

## Assessment of the notification by Belgium in accordance with Article 458 of the CRR concerning a stricter national measure for residential mortgage lending

### Introduction

On 1 April 2014 the European Systemic Risk Board (ESRB), in accordance with Article 458 of the CRR<sup>1</sup>, received an official notification from Belgium of a national measure that it intends to adopt. This measure aims to address the increased systemic risk originating from the domestic market for residential mortgage loans. Under Article 458 of the CRR, the ESRB is required to provide the EU Council, the EU Commission and Belgium with an opinion within one month of receiving the notification. The opinion must be accompanied by an assessment of the national measure in terms of the points mentioned under Article 458(2).

The ESRB's assessment focuses on the net benefits of the national measure for maintaining financial stability. In Decision ESRB/2014/2 of 27 January 2014<sup>2</sup>, the ESRB clarifies the procedural framework for the provision of opinions under Article 458 of the CRR. In particular, the ESRB has assessed the rationale and merit of the measure against the following criteria.

- **Justification:** Has there been an increase in risk and does it pose a threat to financial stability at the national level? Do the existing measures provided for under the CRD<sup>3</sup>/CRR inadequately address the risk, taking into account their relative effectiveness?
- **Effectiveness:** Will the measure achieve its intended objective?
- **Efficiency:** Will the measure achieve its objective in a cost-efficient way, i.e. has the appropriate instrument been used?
- **Proportionality and impact on the Single Market:** Is there the right balance between the costs resulting from the measure and the problem it aims to address, also taking into account any potential cross-border spillover effects? Where appropriate, the ESRB may suggest amendments to the measure to mitigate potential negative spillover effects.

The measure is a 5 percentage point add-on to the risk weights calculated by a subset of banks under Belgian law that apply the internal ratings-based (IRB) approach to mortgage loans to Belgian residents for residential property located in Belgium. The measure is scheduled to be introduced as a regulation by the National Bank of Belgium (NBB) and legally adopted by a Royal Decree. It would be the continuation of a measure that was introduced as an NBB regulation in November 2013 and entered into force on 8 December of the same year. Owing to the entry into force of the CRD/CRR on 1 January 2014, Belgium needs to adopt a new regulation in accordance with the procedure laid down in Article 458 of the CRR if it wants the measure to remain in place.

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<sup>1</sup> CRR (Capital Requirements Regulation) refers to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>2</sup> Decision of the European Systemic Risk Board of 27 January 2014 on a coordination framework regarding the notification of national macro-prudential policy measures by competent or designated authorities and the provision of opinions and the issuing of recommendations by the ESRB.

<sup>3</sup> CRD (Capital Requirements Directive) refers to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

In its assessment of the measure, the ESRB has drawn extensively on information provided by the NBB and discussions with NBB staff, as well as analytical input provided by the ECB.

## Section 1: Analysis of the underlying systemic risks

### 1.1 Vulnerabilities in the property sector

**There are several indications of a significant overvaluation of property prices in Belgium.** Of all the euro area countries, Belgium has witnessed the strongest gains in residential property prices over the past ten years or so, with an annual compound growth rate of around 6% (see Charts 1 and 2 in the Annex). The increase has been broadly based across different regions and dwelling categories. Although it is very difficult to assess misalignments in property prices, the average overvaluation, based on both statistical indicators and model-based estimates, is around 30%<sup>4</sup>, which is the largest in a sample of selected EU Member States (see Charts 3 and 4 in the Annex) and in the euro area.<sup>5</sup>

**While the Belgian measure only covers the residential property sector, there are also signs of overvaluation in the commercial property sector** (see Charts 5 and 6 in the Annex). The NBB has already indicated that this will be one of its priority areas in 2014.

### 1.2 Vulnerabilities in the household sector

**Vulnerabilities associated with household debt have increased, but still compare favourably with those in other EU Member States.** At 57% of GDP, household debt in Belgium is lower than in many other Member States (see Chart 7 in the Annex) and, moreover, it has increased only moderately (by around 20 percentage points) since 2002 when it was at its lowest. At 90%, the ratio of loans to gross disposable income is also better than that for the euro area as a whole and in selected EU Member States that have seen a rapid increase in house prices (see Chart 8 in the Annex).

**Sensitivity of households to interest rate risk is limited.** The amount of interest paid by households has increased since 2004, but has stabilised in recent years (see Chart 11 in the Annex). According to the Belgian authorities, there are large sub-categories of mortgage loan that combine high-risk parameters such as high loan-to-value (LTV) and debt-service-to-income (DSTI) ratios, pointing to potential vulnerabilities for some lower income household segments. At the same time, with a share of 60%, fixed rate contracts constitute the lion's share of the mortgage market in Belgium. Only around 18% of the outstanding stock of mortgages have a variable interest rate (i.e. one that is fixed for a period of less than a year), making households with such mortgages more vulnerable to swings in interest rates.

