Template for notifying intended measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

Please send this template to

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1. Notifying national authority and scope of the notification	
1.1 Name of the notifying authority	National Bank of Belgium (NBB)
1.2 Categorisation of measures	The NBB, in its capacity of macroprudential authority, intends to extend the period of application of its current macroprudential measure based on Article 458(2) (d) (vi) of the CRR. The extension would run for one year, from May 1, 2020 until April 30, 2021. The possibility of an extension of this type of measure is provided for in Article 458(9) of the CRR. The macroprudential measure referred to above increases risk weights for IRB banks' exposures to Belgian residential real estate (retail exposures secured by residential immovable property located in Belgium). The measure consists of two components. The first component imposes a 5-percentage-point risk weight add-on for IRB banks' exposures to Belgian mortgage loans. The second, more targeted, component further increases the risk weights in line with the risk profile of the IRB bank's mortgage portfolio (by applying a multiplier of 1.33 to the (microprudential) risk weight of the residential mortgage loan portfolio). This measure was activated on May 1, 2018 and, in line with Article 458 CRR, remains active for two years, until April 30, 2020.
1.3 Request to extend the period of application of existing measures for one additional year **(Article 458(9) of the CRR)**	In 2018, the NBB identified increases in the intensity of macroprudential/systemic risk in residential real estate (RRE) and related markets. According to the NBB assessment, these increasing vulnerabilities carry the potential of having serious negative consequences for the financial system and potentially the real economy in Belgium. After due consideration of all available options, the NBB deemed that these changes in the intensity of macroprudential/systemic risk are best addressed by means of a stricter national measure (pursuant to Article 458 of the CRR), in the form of an overall risk weight add-on (combining a linear and a risk-based component) on IRB banks' risk weights for mortgage loans covered by Belgian residential real estate (the measure is described in greater detail in Section 2.1 of this notification). This macroprudential measure secured the resilience of Belgian IRB banks against RRE risks. Because the identified systemic risks (vulnerabilities) in the financial system persist (and bank exposures to the Belgian residential real estate market have further increased since 2018), the NBB has decided that an extension

	of the period of application of this measure by one year is required. This extension is necessary to maintain the resilience of the banking sector and ensure sufficient loss-absorbing capacity from a macroprudential perspective, commensurate with IRB banks' exposure to the Belgian residential real estate sector. In order to justify its decision, the NBB is submitting the following relevant quantitative and qualitative evidence (further detailed in Section 4 of this notification): **banks are increasingly exposed to the Belgian RRE and related markets, which are marked by persistent vulnerabilities**, in the form of overvaluation of real estate markets, very loose credit standards for a substantial fraction of mortgage credit and a trend-wise increasing debt ratio for Belgian households. As these indicators point to significant (and increasing) systemic risks, while — at the sector level — (microprudential) risk weights remain stable and low, the NBB sees the need to extend the existing macroprudential measure. Stock risks implicit in the RRE exposures remain important and banks' resilience to a potential severe downturn in the housing market must be maintained by imposing sufficiently strong (macroprudential) capital resources to cover residential real estate exposures. The NBB considers the calibration of the current macroprudential measure to be sufficient to cover the identified macroprudential risks. Extending the measure not only maintains enough additional capital — commensurate with the higher RRE exposures of Belgian IRB banks — (securing resilience in the banking sector), but also continues to discourage excessive credit risk-taking by IRB banks by requiring higher capital resources for the more risky (higher risk weight) mortgage loans. Overall, **the extension of the Article 458 risk weight measure is an integral part of a consistent set of complementary macroprudential instruments activated in Belgium**: (i) the countercyclical buffer (CCyB), which will become binding from July 2020, will increase resilience to overall cyclical systemic risk, (ii) the Article 458 risk weight measure, currently binding until end-April 2020, increases resilience to real estate exposures — covering existing stock risks already on banks' balance sheets — and ensures that banks do not excessively rebalance towards real estate that has low RW, and (iii) the recently introduced supervisory expectations, implemented from January 2020, address flow vulnerabilities related to deteriorating lending standards. The NBB will reassess the need for the current Article 458 CRR measure once CRD5/CRR2 amendments enter into force in 2021. In this assessment, different alternatives will be considered — including the extension/deactivation of the Article 458 measure and/or activation of the sectoral systemic risk buffer (SyRB) — and evaluated in function of the developments in the level and distribution of stock risks in IRB banks' mortgage portfolios.
1.4 Notification of measures to which Article 458(10) of the CRR applies ('notification only procedure')	Article 458(10) does not apply for this measure. Taking into account the total effect of the proposed measure, the risk weights for the IRB banks concerned will increase, on average, by more than 25%.

