

## Notification template for measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

**Template for notifying the European Central Bank (ECB), the European Systemic Risk Board (ESRB) and the European Commission of stricter national measures pursuant to Article 458(2) CRR and for requesting the ESRB to issue a recommendation to other Member States to reciprocate the measures pursuant to Article 458(8) CRR**

Please send/upload this template to:

- [macropru.notifications@ecb.europa.eu](mailto:macropru.notifications@ecb.europa.eu) when notifying the ECB (under Article 5 of the Single Supervisory Mechanism Regulation (SSMR)<sup>1</sup>);
- [DARWIN/ASTRA](#) when notifying the ESRB;
- [FISMA-E-3-NOTIFICATIONS@ec.europa.eu](mailto:FISMA-E-3-NOTIFICATIONS@ec.europa.eu) when notifying the European Commission.

The ESRB will forward this notification to the European Parliament, the European Council and the European Banking Authority (EBA) without delay. This notification will be made public by the ESRB after the relevant authorities have adopted and published the notified macroprudential measure<sup>2</sup>.

E-mailing/uploading this template to the above addresses constitutes official notification; no further official letter is required. To facilitate the work of the notified authorities, please submit the notification template in a format that allows the information to be read electronically.

<b>1. Notifying national authority and scope of the notification</b>	
<b>1.1 Name of the notifying authority</b>	Eesti Pank
<b>1.2 Country of the notifying authority</b>	Estonia
<b>1.3 Categorisation of the measure</b>	The proposed measure is an extension of credit institution specific minimum level of 15% for the exposure-weighted average of the risk weights applied to the portfolio of retail exposures secured by mortgages on immovable property to obligors residing in Estonia.  The measure is applied in accordance with Article 458(2)(d)(iv) of Regulation (EU) No 575/2013.
<b>1.4 Request to extend the period of application of an existing measure for up to two additional years (Article 458(9) CRR)</b>	The existing measure will be extended for two additional years.  The measure was introduced in 30.09.2019 and extended in 30.09.2021 for two additional years. If not extended, the measure would expire by the end of September this year.

<sup>1</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>2</sup> On request by the notifying authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

<b>1.5 Notification of a measure to which Article 458(10) CRR applies ('notification only procedure')</b>	Not applicable
<b>2. Description of the measure</b>	
<b>2.1 Draft national measure (Article 458(2)(d) CRR)</b>	<p>The proposed measure is an extension of credit institution specific minimum level of 15% for the exposure-weighted average of the risk weights applied to the portfolio of retail exposures secured by mortgages on immovable property to obligors residing in Estonia. The measure applies to credit institutions that use the IRB Approach for calculating regulatory capital requirements.</p> <p>The decree of the Governor of Eesti Pank is published in Riigi Teataja, which is the official gazette of the Republic of Estonia (<a href="https://www.riigiteataja.ee/en/eli/504092019002/consolide">https://www.riigiteataja.ee/en/eli/504092019002/consolide</a>).</p>
<b>2.2 Scope of the measure (Article 458(2)(d) CRR)</b>	<p>The scope of the measure will remain unchanged from the existing measure that has been in place since 30.09.2019. The details are as follows:</p> <ul style="list-style-type: none"> <li>• The measure applies to retail exposures secured by mortgages on immovable property to obligors residing in Estonia.</li> </ul> <p>The calculation of the average risk weight at the portfolio level is based on reported data in the COREP template C 09.02 – Geographical breakdown of exposures by residence of the obligor: IRB exposures (CR GB 2), Estonia, and the relevant cells are: row 0070, and columns 0105 and 0125.</p> <ul style="list-style-type: none"> <li>• The measure applies to credit institutions that have adopted the IRB Approach. The measure applies on an individual and consolidated basis.</li> </ul> <p>Currently there are two IRB banks operating in Estonia with an aggregate market share of 72% in mortgage loan stock.</p>
<b>2.3 Calibration of the measure</b>	<p>The calibration of the proposed measure will be unchanged from the existing measure. The minimum level of the average risk weight for residential mortgage loans will remain at 15%.</p> <p>The calibration of the initial measure in 2019 was based on an assessment of credit losses from mortgage loans under a stress scenario. In view of the macroeconomic and financial developments after the adoption of the measure, the calibrated floor level at 15% is assessed to remain appropriate.</p>
<b>2.4 Suitability, effectiveness and proportionality of the measure (Article 458(2)(e) CRR)</b>	<p>The measure is aimed to safeguard the resilience of banks against the systemic risks stemming from lending for residential real estate. High and growing exposure to residential real estate risks by Estonian households and banks is a source of key vulnerabilities for financial stability in Estonia. The risks from lending for residential real estate have not diminished in recent years and the intention in setting an average risk weight floor is to ensure that the banks hold sufficient own funds to cover systemic risks related to mortgage loans and the residential real estate market. The measure is suitable and effective in addressing the macroprudential concerns by pre-emptively limiting any further decrease in risk weights.</p>

