ESRB template for measures taken under Article 458 of the Capital Requirements Regulation (CRR)

1. NOTIFYING NATIONAL AUTHORITY	
1.1 Categorisation of measures	The NBB decided in November 2013 to increase the risk weight for Belgian mortgage loans for IRB banks through a modification of the Belgian Own Funds Regulation. The measure consists of a 5 percentage point add-on to the IRB-banks' internal risk weights for Belgian mortgage loans. This measure applied to the financial position of the Belgian credit institutions as at the end of 2013. For 2014, the NBB intended to make use of Article 458(2)(d) and in particular of the following possibility: i. risk weights for targeting asset bubbles in the residential and commercial property sector This requests an amendment of the art 154.3 of CRR to clarify that, for retail exposures secured by residential immovable properties in Belgium, the RW shall be equal to the sum of 5 % and the RW calculated pursuant paragraph 1 of this article.
1.2 Request to extend the period of application of existing measures for one additional year **(Article 458(9) of the CRR)**	Not applicable
1.3 Notification of measures to which Article 458(10) of the CRR applies ('notification only procedure')	The intended measure is not subject to the notification procedure only as specified in Article 458(10) of the CRR. As mentioned above, the intended measure consists in a 5 percentage point add-on to the IRB-banks' internal risk weights for Belgian mortgage loans. This implies an increase of more than 25% of the risk weights for some IRB banks concerned by the measure.
1.4 Legal basis for the implementation of the	Article 458(2)(d) (vi) of the CRR is the

measure	legal basis for the measure.
2. REASON FOR THE ACTIVATION OFTHE STRICTER NATIONAL MEASURE	
2.1 Description of the macro-prudential or systemic risk in the financial system **(Article 458(2)(a)of the CRR)**	The Belgian residential property and mortgage market was characterized by strong growth of both housing prices and mortgage debt in the period up to the start of the global financial crisis in 2007. Since then, after a marginal correction of housing prices and a temporary slowdown in mortgage loan growth in 2009, there was a new increase in housing prices and mortgage debt, in spite of the still challenging macroeconomic circumstances in the context of the euro area public debt crisis (see note in annex for more details). The NBB and different international institutions, such as the European Systemic Risk Board (ESRB), the Organization for Economic Co-operation and Development (OECD) or the International Monetary Fund (IMF), have drawn attention to potential risks related to the housing market in Belgium, against the background of a number of indicators suggesting a potential overvaluation of house prices in Belgium, even if the degree of overvaluation signaled by these indicators varies a lot from one indicator to the other and several of the used methodologies are associated with important caveats. In addition to the evidence of (some) overvaluation of housing prices, it cannot be totally excluded that external factors (change in the fiscal regime, increase in unemployment or contagion from other countries through confidence effects) might trigger at some point higher defaults and a downturn in the Belgian residential real estate market. Given these developments, the National Bank of Belgium (NBB) has closely monitored developments in the Belgian residential real estate and mortgage loan markets. In this context, the vulnerabilities of the Belgian housing market and residential mortgage loan market have been analysed, in combination with an assessment of the overall risk profile and quality of the residential mortgage portfolios of the main credit institutions. The analyses also revealed the existence of important sub-segments in the outstanding portfolios of mortgage loans that combine high levels of risk parameters — such as loan-to-

	value ratios or debt service charges for the borrowers. Yet, the relative shares of these sub-segments vary from one bank to the other, reflecting fundamental differences in banks' credit standards at origination. These riskier loans could be the source of credit losses for banks if conditions in the Belgian housing market were to become less buoyant than they have been over the past 15 years. In this connection, it must also be noted that the risk weights for Belgian mortgage loans, as calculated by the Belgian banks using an internal credit risk model[1] to compute them, are generally relatively low, and, on average, lower than in other countries. As internal risk models are calibrated on historical credit loss data, these low risk weights can to some extent be explained by the absence of a major crisis on the Belgian housing market in the past and by the – generally speaking – overall still relatively sound lending practices of most Belgian banks. Credit losses have however also been low due to the buoyant market conditions of the past 15 years. Current risk weights may thus be too low for losses that may emerge in less favourable market circumstances and from the materialisation of risks embedded in certain sub-segments of banks' Belgian mortgage loan portfolios.
2.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b)of the CRR)**	Given the importance of residential mortgage loan portfolios in the balance sheet of the Belgian credit institutions (around 15% of total assets), a downturn on the Belgian residential real estate market may have a substantial impact on the solvency position of Belgian credit institutions, which may rapidly have in turn significant negative consequences for the Belgian real economy. Given the importance of cross border banking groups in Belgium, safeguarding financial stability in Belgium will also have positive effects on financial stability in Europe.
2.3 Indicators prompting use of the measure	Main indicators are : - household debt ratio

[1] In Belgium, the following banks rely on internal risk models to compute the minimum regulatory capital buffers for the Belgian mortgage loans: KBC Group, ING Group Belgium, BNPP Fortis, Belfius, Axa Bank, Argenta and Crelan.