2. Description of the measure	
2.1 Draft national measures **(Article 458(2)(d) of the CRR)**	The current measure consists of two parts. <u>The first part of the measure</u> consists of a general risk weight add-on of five percentage points for IRB banks' retail exposures secured by immovable property located in Belgium (EAD_i). The increase in the risk-weighted assets for bank i, ΔRWA_i, from this first component is therefore determined as follows: $\Delta RWA_i = 5\% * EAD_i$ *(eq. 1)* <u>The second part of the measure</u> provides an additional risk-sensitive element by targeting the risk profile of each (IRB) bank's (residential) mortgage portfolio. More specifically, this part of the measure determines the size of the (second) additional macroprudential risk weight add-on as a fraction (33%) of the microprudential risk weight on the (residential) mortgage portfolio, $RW_{RRE,i}$. The resulting additional RWA for bank i from this second component is thus determined as follows: $\Delta RWA_i = (0.33 * RW_{RRE,i}) * EAD_i$ *(eq. 2)* **After application of both parts of the measure**, **<u>the total risk-weighted assets</u>** for IRB banks' retail exposures secured by immovable property located in Belgium, is therefore determined by**:** $RWA_i = (1.33 * RW_{RRE,i} + 0.05) * EAD_i$ *(eq. 3)* The measure increases the overall RWs of the bank and – given regulatory capital requirements – implies that additional capital is needed to meet these requirements. We refer to this additional capital demand as the additional *capital buffers* generated by the macroprudential measure.
2.2 Scope of the measure **(Article 458(2)(d) of the CRR)**	The measure applies to: • retail exposures secured by residential immovable property for which the collateral (immovable property) is located in Belgium; • IRB credit institutions. The measure focuses on IRB banks as their model-implied risk weights are relatively low, compared to those implied by the standardised approach. The IRB banks in scope cover approximately 94% of the Belgian mortgage market; • both non-defaulted and defaulted exposures.
2.3 Calibration of the measure	The current measure primarily aims at enhancing the resilience of Belgian IRB banks to potential (severe) downward corrections in residential real estate markets against the background of intensifying credit exposures of Belgian households (and banks) and sustained price increases (and some overvaluation) in real estate over the past years. For this reason, the calibration of the current measure was based on the severe (macroprudential) stress scenario in the original notification of 2018. In view of recent developments in the Belgian mortgage market, the NBB deems that this stress scenario remains meaningful and severe enough to be used to calibrate the measure. An update of the sensitivity/scenario analysis performed indicates that, on the one hand, microprudential capital requirements (implied by microprudential risk weights) remain insufficient to cover all potential (macroprudential) losses under severe (macroprudential) stress scenarios and, on the other hand, that the current macroprudential