	<p>The measure is proportional, as it is targeted to mortgage exposures of IRB banks. Risk weight floor increased the aggregate risk exposure of the IRB banks by 196 million euros or 2.2% as of 31 December 2022. The estimated impact on the weighted average CET1 ratio of the IRB banks was approximately -0.6 percentage points. None of the banks has needed to raise new capital to meet the additional capital requirement as all Estonian IRB banks hold capital buffers well above the required level - their weighted average CET1 ratio was 26.6% at the end of 2022. The 15% floor applies for the exposure-weighted average of the risk weights applied to the portfolio of mortgage exposures. This means that the IRB banks still have sufficient flexibility to apply lower risk weights to suit the risk profiles of individual loans.</p> <p>The direct negative spillovers from the measure are limited as it applies only to retail exposures secured by real estate property. Hence the measure does not substantially affect the other activities of banks, such as corporate financing. The impact of the measure on lending activity and economic growth has been negligible and the extension of the measure is not expected to have additional impact (see also section 6 on cross-border and cross-sectoral impact of the measure).</p>
<b>2.5 Other relevant information</b>	
<b>3. Timing for the measure</b>	
<b>3.1 Timing for the decision on the measure</b>	The decision referred to in Article 5 of the SSMR was taken on 2 May 2023. The final decision is expected to be adopted in June/July 2023.
<b>3.2 Timing for publication</b>	July 2023
<b>3.3 Disclosure</b>	<p>The decree of the Governor of Eesti Pank is published in Riigi Teataja, which is the official gazette of the Republic of Estonia (<a href="https://www.riigiteataja.ee/en/eli/504092019002/consolide">https://www.riigiteataja.ee/en/eli/504092019002/consolide</a>).</p> <p>The decision to extend the measure together with the underlying analysis will be published on the Eesti Pank website.</p>
<b>3.4 Timing for application (Article 458(4) CRR)</b>	30/09/2023
<b>3.5 Duration of the measure (Article 458(4) CRR)</b>	The existing measure will be extended for two additional years.