### 1.3 Vulnerabilities in the banking sector

**Banks have very much expanded their portfolio of residential mortgage loans.** Total mortgage lending has grown at an annual compound growth rate of around 8% in the past decade (see Chart 10 in the Annex). Double-digit annual growth rates were observed during the period 2005-09, while the share of securitised and transferred loans in total mortgage lending increased substantially after 2007. Since then, there has been a slowdown in the expansion of total mortgage lending, with the growth rate dropping to below 5% in 2013. Thus, the annual growth rate of banks' total mortgage lending far exceeded the average annual growth rate of nominal GDP (3.4%) over this period.

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<sup>4</sup> This figure is the average of the results from all methods, which are described in detail in the box entitled "Tools for detecting a possible misalignment of residential property prices from fundamentals", *Financial Stability Review*, ECB, June 2011.

<sup>5</sup> ECB, *Financial Stability Review*, November 2013, pp. 40 onwards.

As a result, according to NBB figures, the share of residential mortgage loans in banks' total assets rose from 6% in early 2000 to almost 15% in 2013 (see also Chart 9 in the Annex for the share in total lending<sup>6</sup>). The share of mortgage loans also depends on the bank: for the four largest banks, it is around 15% of total assets, while for the rest of the banks targeted by the measure, it is around 35%. Tax incentives played a role in this development, as mortgage loans for energy-saving investments were introduced in 2009 (which led to a surge) and expired in 2011 (which resulted in a decline).

**Average risk weights calculated by Belgian banks are very low.** More than 90% of total residential mortgage lending by banks is carried out by banks that use the IRB approach (hereinafter referred to as "IRB banks"), namely nine institutions (and seven on a consolidated basis). There is significant heterogeneity among these banks, with the share of lending for house purchases in total assets ranging from 12% to 50%. The average risk weights for residential mortgage loans calculated by IRB banks are very low (10%), also in comparison with the EU average (16%)<sup>7</sup>. This is due to the fact there has been no major crisis in the property market and to the low loss-given-default (LGD), which reflects the buoyancy of the property market over the last 15 years.

Against this background, the NBB is of the view that the current risk weights may not suffice to cushion an adverse macroeconomic shock that drives up unemployment and default rates. The resulting increase in the liquidation of collateral under such a scenario may exert downward pressure on property prices and collateral values, and thereby lead to greater losses.

**There are clear signs that banks' lending standards have weakened over time, but there have been recent improvements.** While the risk profile of major IRB banks is somewhat heterogeneous with regard to credit standards, about 50% of loans granted by these banks have an LTV ratio at origination of over 80%. If amortisation and house price changes are taken into account, this figure shrinks to 29%. Nevertheless, 16% of outstanding loans have an LTV ratio of over 90% and 5% of over 100%. A significant share of mortgage loans have a rather high LTV ratio at origination that is accompanied by a significant DSTI ratio at the borrower level. In terms of financial stability, such combinations are of particular concern.

The share of non-performing loans in Belgian IRB banks' total mortgage lending has tended to increase moderately since 2007, but it is still very small (below 1%).<sup>8</sup> The NBB expects this trend to continue, albeit at moderate pace. Recent vintages of loans have shown lower default rates, as banks have become more cautious when granting mortgage loans.

## Section 2: Effectiveness and efficiency of the measure

### 2.1 How the measure addresses the identified risk

**The measure is part of a wider set of initiatives introduced over several years to address concerns about developments in the residential property sector.** In the course of 2011 the NBB conducted a survey of banks' mortgage loan portfolios,<sup>9</sup> the results of which were

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<sup>6</sup> Chart 9 is based on data from monetary financial institutions. It is likely that the denominator of the ratio in this chart is overstated, owing to the inclusion of the assets of money market funds and foreign banks located in Belgium that do not engage in mortgage lending.

<sup>7</sup> These figures are taken from a data collection exercise (with a reference date of December 2012) carried out by the European Banking Authority (EBA) for a set of EU Member States and refer to the exposure at default weighted average rate for IRB residential mortgage portfolios and non-defaulted exposures by country.

<sup>8</sup> Definition of default as used in the Central Credit Register: a default is recorded when three instalments are not (fully) paid or when an instalment has not been (fully) paid after a period of three months.

<sup>9</sup> This survey is now conducted semi-annually.

commented on in its Financial Stability Review (FSR) of June 2012; another FSR article is planned for the near future. On the micro-prudential front, the NBB is conducting a horizontal review of the banks' internal models to evaluate whether the parameters have been adequately calibrated. In order to address concerns over deteriorating credit standards and higher risk lending, banks have also been asked to assess their credit standards against the guidelines of the European Banking Authority (EBA) on mortgage lending and to develop an action plan to address any weaknesses that are identified.

**The measure improves the resilience of the banks concerned by increasing their required regulatory capital.** This will enable them to withstand potential losses on residential mortgage loans that are greater than those experienced in the past. Moreover, a flat-rate add-on seems appropriate as it does not alter the relative riskiness of the loans, which seems to be adequately captured by the internal models used by banks for their respective portfolios, and is justified in the context of the NBB's macro-prudential actions.