	measure (with the original calibration) is sufficient to cover the simulated losses – at sector level. The total impact of the proposed measure on IRB banks' CET1 capital is estimated at € 1,802 million (compared to € 1,486 million at the time of the original notification in 2018), equivalent to approximately 3.4% of IRB banks' total CET1 capital. The bigger impact of the measure on CET1 capital is commensurate with the higher RRE exposures of Belgian IRB banks. A breakdown according to the contribution of each of the two components of the measure implies a CET1 impact of € 1,096 million (2.1% of total CET1 capital) due to the 5 percentage-point risk weight add-on and an additional impact of € 706 million (1.3% of total CET1 capital) from the second component. The measure pushes up the implied risk weights (on mortgage exposures) from approximately 9.8 % to 18.1% on average, broken down into an increase of 5.0 percentage points for the first component (by construction) and 3.1 percentage points for the second component. The substantial increase in risk weights for residential real estate exposures implies that the total impact of € 1,802 million CET1 capital corresponds to an 84% increase in the capital buffer compared to the microprudential CET1 capital requirements for this portfolio. The current Article 458 measure is a complement to other macroprudential measures recently activated by the NBB. On the one hand, the CCyB was activated in July 2019 (at 0.5%) and will become binding from July 2020. Its aim is to target the acceleration in the overall credit cycle, mostly driven by non-financial corporate credit. The CCyB can absorb possible spillovers from RRE risks to the non-financial sector or address specific second-round effects. On the other hand, the current risk weight measure increases resilience on real estate exposures — covering the existing stock risks already on banks' balance sheets — and ensures that banks do not excessively rebalance towards the RRE market (with lower RWs). In addition, as explained in Section 1.3, the supervisory expectations regarding sound credit standards in mortgage lending may, in the medium term, improve credit quality and hence, limit any additional build-up of credit risk in future mortgage portfolios.
2.4 Suitability, effectiveness and proportionality of the measure **(Article 458(2)(e) of the CRR)**	***The NBB considers that the (extension of the) current Article 458 measure, is necessary, suitable, effective and proportionate based on a number of considerations.*** ***First, the proposed measure is necessary to strengthen banks' resilience*** against a potential severe downturn in the housing market by imposing a sufficiently strong capital buffer for residential real estate exposures. As mentioned before, the total amount of additional capital is estimated to be around € 1,802 million. The need for this additional capital arises from the low microprudential risk weights applied to real estate exposures by IRB banks against a background of substantial vulnerabilities at the macro level (RRE prices not fully in line with fundamentals, high household leverage and increasing banks' exposure to RRE risks). These vulnerabilities[1] have also been acknowledged by the ESRB in its recent (September 2019) report: • "Signs of overvaluation on the Belgian housing market."

[1] Note that similar vulnerabilities were identified in the November 2016 ESRB warning, which contributed to the activation of the current measure.

- "Loosening the lending standards operating for some time may have created pockets of vulnerabilities for the outstanding portfolio of RRE loans."
- "(…) the average RWs of the IRB banks for RRE portfolios, without taking into account the macroprudential measure in place, are relatively low in cross-country comparison."
- "Household indebtedness is relatively high and increasing."

In this context, the impact of a potential crisis at the macro level may not accurately be reflected in internal models (and implied microprudential risk weights) given the macrofinancial nature of the vulnerabilities and especially since Belgium has not experienced any major real estate crisis in the recent past. The lack of crisis episodes in Belgian data possibly makes it harder for IRB models to fully reflect the potential outcome of such crises. The macroprudential risk weight add-ons thus complement the IRB models.

Second, the current measure is suitable and effective as it directly acts on – and increases – the risk weights (from 9.8 % to 18.1% on average) of IRB banks for RRE portfolios, that are deemed too low compared to the observed persistent systemic risks in the residential real estate markets (see Section 4.1). The suitability of capital-based measures was also emphasised in the September 2019 ESRB report on "vulnerabilities in the RRE sectors of the EEA countries", where it is explicitly stated that "Capital measures (…) are appropriate to address the stock of RRE vulnerabilities in Belgium".