	- house prices, including indicators for prices valuation - LTVs, DTIs - mortgage loans' maturity - risk weights for real estate exposures (see documents in annex)
2.4 Justification why the stricter national measure is necessary **(Article 458(2)(c) of the CRR)**	As mentioned above, the analyses performed by the NBB have revealed the existence of important sub-segments in the outstanding portfolios of mortgage loans that combine high levels of risk parameters — such as loan-to-value ratios or debt service charges for the borrowers. Yet, the relative shares of these sub-segments vary from one bank to the other, reflecting fundamental differences in banks' credit standards at origination. These riskier loans could be the source of credit losses for banks if conditions in the Belgian housing market were to become less buoyant than they have been over the past 15 years, in particular in the context of low risk weights. These macro-prudential concerns can be eased if the capital requirements on residential mortgage loans are sufficiently high to absorb a potential increase in credit losses on Belgian mortgage loan exposures. However, for credit institutions using IRB models (that represent more than 90 % of the market), the average IRB-risk weight is lower than 10 % and is one of the lower averages in Europe. Based on its assessment of the specific portfolio of each institution, there are also clear indications that there are important sub-segments in the outstanding portfolios of mortgage loans that combine high level of risk parameters (i.e. high Loan to value ratio and debt to service ratio), which may generate higher than expected losses for the banks if the Belgian housing market were to prove less buoyant than it has been over the past 15 years. In this context, the NBB considered that prudential measures were and still are warranted in order to enhance the capacity of the Belgian credit institutions to absorb a potential increase in credit losses and to mitigate the concentration risk associated with the high weight of Belgian mortgage loans in banks' total assets. ***Why other measures or legal basis are not***

	adequate? **<u>Art 124</u>** Article 124 enables the competent authority to increase the risk weight of mortgage loans in the standardized method: the measure that was taken by the NBB in 2013 is not applicable to banks using the standardized method for residential mortgage loans. For these institutions, the current risk weight applicable in Belgium (35 %) is considered to be sufficient. An increase of this risk weight may be warranted in the future on basis of the evolution of the residential real estate market. The measure is only applicable to IRB-banks because the risk weight from the internal models is relatively low due to limited historical losses on the Belgian banks' domestic residential real estate credit portfolio. The internal models are nevertheless not designed to fully anticipate a potential macro-economic shock like an unexpected decrease in housing prices, increase of unemployment, overvaluation of the real estate prices or change in the tax treatment of mortgage loans. Article 164 enables the competent authority to increase the LGD floor of mortgage loans. As mentioned above, the risk weight produced by internal models of the banks is consistent with their respective portfolios' (relative) risk profiles. Increasing the floor will have no impact for banks that use the lesser conservative credit standards compared to those that use the stricter conservative standards (and have also the lowest risk weight). In other words, increasing the floor does not give an adequate incentive to banks to be stricter with regard to their credit standards at origination, which is one objective of the proposed measure. Consequently, the NBB considers that it is more adequate to increase the risk weight than to increase the LGD floor. Articles 102, 103 and 104 of directive 2013/36/EU With regard to article 102, this article is not applicable as the banks using IRB models comply with all the requirements of the Regulation N° 575/2013 and there is no evidence of a likely breach of this Regulation.

	The proposed measure is also not based on the risk assessment made pursuant to Article 97 on an individual basis but on macroeconomic concerns relating to the potential evolution of the residential real estate market in Belgium and the size of the mortgage loan portfolio within the banking sector as a whole. The measure is designed to apply to all the banks using an internal model even if the risk profile of these banks, and their residential mortgage loan portfolio, are different. The measure is proposed by the NBB as macro-prudential authority in Belgium and not as a micro-prudential authority. Measures taken under Articles 103 and 104 are designed to be used as micro-prudential measures even if the methodology used for the risk assessment under article 97 may be identical for credit institutions with a similar risk profile. Using the articles 103 and 104 is also less transparent than using the article 458, as pillar 2 measures are not publicly disclosed. The NBB considers that the macro-prudential measure should also have a signaling function. Moreover, it should be noticed that under the Regulation N° 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, the NBB will not be the competent authority for the Belgian banks using an internal model because the competent authority, which may use the articles 103 and 104, will be the ECB. As mentioned above, the proposed measure has been adopted by the NBB for a macro-prudential purpose and macro-prudential tools of the Directive 2013/36 and Regulation 2013/575 should be used. Article 133 and 136 of Directive 2013/36/EU Pursuant to article 133 and recital (85) the systemic buffer should be used to prevent and mitigate long term non-cyclical or macro-prudential risk. The increase of the risk weight for residential mortgage loans is proposed to limit the risk of a potential downturn in the residential real estate market and is justified by the current indicators flagging a potential overvaluation of housing prices in Belgium. Our understanding of Article 133 is that the