**The 5 percentage point calibration seems justified for the following reasons:**

- **Sensitivity of results.** The NBB did not perform a broad macroeconomic stress test to calculate the IRB risk parameters, partly because the absence of a major crisis in the past would most likely result in the parameters not being particularly sensitive to macroeconomic variables. Instead, the NBB assessed the impact on the IRB banks' loss-absorbing capacity under different scenarios for probabilities of default (PDs) and LGDs. Under a scenario using a default rate multiplied by a factor of 5 and a stressed LGD of 35%, banks would require additional capital of €800 million, compared with €600 million after the 5 percentage point add-on.

The stressed LGD represents an increase of 20 percentage points in the LGD, which is in line with the NBB's estimated overvaluation of residential property prices.<sup>10</sup> The five-fold increase in PDs is comparable to the recent downturn in the Spanish housing market in which the default rate on mortgage loans rose to about 5% in the course of 2013, up from below 1% before the shock (see Chart 12 in the Annex). Such cross-country comparisons of non-performing loan ratios should, however, be interpreted with caution.

- **International comparison.** According to EBA figures for the end of 2012, IRB banks in Belgium have an average risk weight of around 10%, whereas for its neighbouring countries (with the exception of the Netherlands, where the figure is comparable with that in Belgium) the figure is around 15%. The 5 percentage point add-on would therefore bring the Belgian risk weight more into line with that of most of its neighbouring countries.
- **Desire for a soft landing.** By increasing the risk weights by a relatively small amount, the NBB is aiming to avoid unsettling the market. While vulnerabilities have clearly built up over time, the financial position of banks and households would not warrant any immediate drastic action. Moreover, active macro-prudential policy is still a new area for policy-makers, which justifies a rather cautious start. Furthermore, the calibration is based on a limited sensitivity analysis and there is considerable uncertainty about how the measure will be transmitted and future developments in the economy and housing market.

**The main benefit of the measure is considered to be its signalling effect.** The measure is a clear signal to the banking sector and the public at large that there are growing concerns over developments in the residential property sector. The impact of the measure is therefore expected to be larger than would be expected from the small increase in risk weights. The measure falls under Pillar I of the CRD/CRR and is therefore part of a regulation that is public. It

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<sup>10</sup> According to NBB's own estimates, house prices are overvalued by 15%-20%.

has also been discussed by the NBB in its annual report and has been commented on by the press.

**Whether the proposed add-on is going to be sufficient to boost the resilience of IRB banks in Belgium also hinges on the findings of the on-going Comprehensive Assessment that is being conducted in the context of the establishment of the Single Supervisory Mechanism (SSM).** Therefore, there is some justification for reassessing the calibration once the results of the asset quality reviews and stress tests of the affected Belgian banks are known.

## 2.2 How the measure relates to possible alternatives

As required under Article 458 of the CRR, this section explains why other available measures would not adequately address the increase in systemic risk, taking into account their relative effectiveness. It should be recalled that these measures need to be considered before having recourse to Article 458 of the CRR to adopt stricter national measures.

### a) Increasing the risk weights for banks applying the Standardised Approach (Article 124 of the CRR)

**On the basis of financial stability considerations, the competent authority is allowed, under Pillar I of the CRD/CRR, to increase the risk weights of banks that apply the Standardised Approach (SA) to their exposures secured by mortgages on immovable property from 35% to up to 150%, or to apply stricter criteria.**

**This alternative is not considered to be useful.** The SA flat risk weight of 35% is seen as sufficient (compared with an average risk weight of around 10% for IRB banks). Moreover, the share of SA banks in the market of residential mortgage lending by banks is less than 10%.

### b) Increasing the LGD floor for IRB banks (Article 164 of the CRR)

**On the basis of financial stability considerations, the competent authority is allowed, under Pillar I of the CRD/CRR, to increase the exposure weighted average LGD floor of IRB banks for their retail exposures secured by residential property.** The LGD is one of the parameters used in the risk weight function. By increasing the LGD, the risk weight and capital requirements increase indirectly.

**This alternative is not considered to be useful.** Raising the LGD floor would increase the relative cost of issuing lower risk (e.g. lower LTV) loans, but potentially not affect higher risk lending, which would already be subject to a higher LGD in the internal model. Banks would therefore have an incentive to loosen their credit standards by providing loans with a weaker collateral position. This effect would be reinforced by the fact that the CRR refers to the average LGD floor, which allows both lower and higher LGDs on individual loans. In addition, there is the risk that banks may try to offset the impact of a higher LGD floor by tweaking other model parameters (e.g. the PDs) that are used in the risk weight function.

### c) Using the systemic risk buffer (Article 133 of the CRD)

**Member States may introduce a systemic risk buffer to address long-term non-cyclical systemic or macro-prudential risks not covered by the CRR.** The systemic risk buffer can be used by all banks or a subset of banks.

**This alternative is not considered to be useful.** First, the risk that the NBB wants to address is cyclical rather than structural. This is reflected in the fact that the NBB will consider further increasing the risk weights over time or decreasing them if this proves necessary. While monitoring developments on an on-going basis, the NBB will re-examine and reassess the situation of the residential mortgage market on a half-yearly basis, although this does not imply that the risk weights will also be reconsidered at such intervals. It should be noted that a further increase in risk weights would require another procedure under Article 458 of the CRR.