Third, the current measure remains necessary, suitable and effective, also taking into account the recent publication by the NBB of supervisory expectations regarding mortgage credit standards. Issued in response to the ESRB Recommendation of September 2019, these new supervisory expectations are aimed to act on the flow of new mortgage loans, whereas the current Article 458 measure is designed to ensure sufficient capital for the stock risks in banks' RRE mortgage portfolios. Both measures are therefore **complementary.** Besides, in its September 2019 report, the ESRB states that "**BBMs** [i.e. supervisory expectations in this case] **are more effective when combined with measures targeting the stock vulnerabilities**", which is precisely the goal of the current Article 458 measure.

Fourth, the NBB considers the measure to be proportionate as it provides an incentive-compatible mechanism for enhancing overall resilience to the persistent credit risk imbalances on the real estate market. Thanks to the risk weight multiplier (second component) of the measure, banks with better risk profiles and higher credit quality (contribute less to the overall build-up of systemic risk) are affected to a lesser extent by this measure. Moreover, the measure is sufficiently targeted and proportionate. No signs of any strong impact on overall credit supply (either in pricing or in volume terms) and, indirectly, on the real economy have been observed. Nor have any signs of disruption of the Single Market (through cross-border spillovers) been observed during the period of application.

To conclude, the NBB considers the extension of Article 458 measure as necessary, suitable, effective and proportionate. This targeted measure not only addresses the persistence of systemic risks (overvaluation, increasing household leverage and low capital buffers) by targeting the stock risks in banks' RRE exposures — by providing sufficient capital buffers (securing resilience in the banking sector) to overcome a severe downturn scenario — but is also complementary to the recently published NBB supervisory expectations, addressing the flow risks in new mortgage loans.

	The NBB will continue to monitor and review the measure on the basis of its overall macroprudential (mitigating) impact on the observed systemic risks in mortgage portfolios and RRE markets. In line with Article 458(4), the NBB will reconsider the calibration (or even the withdrawal) of the measure if a sustained reversal in the level and/or trend-wise build-up of these risks is observed. The developments in risk profiles (e.g. total risk weights, LTV, DSTI) as well as the overall coverage of banks' exposure to real estate risks and household leverage are important indicators in this assessment. The NBB will consider immediate withdrawal of the measure should banks start taking substantial losses in the event of severe residential real estate price corrections and rising defaults. The release modalities will be based on specific market developments.
2.5 Other relevant information	/
3. Timing of the measure	
3.1 Timing of the Decision	May 1, 2020
3.2 Timing of the Publication	May 1, 2020
3.3 Disclosure	The NBB will announce the extension of the current Article 458 CRR measure by means of a press release on its website. This decision including the NBB Regulation and the enacting Royal Decree will be published in April 2020.
3.4 Timing of Application (Article 458(4) of the CRR)	May 1, 2020, for one year
3.5 Phasing in	As it concerns an extension of a measure already in force, no phasing-in stage is planned. The current measure will continue to be fully applicable to the Belgian (residential) mortgage loan portfolios held by all Belgian IRB banks.
3.6 Term of the measure (Article 458(4) of the CRR)	The measure is extended for a period of one year, until April 30, 2021.
3.7 Review (Article 458(9) of the CRR)	The calibration and appropriateness of the measure will be reviewed in December 2020.

4. Reason for the activation of the stricter national measure

4.1 Description of the macro-prudential or systemic risk in the financial system

(Article 458(2)(a) of the CRR)

Since the introduction of its macroprudential measure based on Article 458 in 2018, the NBB has been closely monitoring developments on the Belgian real estate market, the sustainability of household indebtedness (in particular the emergence of risk pockets) and the quality of banks' loan portfolios. **This monitoring indicates that, in the event of an important price correction/decline for residential real estate, banks may suffer major credit losses on their mortgage portfolios.**

