What *Oslo tingrett* has done, when claiming that the alternative measures entail an "acceptable" level of risk is simply to substitute the Norwegian State's view on what the acceptable risk is with its own. In that process, *Oslo tingrett* made itself guilty of the very same critique it raised against the authorities for not defining *ex ante* the optimal level of risk. The Authority's view on the necessity test replicates in essence this error of law.

The Norwegian authorities have however numerous times demonstrated that a high level of protection is sought. Reference is made to section 4.5.4 above.

Since the Authority has not examined the *necessity* of the measure with a view to attaining this objective, the Authority has also not either assessed any alternative measures in that regard. While increased supervision of financial institutions with concentrated ownership may be a way to further scrutinise the conduct of those institutions, it is not a panacea to all problems.

In the Government's view, increased supervision is not a sufficiently effective alternative measure. The rejection of this as an equally effective alternative measure is not a matter of the Government seeking to reduce the administrative costs, as administrative concerns are not in themselves capable of justifying a restrictive measure. Rather it is a matter of choosing the most effective regulatory tools to address a problem inherent in the ownership structure of financial institutions with dominant shareholders.

The CJEU has in several cases acknowledged that member states cannot be prevented from attaining legitimate objectives by virtue of rules which are easily managed and supervised, those being more effective.[90]

The Norwegian Government is therefore of the view that general and simple rules which are easily managed and supervised, will attain the objectives pursued more effectively than measures of lesser scope and greater complexity, which often will pose challenges in terms of control and monitoring effectively than measures of lesser scope and greater complexity, which often will pose challenges in terms of control and monitoring.

The most effective way to address this problem is by preventing the emergence of the particular ownership structure causing the excessive risk-incentives. From a risk-reducing perspective it is clearly more efficient to prevent excessive risk-incentives

[90] See Case C-110/05 Commission v Italy, Italian trailers paragraph 67, Case C-142/05, Mickelsson and Roos, paragraph 36 and Case C-512/13 Sopora, paragraph 33.

from ever occurring (or at least to reduce that possibility significantly) than to simply increase the supervision of those acting on an excessive risk-incentive. The Government maintains therefore that the measure is also and in any event necessary for the achievement of the objective of reducing general the excessive risk appetite due to concentrated ownership structure at the level of protection sought.

5.3.3 The measure is also necessary for the attainment of other, interrelated objectives

The Government also submits that the measure is necessary with a view to attain the other interrelated objectives.

Reference is made to section 3.3 above from which it follows that the dispersed ownership rule provides for several additional benefits which all form part of the objectives of the Norwegian financial regulation. These additional benefits consist of contributing to a sound capital situation for the financial institution, the promotion of compliance with regulations, the facilitation of supervision and enforcement of such regulations, and the increase in the confidence of investors and creditors in the Norwegian financial market.

As demonstrated in section 3.3, all else equal, each and every additional benefit entails that the dispersed ownership rule is to be preferred as it contributes to a higher level of protection than any alternative regime.

5.4 Conclusion

As described, Norway has opted for a high level of protection in the banking and insurance sector. In the view of the Government, the nature of the risks involved, demonstrates that it is necessary with adequate mechanisms put in place ex ante.

The Norwegian rules effectively secure a diversified ownership, thus preventing concentration of power and dominant influence. Preventing concentration of power makes it less likely that the governance by owners will rely on motives that is not in the interest of the institution, or the society as a whole. Furthermore, a dispersed ownership structure will significantly reduce the risk of misuse of power by granting favourable loans, guarantees etc. for the shareholder's own benefit or for the benefit of their business or private associates.

A dispersed ownership structure also effectively prevents other conflicts of interest and ensure the institutions' independence in relation to other business and industry, and in relation to owners that could conceivably use their influence for their own benefit or for the benefit of other closely related.

Moreover, a dispersed ownership structure will have a significant effect on the prevention of excessive risk-incentives stemming from financial institutions with large shareholders. It will also promote compliance with other regulations, such as restrictions on banking activities, and it will also ensure the effectiveness of other regulatory measures, such as capital regulations and deposit insurance policies. It will also facilitate an effective supervision, increase trust and contribute to a sound capital situation for the financial institution.

The Government therefore contends that the national measure is necessary in order to achieve the level of protection, and that other, less restrictive measures would not be as effective in achieving the level of protection sought. The Government is also of the opinion that the alternative measures must be considered as supplements, not alternatives to the national measure.

6. FINAL REMARKS

For the reasons above, the Government respectfully submits that the dispersed ownership rule is justified on the basis of overriding reasons and also complies with the principle of proportionality. The Government once again kindly requests that the Authority will allow the judiciary time to complete the on-going proceedings. The Government would also be happy to facilitate any further needs for information, including the literature referred to above.

Yours sincerely,

Geir Åvitsland
Director General

Åse Natvig
Deputy Director General

This document has been signed electronically and it is therefore not signed by hand.