	systemic buffer may be applied to a subset of the financial sector, which may be in this case the credit institutions using IRB models, but the buffer rate should be identical for all these institutions and the buffer rate should apply to all exposures with potentially a distinction between all exposures located in the Member State, exposures located in another Member State and exposures locates in third countries. The systemic buffer is not designed to apply to specific exposures, like residential mortgages credit exposures, within a Member state. For this purpose, articles 128, 164 and 458 of the Regulation 2013/575 are available. If the systemic buffer is used and applies to all exposures in Belgium, this will equally penalize credits and other exposures to SME's and corporates in Belgium, which is not the desired outcome. If the interpretation of the current Article 133 is that the buffer rate may apply to subset of exposures within a Member States, this should be clarified. In this case, it should also be clarified how paragraph 11 to 14 will apply and how the buffer rate mentioned in these paragraphs should be calculated in practice. In any case, even if the systemic buffer may apply to the mortgage loan exposures only, which is doubtful on basis of the article 133, setting a buffer rate of x % of CT1 for this portfolio will have some drawback compared to the proposed measure to increase the risk weight by 5 percentage points. For example, if the buffer rate is set at 3 percentage points, the impact for an IRB Bank which have a risk weight of 25 % under the IRB approach will be huge compared to an increase of the risk weight by 5 percentage points. For a credit institution with an initial risk weight of 4 %, the impact will be too limited to ensure that the buffer will be sufficient to absorb additional losses in case of a downturn on the residential real estate market. A possibility will be to set a different buffer rate for each banks but this means that each credit institution will be a subset of the sector, which is not the purpose of this article. Moreover the process set in paragraph 11 to 15 will be different for each credit institution. With regard to Article 136, the buffer rate for the

	countercyclical buffer should apply to all exposures located in the related Member State. Applying a buffer rate to all credit exposures in Belgium will equally penalize the credits and other exposures to SMEs and Corporates in Belgium, which is not the purpose of the measure. Moreover, even if there is some sign of excessive credit growth for residential mortgage credit, there is no sign of excessive credit growth for credits to other economic sector. Consequently, the condition to use the countercyclical buffer is not fully met.
3. DESCRIPTION OF THE INSTRUMENT (MEASURE BEING NOTIFIED)	
3.1 Draft national measures **(Article 458(2) (d) of the CRR)**	The risk weight applicable to retail residential mortgage loans will be increased by 5 percentage points meaning, for example, that the risk weight will be 14 % for a credit institution for which the initial risk weight is 9 %. The measure will apply: • only to residential mortgage loans for which the collateral is situated in Belgium because the risk is linked to the current overvaluation of real estate prices and potential evolution of the residential real estate market in Belgium ; • only to credit institutions using an internal model for these exposures because the risk weight of these models are relatively low, compared to the standardized approach which applied a risk weight of 35%. As risk weights derived from internal models are calibrated on historical credit loss data in Belgium and given the absence of major housing shocks in Belgium in recent decades, these risk weights might not be sufficient to absorb credit losses that could materialise from high-risk sub-segments in banks' mortgage loan portfolios in a severe downturn of the Belgian housing market (for which several indicators signal a potential overvaluation of housing prices relative to fundamentals). • only to the exposures qualifying for the retail market as the current study of the NBB relates only to the retail exposures These exposures represent the bulk of

	the credit exposures on the residential real estate market. We have not yet prepared a draft Legal text applicable under the CRR but this measure will require an amendment to the article 154.3 of the CRR. The wording will be : “the following paragraph is added to article 154.3 of the CRR : “For retail exposures secured by residential immovable property collateral located in Belgium, the RW shall be equal to the sum of 0.05 and the RW calculated pursuant the previous paragraph. (This paragraph applies only to Institutions under Belgian law)”.
3.2 Scope of the measure **(Article 458(2) (d) of the CRR**	The measure will apply to Belgian credit institutions using an IRB model for their Belgian retail residential mortgage loans portfolio. The measure targets only Belgian retail residential mortgage credit portfolio and not commercial real estate or credits covered by mortgages in other Member State. This is due to the fact that the NBB analysis focuses only to retail residential loans. For the banks using the Standardised Approach, nothing changes.
3.3 Calibration of the measure	Having regard to the relatively low capital buffers that banks currently hold for Belgian mortgage loan portfolios, financial stability considerations pleaded for a moderate strengthening of the capital buffers for Belgian mortgage loans in IRB banks. This should raise the resilience of the Belgian banking system to a potential increase in credit losses on a portfolio which in recent years — in supportive market conditions — has generated very low losses for banks. Given the recent signs of a moderation in the growth of house prices and mortgage lending and the recent selective tightening of credit standards at origination by banks, the NBB decided that the size of this additional capital buffer could be kept at a very moderate level for the moment, but also decided that it could be reviewed in light of further market developments in the future. Considering the findings of the detailed analysis conducted by the NBB and with a view on the very low risk weights for Belgian mortgage loans in many IRB-banks, it seemed adequate to generate some additional capital buffers for this portfolio in the IRB-banks, while avoiding