This assessment stems from a substantial level of systemic risk in banks' mortgage portfolios as well as the persistence of macrofinancial vulnerabilities, mainly related to: (i) protracted expansion of banks' exposures to mortgage lending to Belgian households, secured by low capital buffers as a consequence of the low risk weights applied by IRB banks against these exposures; (ii) persistent signs of some overvaluation and downside risks in housing prices; (iii) the persistence of household indebtedness (in particular risk pockets) supported by excessively loose credit standards for the riskier loan segments; and (iv) intense competition between credit institutions on the mortgage loan market as a consequence of the low interest rate environment which puts pressure on banks' profitability. **The persistence of these vulnerabilities (further detailed below) justifies the decision to extend the current macroprudential measure, which ensures sufficient additional capital resources in IRB banks.**

i. *Protracted expansion of banks' exposures to mortgage lending to Belgian households*

Resident banks are increasingly exposed to the Belgian RRE market and continue to expand their mortgage portfolios. Total outstanding mortgage loans granted by Belgian banks to Belgian households grew from € 169 billion at the end of 2014 to € 212 billion in November 2019, which corresponds to an increase from 15% to about 20% of banks' total assets. Expressed in terms of CET1 capital, these exposures rose from 362% to 406% over the same period. This is the result of a persistently high growth rate of mortgage lending to Belgian households, with an average (year-on-year) growth rate of 5.5% (5.7% in November 2019), which is well above the average growth of mortgage lending to households of 2.6% recorded in the euro area over the same period. Moreover, Belgian banks are also increasingly exposed to the RRE market indirectly, mainly through their widening commercial real estate (CRE) exposures through construction and real estate firms, whose investment projects are also vulnerable to developments in the RRE market.

In a context of significant macrofinancial risks and vulnerabilities (see below), low microprudential risk weights (9.8%) applied by IRB banks to RRE exposures are from a macroprudential perspective a source of concern. The current Article 458 measure ensures the build-up of capital buffers — commensurate with the increasing IRB banks' residential real estate exposures — that are deemed sufficiently high to absorb a potential increase in credit losses on Belgian mortgage loan exposures.

ii. *Persistent signs of overvaluation in housing prices*

Nominal property prices (for residential real estate) in Belgium have more than doubled (times 2.5) since 2000, without experiencing any major price correction, while real prices have risen by 77%. In

comparison with other euro area countries, Belgian nominal property prices suffered smaller and less persistent corrections in the aftermath of the financial crisis. With an average year-on-year growth rate of 5.0% since 2000, the reference price index for residential real estate currently stands, in nominal terms, at the highest level recorded. This growth of nominal RRE prices has significantly outpaced general consumer price indices and pushed up the real price of residential real estate by 77%. In 2019Q3, the year-on-year growth rate of housing prices stood at 3.6% in nominal terms, and at 2.6% in real terms. Note that RRE price developments have been more dynamic than justified by changes in fundamentals, leading currently to signs of some persistent overvaluation in the Belgian RRE market.

Measuring over- or undervaluation in the residential real estate market remains difficult and subject to substantial uncertainty as the estimates crucially hinge on a number of assumptions underlying the model or benchmark being used as equilibrium level. Nevertheless, many of the benchmark valuation measures currently point to some degree of overvaluation in the Belgian real estate market. The precise degree of such overvaluation differs significantly across valuation methods, however.

The NBB uses a model-based time series approach to explain (real) house price developments based on a number of key determinants, including interest rates, real disposable income, characteristics of mortgage loans, the tax regime applicable to residential property and demographic developments. To the extent that these determinants are considered to reflect their (long-run) equilibrium value, the model's residuals can be used to assess over- and undervaluation in the Belgian residential real estate market. Between 2009 and 2014, the model suggested an overvaluation of RRE prices in the range of 0 to 5%. **From 2015 until the most recent period, the overvaluation has further increased, fluctuating within a range of 5 to 10%.** For the third quarter of 2019, the overvaluation of Belgian RRE prices is estimated at 7.3%.