Second, the systemic risk buffer is not calculated solely on the basis of residential property exposures. It would therefore affect all lending, with the potential for unwanted effects in other markets. Third, the systemic risk buffer is subject to a minimum threshold of 1% based on the exposures to which it applies. As this exposure base includes more than just residential mortgage lending, the capital impact may also be much bigger. This may, in turn, impinge on the objective of a soft landing.

### **d) Using the countercyclical capital buffer (Article 136 of the CRD)**

**The CRD provides for the introduction of a countercyclical capital buffer to address some of the procyclicality in the financial system.** The countercyclical capital buffer is a requirement for domestic exposures. The rate for the countercyclical capital buffer is set on a quarterly basis by the designated authority and there is typically a 12-month lead time from when an increase in the rate is announced to when banks have to apply it.

**This alternative is not considered to be useful.** In accordance with the CRD, the countercyclical capital buffer will be phased in from 2016. Early implementation is possible, but Belgium intends to follow this timetable. Moreover, the calculation basis of the countercyclical capital buffer includes all domestic exposures and not only residential mortgage loans. While there are concerns about excessive growth in the latter market segment, there are no similar concerns about other domestic exposures, such as SME or corporate exposures. Finally, a 12-month (maximum) lead time is also rather long, given the concerns about the increase in systemic risk.

### **e) Using Pillar II (Articles 101, 103, 104, 105 of the CRD)**

**Under the supervisory review process (Pillar II of the CRD/CRR), the competent authority can implement a wide range of supervisory measures** to address (elements of) risk that are not sufficiently covered by Pillar I and provide incentives for banks to enhance their risk management (see Article 104 of the CRD). Furthermore, the CRD allows the use of Pillar II for macro-prudential purposes (see Articles 97 and 98 of the CRD). It should also be flagged that there is a precedent for the use of Pillar II in addressing the type of risk of concern to the Belgian authorities: in 2013 the Swedish supervisory body *Finansinspektionen* introduced, under Pillar II, a risk weight floor of 15% for Swedish mortgages. This measure was publicly disclosed by the supervisor.

**In the case of Belgium, the NBB has put forward several arguments in favour of using a Pillar I measure instead of a Pillar II measure, mainly relating to their relative effectiveness. The ESRB shares these arguments.**

- **Disclosure.** Pillar II practices vary considerably across Member States. In Belgium, there is no tradition of publicly disclosing Pillar II conclusions and the resulting supervisory measures. The main benefit of using Pillar I is the signalling effect. The impact of higher regulatory capital requirements is enhanced by a communication addressed to all market participants and the general public, as it raises awareness of the risks. This would not be achieved under Pillar II, as it involves the supervisor addressing a non-public decision to each bank separately. From a legal point of view, however, there is nothing to prevent a Pillar II measure being combined with a public disclosure requirement.
- **Transparency.** Increasing risk weights under Pillar I will reduce banks' reported capital adequacy ratio and thus better highlight their lower capacity to absorb unexpected losses. This would not be the case with a Pillar II approach and so the signalling and market discipline effects would be fewer than those expected from a more transparent measure.
- **Divergence in the risk profile of IRB banks.** The competent authority may apply the supervisory review and evaluation process in a similar or identical manner to institutions

with a similar risk profile in case they are or might be exposed to similar risks or pose similar risks to the financial system (see Article 103 of the CRD). This article could potentially be used to apply a capital add-on, as a Pillar II measure, to the IRB banks concerned. However, looking into some key risk drivers of the residential mortgage loan portfolios (LTV, DSTI and loan maturity) of these banks, it seems that they exhibit very different combinations of these indicators and therefore have very different risk profiles.

- **Potential legal challenge of the measure.** If the capital add-on were to be implemented under Pillar II, this would require the add-on to be commensurate with the risk profile of the bank concerned. As the risk profiles of the IRB banks' residential property portfolios are very different (see previous bullet point), a uniform add-on, while appropriate from a macro-prudential perspective (see earlier), would open up the possibility of a legal challenge of the measure by the individual banks concerned. A Pillar I measure, by contrast, would not entail such a risk.
- **At this stage, there are no indications of material deficiencies in banks' internal models.** The NBB is currently reviewing banks' internal models, but it has yet to find any indication of any material deficiencies (cf. possible recourse to Article 101 of the CRR). On the contrary, the very low risk weights seem to be the result of the absence of major problems in the Belgian housing market, as reflected in the very low level of credit losses suffered over the years. The problem thus seems to be broad in nature rather than bank-specific.
- **Timeliness.** A Pillar II measure would need to be part of the supervisory review and evaluation process involving the supervisory colleges. In Belgium, this process typically starts in late spring and ends in early autumn of each year. This schedule would therefore delay the introduction of the measure. Given the developments mentioned above, an earlier intervention is warranted from a financial stability perspective.
- **Continuity.** The measure has already been in place as a Pillar I measure since December 2013. Keeping the measure in place now after the entry into force of the CRD/CRR would ensure continuity and thus avoid any potential problems related to communication, adjustments, consistency, etc.