<b>3.6 Review (Article 458(9) CRR)</b>	<p>The measure will be reviewed again within two years after extension, taking into account the developments of the systemic risk and possible changes in other macroprudential measures.</p>
<b>4. Reason for the activation of the stricter national measure</b>	
<b>4.1 Description of the macroprudential or systemic risk in the financial system (Article 458(2)(a) CRR)</b>	<p>Housing market related vulnerabilities are one of the main risks to financial stability in Estonia. The housing loan growth in Estonia was around 7% already in 2017-2019, almost twice as high as the average growth in the euro area. The COVID-19 crisis had only a temporary effect - the housing market and lending activity rebounded sharply and stayed extremely active in the following two years. The elevated activity was supported by pent-up demand, marked increase in household income and savings, changes in the second pillar of the pension system and by the low interest rates. The number of housing loans was 15% higher in both 2020 and 2021, compared to previous years. The housing price increase reached 24% yoy in Q3 2022, but moderated somewhat in the end of 2022 (to 17% in Q4 2022) and beginning of 2023. Nevertheless, the housing loan growth has remained almost three times higher than the euro area average. According to the Eesti Pank econometric model for measuring overvaluation in the housing market, housing prices on average were 10-15% overvalued in 2022. Based on the latest forecast, Eesti Pank expects the housing prices to decline modestly in 2023 and resume growth thereafter while the housing loan growth is expected to stay strong at close to 6-7% in the next few years.</p> <p>The rapid growth of housing prices has increased household debt servicing costs, as they have taken larger loans compared to their income, reflected in the higher DSTI ratios. Also, the interest rates for housing loans increased above 4% in December, swelling the loan servicing expenses. As the majority of housing loans in Estonia have variable interest rates, higher interest rates pass through to borrowers quickly. Against the backdrop of slowing economic growth the recent rapid loan growth results in mounting systemic risks as households have to cope with higher loan servicing costs. If economic situation would deteriorate unexpectedly, increased risks of borrowers could result in higher loan losses for banks.</p> <p>The exposure of the Estonian banking sector to residential real estate risks is high. In 2022, housing loans accounted for 44% of the real sector loan and leasing portfolio, compared to 41% in 2018. Banks are the main providers of housing loans in Estonia while the banking sector in Estonia is also highly concentrated and a few large players dominate the market. At the end of 2022 the share of the two IRB banks was 72% of the total housing loan market and their share in new housing loans was 64%. This reflects the crucial role played by the IRB banks in the supply of housing loans to households. In 2022, the pre-floor exposure-weighted average risk weight of the IRB banks on retail exposures in Estonia secured by immovable property stabilised at 14.9%, but at the same time the divergence of model-based risk weights among the IRB banks increased.</p> <p>Model based assessments carry a risk that in a rapidly changing environment banks may not be sufficiently prepared if system-wide risks were to materialise unexpectedly. Estonia's past experience from 2008-2009 has shown that a deterioration in the economic environment can lead</p>

	<p>to significant debt servicing problems for households and that the need for credit institutions to make additional provisions for NPLs can increase very rapidly.</p>
<p><b>4.2 Analysis of the serious negative consequences or threat to financial stability (Article 458(2)(b) CRR)</b></p>	<p>Residential mortgage loans make up a large share of the total exposure of the Estonian banking sector. This means that low risk weights could lead to insufficient capital being held against the systemic risks related to lending for residential real estate. If systemic risks were to materialise, the capital buffers of the banks may be insufficient to withstand the potentially large loan losses.</p> <p>Given the high level of exposure of Estonian banks to mortgages and the high share of the systemically important IRB banks in the lending, the materialisation of any negative scenarios would have a significant impact on the Estonian economy and the financial sector. Given the high degree of dependence of households and NFCs on financing by banks and the high level of concentration of the banking sector, it is essential that the capital buffers be sufficient to ensure the functioning of the financial system and a smooth supply of credit to productive sectors also under negative macroeconomic scenarios.</p>
<p><b>4.3 Indicators prompting the use of the measure</b></p>	<p>The main indicators are:</p> <ul style="list-style-type: none"> <li>• Housing loan growth and household indebtedness</li> <li>• Housing prices and indicators for price valuation</li> <li>• The model-implied risk weights of retail exposures secured by mortgages on immovable property</li> <li>• The share of housing loans in the total lending and in the total assets of the banking sector</li> <li>• Concentration in the housing loan market and the share of the IRB banks' exposures</li> </ul>
<p><b>4.4 Justification for the stricter national measure (Article 458(2)(c) CRR)</b></p>	<p>The risk weights for mortgage loans calculated using internal models have declined reflecting favourable macroeconomic conditions over the past decade. However, mainly backward-looking assessments carry a risk that in a rapidly changing environment banks may not be sufficiently prepared if system-wide risks were to materialise unexpectedly. Current low NPL levels reflect the recent favourable economic environment, but looking forward, the household loan servicing capacity is strained by increased price level, higher interest rates and deteriorated economic outlook. Thus, the level of systemic risks arising from the macroeconomic environment and from</p>