The model-based overvaluation estimate is (as with any other metric) not only subject to uncertainty. It is also conditional on the current fundamentals (e.g. low interest rates), representing the equilibrium price level. Potential reversals over the medium term to a higher (equilibrium) interest rate level are not taken into account in the current model-based assessment of the over- or undervaluation of the real estate market. Therefore, in this context, and in addition to the measured overvaluation, a return to a higher interest rate environment could result in substantial downward price corrections towards a new equilibrium, consistent with these higher interest rates.

Finally, the above analysis also does not rule out potential risks of sharp house price declines stemming from unexpected severe shocks to one or more explanatory factors (interest rates, tax regime, demographics, disposable income, etc.) which would also significantly affect RRE prices. Moreover, price corrections in the real estate market following such contingencies could be substantially larger than the estimated (over)valuations should any negative feedback loops occur that trigger (negative) overshooting of the equilibrium price.

iii. Persistence of household indebtedness supported by excessively loose credit standards

These developments have led to a gradual increase in the debt ratio of households which increased from 38.4% in 2002Q1 to 61.1% GDP in 2019Q3 (and 55.3% in 2012), raising some concerns about debt sustainability, especially for certain segments of the population (young, low-income).

	Belgium is one of the countries experiencing continued active leveraging by households, compared to other euro countries where – on average – households have been deleveraging since 2010. As a result of these diverging developments, Belgian households' debt ratio now exceeds the euro area average debt ratio and the difference is projected to widen further in the coming years**. In a context of deterioration in lending standards, these developments may also be indicative of the presence of risk pockets of over-indebted households which may be vulnerable in case of crisis/recession.** Despite some previous tightening of lending conditions observed in 2013-2014, the NBB considers that the current proportion of loans in the riskier segments remains too high. As credit standards continue to deteriorate, they contribute to future stock risks in banks' portfolios: • Recent developments in LTV ratios remain a point of particular concern. The fraction of new loans carrying a high LTV (>90%) has gradually expanded in recent years from 28% in 2014 to 35% in 2019H1. Average index-linked LTV figures indicate that 14% (i.e. € 29 billion) of the total outstanding stock carried an indexed LTV above 90%. • Banks have recently started to extend the maturity of mortgage loans. The most recent data show that loans with maturity between 20 and 25 years have become increasingly popular, with a share of new mortgage loans granted with a maturity of more than 20 years at 39% in 2019H1, compared to 29% in 2016. • The share of new mortgage loans with debt service (to income) ratios above 50 % (DSTI >50%) remains high, at 21.5% in 2019H1, and there has been no significant tightening of banks' DSTI policies since 2016. • There has been no reduction in the relative share of the "riskier loan segments", combining high LTV and/or DSTI and/or maturity levels at origination, in the total mortgage loan stock. Notwithstanding the relaxing of credit standards, the average IRB risk weight for mortgage loans (before taking the macroprudential measures into account) remains low (at 9.8%). *iv. Intense competition between credit institutions on the mortgage loan market* **Based on an analysis of banks' business plans, banks expect sustained new mortgage lending in the coming years.** In view of the low interest rate environment which puts pressure on banks to mitigate its impact on profitability, a widespread strategy of stepping up mortgage lending may induce intense competition between the main credit institutions. **Strong competition could support greater risk-taking**, i.e. underpricing of risks.
4.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b) of the CRR)**	Given the growing importance of residential mortgage loan portfolios in the balance sheet of Belgian credit institutions (around 20% of total assets and 401% of CET1 capital, on average), a severe downturn in the Belgian residential real estate market may have a substantial impact on Belgian credit institutions' solvency positions, which may in turn bring unfavourable consequences for the Belgian real economy (potentially amplified by relatively high household leverage). As experienced in other countries, it could also spill over to the commercial real estate market.