### f) Using LTV, LTI and DSTI thresholds

**Belgium might also have considered introducing LTV or DSTI thresholds**, either as a measure that falls exclusively within the national remit or in combination with the measure taken (e.g. by differentiating the risk weights on the basis of the LTV/DSTI ratio of the loans).

**This alternative is considered not to be useful.** The application of thresholds as outright limits is viewed by the NBB as politically very sensitive, as it would have a direct impact on access to mortgage credit by certain segments of the population. The use of thresholds in combination with differentiated risk weights would allow a more risk-sensitive approach. However, it would also change the relative riskiness of the individual loans in the banks' internal models, whereas the NBB, at least at the current juncture, has yet to find any indication that the models are inadequate with regard to such ranking.

## Section 3: Net benefits analysis of the measure

### 3.1 Effects on financial stability, financial system resilience and economic growth

**Increasing the required capital has improved the resilience of the Belgian banking sector.** The total increase in required capital is around €600 million, compared with a Tier 1 capital base of €55.6 billion and a consolidated Tier 1 capital ratio of more than 16% (at the end of 2013) of the banks concerned. As mentioned above, it will enable banks to withstand a shock in which default rates increase by a factor of 5 and LGDs rise by 20 percentage points. Owing to the high

level of interconnectedness in the Belgian banking sector,<sup>11</sup> a more resilient Belgian banking sector would also be beneficial in terms of financial stability in the EU. It should also be noted that under the procedure laid down in Article 4 of Decision ESRB/2014/2, no member of the General Board raised any material concerns regarding negative externalities of the measure, in terms of adverse cross-border spillover effects.

**Recently there have been signs of banks tightening their lending standards** (compared with the 2007-09 vintages of loans), which has also contributed to maintaining financial stability.

**No information is available on the possible impact of the measure on economic growth**, but given the rather limited change in capital requirements, the impact would be expected to be rather small. For the same reason, the impact on growth in other countries would also be expected to be minimal, if any at all.

### 3.2 Effects on both domestic and cross-border lending

**There are already signs that the combination of micro- and macro-prudential measures may have the desired impact on mortgage loans and house prices.** The issuance of new mortgage loans during the first quarter of 2014 was lower than in the first quarter of previous years, but this decline had already started before the measure had been formally introduced. The fact that the NBB has regularly signalled to banks the importance of conservative credit standards at origination may also have contributed to this development. Recently, there has also been an increase in rates for mortgage loans with an initial fixed rate of at least ten years, but again, this pre-dates the introduction of the measure. There was a slowdown in nominal house price growth over the first three quarters of 2013 and, in real terms, prices have tended to stabilise over the past few quarters.

**There are no signs that non-banks are expanding their market share**, but the NBB is monitoring the situation closely. With a share of around 13%, non-banks (e.g. insurance companies, specialised mortgage lenders) are anyway only small players in the market of residential mortgage loans.

**Foreign branches are very small players in the market and there has not been any significant new entrance in recent years.** At the end of 2013 the residential mortgage lending activity of foreign branches totalled €1.4 billion, or somewhat less than 1% of the total market, and around €1 billion of that was accounted for by one institution.

### 3.3 Effects on banking groups' intragroup behaviour

**Most banks have been able to meet the additional capital requirements by using their voluntary capital buffers.** None of the banks needed to raise additional capital, but one bank needed to reduce its dividend payouts. Given that the banks have been able to meet the increased capital requirement with existing capital buffers, it is unlikely that this measure will cause a shift in capital from operations to other countries.

**Belgian subsidiaries of EU banking groups are important market players.** Among the 15 major players in the market for residential mortgage loans, seven are Belgian subsidiaries of EU banking groups, with a market share of around 50%. The largest of these banks (ING Belgium, BNPP Fortis, Record Bank and Axa Bank Europe) are IRB banks.

**Some of the EU banking groups with Belgian subsidiaries also have branches in Belgium, which opens up the possibility of shifting loan portfolios from subsidiaries to branches to avoid the measure.** At the moment, these branches are not engaged in any mortgage lending activity in Belgium, but the NBB is monitoring the situation closely.

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<sup>11</sup> See, for example, IMF, *"Integrating stability assessments under the financial sector assessment program into Article IV surveillance"*, 27 August 2010, pp. 13-14.

**In the light of a possible reciprocation of the measure, the possible rebooking of mortgage loans from Belgian subsidiaries to Belgian branches should continue to be monitored by both the national authorities and the EBA.** In its notification, the NBB indicated that it would like to ask the ESRB to recommend that other Member States reciprocate the measure. However, during further discussions with NBB staff, it was argued that there is no immediate need for such a reciprocation at the current juncture, as there are not yet any concrete signs of intragroup transfers or a significant increase in mortgage lending through cross-border lending or branches.

If such developments were to occur in the future, the ESRB could revisit the issue of a formal reciprocation at the request of the Belgian authorities. With this in mind, mortgage lending through cross-border lending or branches in general should be monitored over time. A further investigation of developments at the institution level (in particular by the supervisory colleges of the banking groups concerned) could take place if there were a significant pick-up in such activity. It should also be kept in mind that the banking groups concerned will soon be supervised directly by the ECB under the SSM.