	<p>mortgage lending in particular remain elevated and the systemic risk has not weakened.</p> <p>The aim of the proposed measure is to safeguard the banking sector from the systemic risks that are related to residential mortgage loans. The large market share of the IRB banks makes it especially important that they are sufficiently capitalised to withstand the impact of the negative economic scenario and worsening of loan servicing ability of borrowers. The measure reflects the minimum level of risk weights that Eesti Pank as a macroprudential authority considers acceptable for the existing IRB banks or banks that potentially intend to adopt the IRB approach, given the level of systemic risk.</p> <p>In addition, the war in Ukraine initiated by Russia and the resulting uncertainties in the macroeconomic environment call for increased vigilance towards potential risks and additional prudence from the banks in addressing potential vulnerabilities and unexpected developments.</p> <p>Eesti Pank is of a view that under these circumstances, it is necessary to extend the measure for two years and prevent the reduction of capital buffers that are necessary to cover systemic risks.</p> <p>The ECB as a microprudential supervisor may take decisions that might have an impact on the average risk weights on retail mortgage exposures of the Estonian IRB banks. However, these decisions are not expected to change the current status quo in terms retail mortgage exposures risk weight positioning (below or above the 15% floor). In addition, future regulatory changes around the implementation of the final Basel III reforms, including the output floor, can be expected to impact IRB banks' risk weights and may lessen the need for the additional macroprudential measure. However, at the current stage it is too early to anticipate the effects for Estonian IRB banks.</p> <p><b>Article 124 of Regulation (EU) No 575/2013</b> allows the relevant authorities to set higher risk weights for exposures secured by mortgages on immovable property where the standardised approach is used for calculating the own funds requirements for credit risk. Article 124 does not apply to banks using the IRB approach.</p> <p><b>Article 164 of Regulation (EU) No 575/2013</b> allows the relevant authorities to set a higher minimum level for the exposure-weighted average loss given default (LGD) rates for retail exposures secured by mortgages on residential property. The underlying cause for Eesti Pank increasing the risk weights is not related to the dynamics of LGD values. Rather, a favourable macroeconomic environment and low interest rates over the last decade have led to more favourable credit risk characteristics and lower PD values. Increasing the minimum LGD level by applying Article 164 would be less transparent and have only a limited effect on risk weights.</p>
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	<p><b>Under Article 133 of Directive 2013/36/EU</b>, each Member State may introduce a systemic risk buffer of Common Equity Tier 1 capital for the financial sector, or for one or more subsets of that sector, in order to prevent and mitigate macroprudential or systemic risks not covered by Regulation (EU) No 575/2013, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State. The systemic risk buffer can also be applied to sectoral exposures defined in Article 133 (5)(b) or subsets of these exposures.</p> <p>The aim of the risk weight floor, that has been in place from 2019, is to safeguard the sufficiency of the capitalisation of the banks using internal risk models against risks stemming from domestic mortgage loans. Applying a systemic risk buffer to all exposures would have an impact also on credit to the corporate sector and SMEs. Therefore, such measure would have sizeable side effects and would not achieve the desired impact of limiting risks related to residential mortgage loans.</p> <p>Applying a sectoral systemic risk buffer only to retail exposures secured by residential property would not be efficient in achieving the desired outcome of establishing a floor to prevent further decline in risk weights. The sectoral buffer requirement would not act as a floor and would have to be set at a relatively high level to achieve the equivalent impact to existing measure. It would also affect disproportionately those banks that are using a more conservative risk assessment. Targeting systemic risks at the level of the whole banking sector is preferable to tailoring macroprudential measures to individual institutions. In addition, in the current economic environment, and considering the forthcoming implementation of revised Basel requirements, extending the already existing measure is preferable to changing the policy framework and introducing a new capital buffer requirement.</p> <p><b>Under Article 136 of Directive 2013/36/EU</b> the designated authority can set the countercyclical buffer rate. The purpose of the countercyclical buffer is to mitigate the risks arising from excessive credit growth in a Member State and it is guided by the deviation of the credit-to-GDP ratio from its long-term trend.</p> <p>As the countercyclical buffer rate is applied as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, it is not a suitable instrument for addressing risks related to only a subset of exposures such as mortgage loans.</p>
<b>5. Sufficiency, consistency and non-overlap of the policy response</b>	
<b>5.1 Sufficiency of the policy response</b>	Eesti Pank considers that the applied risk weight floor is sufficient to mitigate the build-up of risks, while having limited impact on the general economy, as described in sections 2.3, 2.4 and 4.1.