<table>
<tr><td></td><td>Furthermore, recent experience in other countries shows that severe market corrections can also affect the real economy, even in the absence of any major rise in defaults. A decline in consumer confidence as a consequence of increased market volatility or negative wealth effects, for instance, or the prioritisation of solving a potential debt overhang problem, are likely to weigh on consumption and on the economy at large with potential second-round effects in the form of increasing overall credit risks.

Finally, in view of the importance of cross-border banking groups in Belgium and the degree of openness of the economy, safeguarding financial stability in Belgium will also have positive effects on financial stability in Europe.</td></tr>
<tr><td>4.3 Indicators prompting use of the measure</td><td>The main indicators are:
• house prices, including indicators for price valuation
• household debt ratio
• mortgage loan growth
• credit standards (LTVs, DSTIs, mortgage loan maturity, banks’ interest rate margins, etc.)
• risk weights</td></tr>
<tr><td>4.4 Justification why the stricter national measure is necessary

(Article 458(2)(c) of the CRR)</td><td><u>General comment:</u> Based on the above risk assessment, the NBB considers that the extension of the measure is necessary and justified. In addition, maintaining (by extending) the existing measure would ensure continuity of the current macroprudential measure and avoid unnecessary confusion compared to the situation where the NBB would act on a different legal basis. Moreover, the extension of the measure under Article 458 CRR is also in line with ESRB Recommendation 2019/4 on vulnerabilities in the real estate markets, which refers to the complementarity between the current macroprudential measure and additional borrower-based measures.

<u>Why other measures or legal bases are not adequate?</u>

<u>Article 124 of the CRR (Exposures secured by mortgages on immovable property)</u>

Article 124 enables the competent authority to raise the risk weight for mortgage loans in the standardised approach. In Belgium, exposures risk-weighted according to internal models account for about 94% of the total market. In order to increase resilience of the Belgian banking sector to the identified systemic risks, Article 124 would therefore not be adequate.

<u>Article 164 of the CRR (Loss Given Default)</u>

Article 164 enables the competent authority to raise the LGD floor for mortgage loans.

However, the NBB considers that this legal framework is not adequate/effective for the following reasons:

- The measure is of a macroprudential nature, while Article 164 is, under the current Regulation, still a microprudential measure which can be implemented/imposed by the competent authority (and not the designated macroprudential authority).</td></tr>
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	- While Article 164 would lead to a change/intervention in banks' internal models, the intended measure aims to impose an additional *macroprudential* capital add-on – over and above the current microprudential requirements – without affecting or disrupting banks' internal models. The capital add-on implied by the measure will also vary according to the (changes in the) general risk profile (risk weights) of the respective banks' portfolios (unlike an Article 164 LGD floor). - An increase in the average LGD floor in Article 164 would have implications beyond the calculation of the risk-weighted exposure amounts in Article 164 and would also apply to, e.g., the calculation of expected loss amounts in Articles 158-159 CRR. - LGD estimates have increased over the last years in Belgium. The low level of risk weights applied by IRB banks does not reflect developments in LGD estimates but results from a fall in PD estimates. Therefore, raising the average LGD floor would miss the point and would be a biased way to increase risk weights. **Articles 101 (Ongoing review of the permission to use internal approaches), 103 (Application of supervisory measures to institutions with similar profiles) and 104 (Supervisory powers) of Directive 2013/36/EU** There are different reasons why these articles are not considered as appropriate in the current context. - First, the proposed measure is not based on the risk assessment made pursuant to Article 97 on an individual basis but on macroeconomic concerns, relating to the potential developments in the residential real estate market in Belgium, the size of the mortgage loan portfolio within the banking sector as a whole and the important share of loans with high LTVs. The measure is designed to apply to all banks using an internal model. - Second, making use of Articles 103 and 104 is also less transparent than making use of Article 458, as the ECB does not necessarily intend to communicate to the credit institutions or the public any detailed quantification and/or breakdown of the Pillar 2 requirements according to the type of risks. The NBB emphasises the importance of the macroprudential measure's signalling function to the banks and the general public, especially with a view to the build-up of vulnerabilities (riskier loans) in Belgium. - Third, in the forthcoming amendments to the CRD (CRD5/CRR2), the option to use Pillar 2 for macroprudential purposes will be removed. - Fourth, we should take into account the fact that the common practice of the supervisory authorities (NBB and ECB) is to take a SREP (Pillar 2) decision once a year in the form of a general CET1 ratio requirement. In theory, it is possible to raise the required Pillar 2 CET1 ratio by an appropriate percentage reflecting the amount of capital needed to cover the current measure on mortgage loans at the date of the decision. Nevertheless, in doing so, the mortgage loan add-on included in the required Pillar 2 CET1 ratio will also affect the capital requirements related to any new lending and exposures other than mortgage loans. This is not in line with the aim of the measure, which is to target only mortgage loans.