### Conclusions

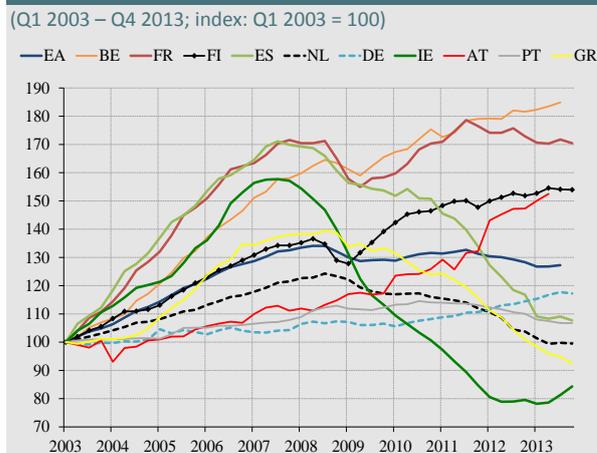
**The cyclical upturn in the Belgian residential mortgage market does not seem to be sustainable in the medium term, which is why precautionary macro-prudential measures are warranted.** Vulnerabilities have been building up in this market. These vulnerabilities are not reflected in the low risk weights that are used by the IRB banks for their mortgage lending activity and are based on historical data. Mortgage lending has increased rapidly since 2000, at a pace largely exceeding nominal GDP growth, and now represents a large share of banks' loan portfolios. A significant share of these mortgage loans have a rather high LTV ratio at origination that is accompanied by a significant DSTI ratio at the borrower level. As a result of the increase in mortgage indebtedness, vulnerabilities have also increased in the household sector, although the level of household indebtedness still compares favourably with that in other EU Member States.

**The ESRB is of the view that the measures listed in Article 458 of the CRR, which have to be considered before any stricter national measure can be taken, do not adequately address the increase in risk.** Measures such as those listed in Articles 124 and 164 of the CRR, as well as the systemic risk buffer or the countercyclical capital buffer are considered to be inadequate, either because they provide the wrong incentives, are too broadly based, or do not address the relevant type of risk or bank. While Pillar II comes closest as a possible alternative in terms of adequacy and relative effectiveness, a national measure under Pillar I is preferable in the specific case of Belgium for reasons of disclosure, transparency, taking into account banks' divergent risk profiles, timeliness and continuity. The ESRB also found that the measure does not entail disproportionate adverse effects on the internal market or other national financial systems. Therefore, the ESRB is of the view that the stricter measure is justified, proportionate, effective and efficient.

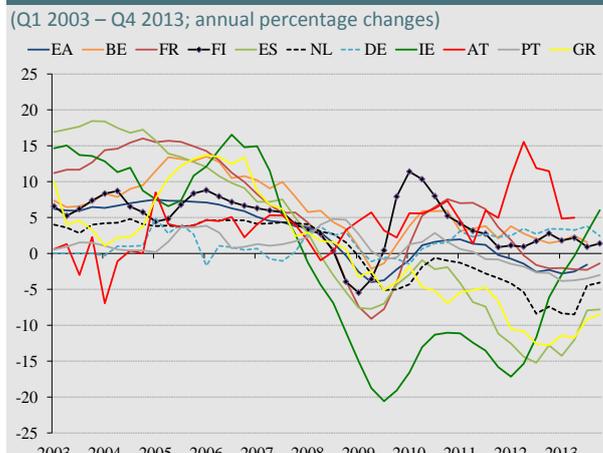
**Finally, the ESRB identified a number of issues that need to be followed up.** These include the situation in the commercial property market, the development of mortgage lending through branches and cross-border lending over time, and the outcome of the SSM's Comprehensive Assessment of the banks targeted by the measure. In the event that the stricter measure does not have the intended effect, further measures to address the increased risk could be considered by the Belgian authorities.

Annex

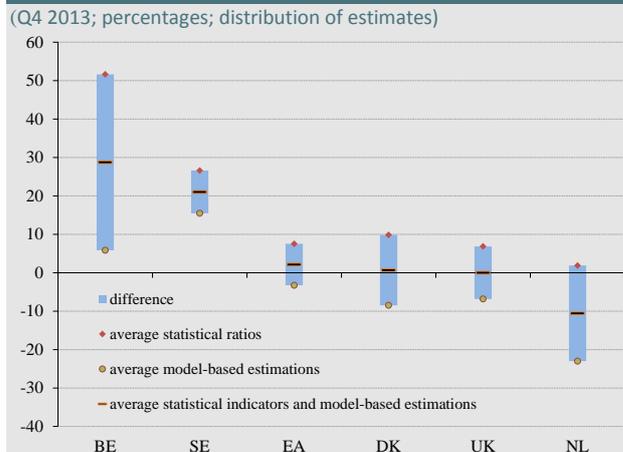
**Chart 1 Residential property prices in the euro area as a whole and selected euro area countries**