<p><b>5.2 Consistency of application of the policy response</b></p>	<p>Eesti Pank is of the view that the risk weight floor increases the resilience of banks against the systemic risks stemming from lending for residential real estate, and is the most effective and efficient macroprudential tool for this purpose, as discussed in sections 2.4 and 4.4. The measure is implemented in accordance with the common principles set out in the relevant legal texts.</p>
<p><b>5.3 Non-overlap of the policy response</b></p>	<p>From March 2015 three requirements have applied for credit institutions when they issue housing loans: an LTV limit of 85%, a DSTI limit of 50%, and a maximum maturity for housing loans of 30 years.</p> <p>O-SII buffer requirements apply to systemically important credit institutions and the two IRB banks are both subject to an O-SII buffer requirement of 2%.</p> <p>Eesti Pank has set a countercyclical buffer base requirement at 1% and has decided to increase the cyclical requirement to 0.5% from 01.12.2023, resulting in a total CCyB requirement of 1.5%.</p> <p>These policy measures do not target the systemic risk from low risk weights applied to the portfolio of retail exposures secured by mortgages on immovable property to obligors residing in Estonia.</p>
<p><b>6. Cross-border and cross-sector impact of the measure</b></p>	
<p><b>6.1 Assessment of cross-border effects and the likely impact on the Internal Market (Article 458(2)(f) CRR and Recommendation ESRB/2015/2<sup>3</sup>)</b></p>	<p>The risk weight floor is to be applied on the basis of the exposure-weighted average risk weight of Estonian retail exposures secured by mortgages on immovable property. At more than 99%, the vast majority of the retail loans secured by mortgages held by the IRB banks have been issued in Estonia. Besides, the average applicable risk weight on mortgage loans of banks in other countries in the region is generally higher, thus disincentivising banks to shift the mortgage exposures from Estonia to other countries. Therefore, the likelihood of any direct impact on other Member States is small.</p>
<p><b>6.2 Assessment of leakages and regulatory arbitrage within the notifying Member State</b></p>	<p>Residential mortgage loans in Estonia are predominantly issued by credit institutions. The share of non-bank mortgage lending is very small. The current capital buffers of credit institutions that would be subject to the intended measure are sufficient to allow them to meet the requirement without needing to raise additional capital. The current levels of the voluntary capital buffers mean that extending the measure should not limit</p>

<sup>3</sup> Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/3) (OJ C 97, 12.3.2016, p. 9).



	or significantly influence the lending by credit institutions to other economic sectors.
<b>6.3 Request for reciprocity by other Member States</b> <b>(Article 458(8) CRR and Recommendation ESRB/2015/2)</b>	<p>The proposed measure would apply to credit institutions licensed in Estonia. It would not apply to banks providing credit in Estonia through branches or as direct cross border lending.</p> <p>As of end 2022, five branches of foreign credit institutions were licensed to operate in the Estonian market. The two credit institutions that use internal model approaches for credit risk assessment held about 72% of housing loans, while branches of foreign credit institutions held only around 1% of all outstanding housing loans. The provision of direct cross-border mortgage lending is currently very limited.</p> <p>Because of the limited activity and market share of the foreign branches in the Estonian mortgage market, Eesti Pank has decided not to ask for reciprocity for the proposed measure. Eesti Pank will follow developments closely and may reconsider the need for reciprocity should the share of residential mortgage loans issued by branches increase considerably.</p>
<b>6.4 Justification for the request for reciprocity by other Member States</b> <b>(Article 458(8) CRR and Recommendation ESRB/2015/2)</b>	N/A
<b>7. Miscellaneous</b>	
<b>7.1 Contact person(s)/mailbox at notifying authority</b>	Jaak Tõrs, Head of Financial Stability Department +372 6680 905 jaak.tors@eestipank.ee
<b>7.2 Any other relevant information</b>	
<b>7.3 Date of the notification</b>	02/05/2023