	treating all banks' portfolios as if they were fully comparable in terms of risks. The NBB's decided measure in 2013 was to take the individual banks' IRB risk weights as a starting point (possibly increased with a corrective add-on if models' performance reveals weaknesses, see below) and to add a fixed 5 percentage points to the current risk weight through Pillar I framework for Belgian mortgage loan exposures. For the banks using the Basel Standardised Approach, nothing changes. Concretely, if an IRB bank has currently an average risk weight of 10% for Belgian mortgage loans, the proposed measure will imply a risk weight of 15% for Belgian residential mortgage loans (see more details in Annex B). The estimated impact for the Belgian banking sector is an increase in the minimum capital requirement for Belgian mortgage loans of about 0.55 billion, based on the exposures and average risk weight. This represents about 1.3% of the current Tier one capital outstanding of the banks concerned or 2.3% of the total minimum capital requirement in Pillar 1. With reference to the current average risk weight of 9.6 %, the measure would imply that for every 100 euro lent by banks, the minimum capital requirement for banks would increase from 77 cents (100 x 9.6 % x 8 %) to 1,17 euro (100 x 14.6 % x 8 %), with the remainder of the exposure still being financed with funds other than the banks' minimum required own funds. Following the implementation of this macro prudential measure, the average risk weight for domestic mortgage loans for Belgian IRB-banks will increase up to around 14.6%, which tends to be closer to the average risk weight observed in other core European countries (France, Germany, Luxembourg,...).
3.4 Suitability, effectiveness and proportionality of the measure **(Article 458(2) (e) of the CRR)**	As there is no evidence that a decrease of real estate prices will have a different impact between credit institutions, it has been decided that the increase of the risk weight should be identical for all the credit institutions. A 5 percentage point increase in the risk weight is seen as a minimum to give an incentive to credit institutions to be more prudent in their credit standards at origination, and to create a capital cushion. A 5 percentage point increase in the risk weight,

	compared to the increase of the LGD floor for real estate exposures, has also the advantage to not penalise credit institutions that seem to adopt the more conservative credit policy when originating Belgian mortgage loans. We did not apply the add-on for banks using standardized approach as we consider that given the relatively conservative credit standards of Belgian banks, a risk weight of 35% might be considered as sufficient to absorb a potential downturn in the real estate market. If the measure is not sufficient to limit the credit growth in the residential real estate market and if there are further signs of overvaluation of the prices in this market, an increase of this percentage will be considered by the NBB as macro-prudential authority.
3.5 Assessment of the likely impact on the internal market **(Article 458(2) (f) of the CRR)**	As a positive element, the measure will reinforce the solvency position of Belgian credit institutions active in the residential real estate market. As the measure applies only to the Belgian residential market and Belgian banks, there is no indication that the measure may have any impact on individuals or companies outside Belgium. Only Belgian credit institutions will be subject to the increase of RWA but we expect that other Member States will recognise the measure pursuant to paragraph 5 of the Article 458. If there is no recognition, we expect that the impact will be limited as the residential mortgage loans in Belgium are mainly granted by Belgian credit institutions.
3.6 Timing of the measure **(Article 458(4) of the CRR)**	The measure has already been applied at the end of 2013 through the Belgian own funds regulation. (see in annex the NBB of Regulation of 22 October 2013. The purpose of this demand is to maintain the measure.
3.7 Term of the measure **(Article 458(4) of the CRR)**	There is no predefined term. NBB follows constantly the evolution of the real estate market, the residential loans market and the related RWA. Desactivation or increase of the additional capital charge may be proposed in function of different indicators notably the

	potential overvaluation of the residential property prices, growth of residential mortgages loans or other relevant indicators.
3.8 Review **(Article 458 (9) of the CRR)**	It's schedule to evaluate the measure on an annual basis. NBB is updating its study on residential real estate market every 6 month.
3.9 Recognition by other Member States **(Article 458(8) of the C**	Yes, we ask the ESRB to recommend to other Member States to recognize the measure as their banking sector may be exposed directly or through their subsidiaries to the risk of residential real estate market in Belgium.
4. MISCELLANEOUS	
4.1 Disclosure	The measure is already public in Belgium. It shall be disclosed to be applicable as a pillar 1 measure.
4.2 Contact person(s) at notifying authority	Martine.druant@nbb.be
4.3 Any other relevant information	/