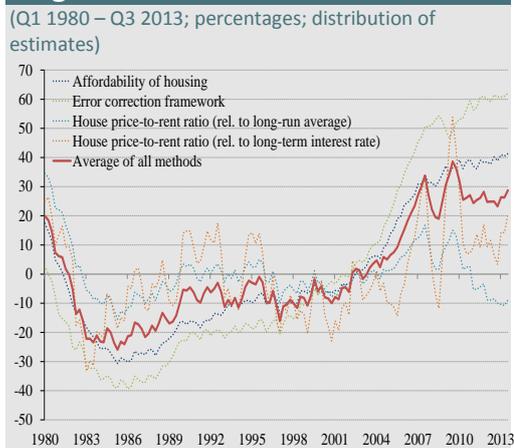
**Chart 2 Residential property prices in the euro area as a whole and selected euro area countries**



**Chart 3 Residential property price valuation indicators for selected EU Member States**



**Chart 4 Residential property price over/undervaluation indicators for Belgium**

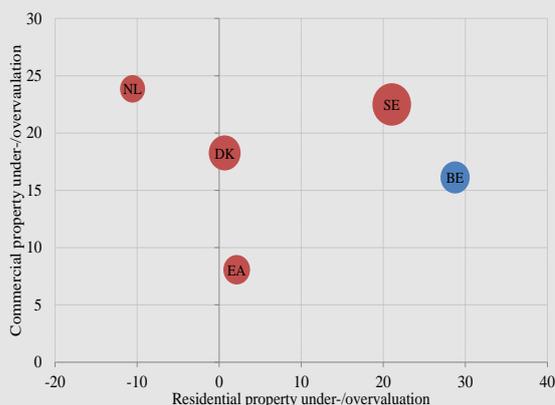


### ASSESSMENT OF THE POSSIBLE OVERVALUATION IN THE COMMERCIAL PROPERTY MARKET

Data on Belgian commercial property prices suggest an overvaluation in the prime commercial property market (see Charts 5 and 6). Authorities should therefore consider carrying out an in-depth analysis of this market segment and appropriate interventions to address potential risks.

**Chart 5 Over/undervaluation of residential and commercial property markets in selected countries**

(Q4 2013; percentages; distribution of estimates)



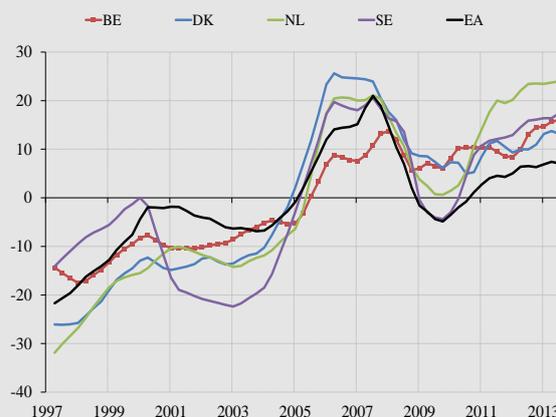
Sources: ECB, European Commission and ECB calculations.

Notes: Estimates are calculated using four different valuation methods: price-to-rent ratio, price-to-income ratio and two model-based methods. For each country, the average of the two statistical ratios, the average of the model-based methods and the overall average are shown. The size of the bubbles is indicative of the GDP growth forecast for 2014.

NL=Netherlands, DK=Denmark, EA=euro area, SE=Sweden, BE=Belgium.

**Chart 6 Developments in the euro area prime commercial property market in selected countries**

(Q1 1997 – Q4 2013; percentage deviation from average values from Q1 1997 to Q1 2013; two-quarter moving average)



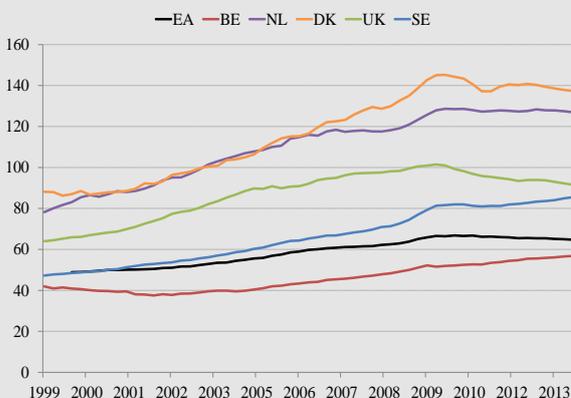
Sources: Jones Lang LaSalle, ECB and ECB calculations.

Notes: For further details, see the box entitled "Indicators for detecting possible value misalignments in commercial property market", *Financial Stability Review*, ECB, December 2011.

BE=Belgium, DK=Denmark, NL=Netherlands, SE=Sweden, EA=euro area.

**Chart 7 Ratio of household debt to GDP**

(Q1 1999 – Q3 2013; percentages)

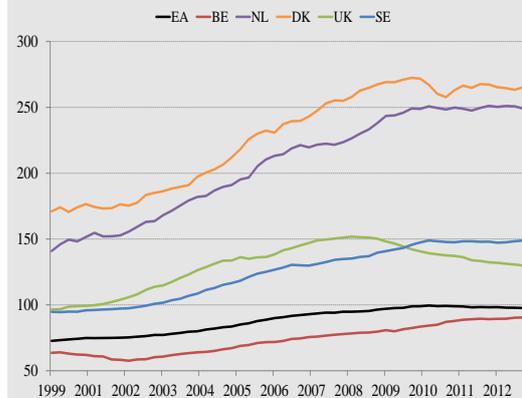


Sources: ECB and ECB calculations.

EA=euro area, BE=Belgium, NL=Netherlands, DK=Denmark, UK=United Kingdom, SE=Sweden.

**Chart 8 Ratio of household loans to gross disposable income**

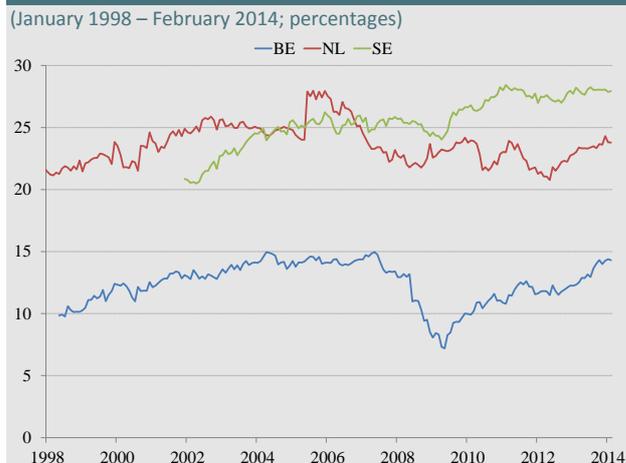
(Q4 1999 – Q3 2013; percentages)



Sources: ECB and ECB calculations.

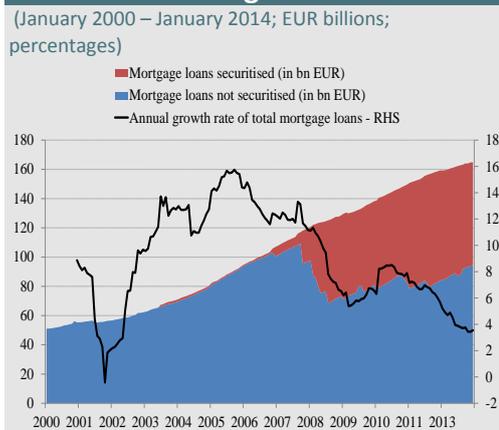
EA=euro area, BE=Belgium, NL=Netherlands, DK=Denmark, UK=United Kingdom, SE=Sweden.

**Chart 9 Lending for house purchases as a share of total loans in selected countries**



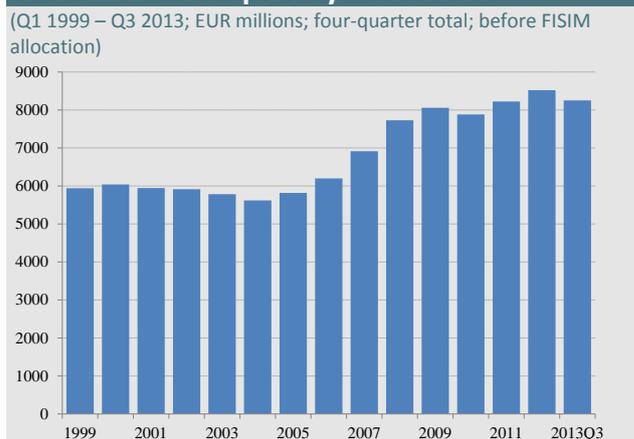
Sources: ECB and ECB calculations.  
 Notes: The chart shows lending for house purchases by monetary financial institutions, excluding ESCB reporting sector, (to domestic households) as a share of total loans (to all counterparts).  
 BE=Belgium, NL=Netherlands, SE=Sweden.

**Chart 10 Stock of Belgian mortgage loans and annual growth rates**



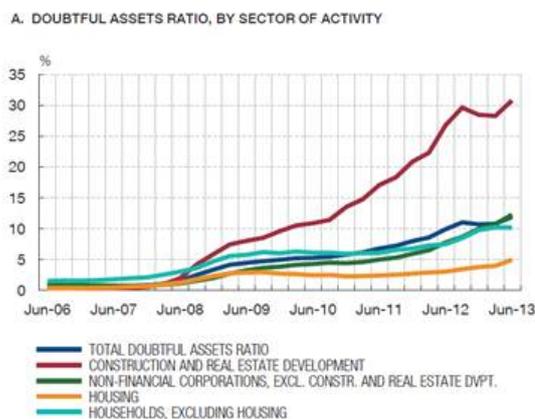
Sources: NBB and ECB calculations.  
 Note: Securitised loans also include transferred loans.  
 RHS= right-hand scale

**Chart 11 Interest paid by households**



Source: NBB.

**Chart 12 Doubtful assets ratio, by sector of activity**



Source: Banco de España, Financial Stability Report, November 2013, p. 28.