- Fifth, Articles 101 is not applicable as the IRB banks using internal models comply with all the requirements of Regulation N° 575/2013 and there is no evidence of any breach of this Regulation. The transversal review conducted by the NBB in 2014 did not raise any general concerns about the adequacy of the internal models. The low risk weights implied by these models partly reflect the absence of a major crisis in Belgium in recent decades, which makes it harder to fully reflect the potential outcome of such crises. However, where individual and specific weaknesses were observed, the bank concerned was required to review its internal models. A further in-depth horizontal review of banks' internal models by the ECB (TRIM) has, up to now, not resulted in major changes in this regard.

- Sixth, and more importantly, the risk weight add-on was implemented in the first place with a view to mitigating macroprudential risk stemming from (expected) developments in the real estate market and increasing borrower vulnerability, and not in order to correct any microprudential issue of potential miscalibration of internal models. In the specific case of the Belgian real estate market, the current measure provides, in addition to greater resilience of banks, an important signalling effect to banks that the NBB, as the macroprudential authority, monitors general vulnerabilities and stands ready to take necessary actions to impose required measures to safeguard financial stability.

- Seventh, with regard to Article 101, and independently of internal model calibration, it is important to highlight that the current risk weight calculation based on the Basel formula does not necessarily account appropriately for the systemic risk dimension as the asset correlation parameter for mortgage loans is low, relative to what could happen during a RRE crisis.

Article 105 (Specific liquidity requirements) of Directive 2013/36/EU is outside the scope of the assessment.

Article 133 (Requirement to maintain a systemic risk buffer) and 136 (Setting countercyclical buffer rates) of Directive 2013/36/EU

- First, pursuant to **Article 133** and Recital (85) of the current Regulation/Directive, the systemic risk buffer should be used to prevent and mitigate long-term, non-cyclical or macroprudential risk. The extension of the increase in risk weights for residential mortgage loans is proposed in order to limit the risk of a potential severe (cyclical) downturn in the residential real estate market.

- Second, under the current Directive, the systemic risk buffer should apply to all exposures, with possibly a distinction being made between exposures located in the Member State, exposures located in another Member State and exposures located in third countries. It is **not designed to apply to specific (sectoral) exposures**, such as residential mortgage credit exposures within a Member State. For this purpose, only Articles 124, 164 and 458 of the CRR are available under the current Regulation/Directive. If the systemic buffer were to be used and applied to all exposures in Belgium, this would equally penalise credit and other exposures to SMEs and corporates in Belgium, which is not the desired outcome. Therefore, the NBB considers that the systemic risk buffer, in its current form, is inadequate to address the specific risk in the residential real estate market as targeting such

	exposures directly is not possible under Article 133 of Directive 2013/36/EU. However, the NBB intends to reassess the need for the current Article 458 measure when Directive (EU) 2019/878 becomes applicable and allows for the application of a sectoral systemic risk buffer to retail exposures secured by immovable property for which the collateral (immovable property) is situated in Belgium. - With regard to **Article 136**, the countercyclical buffer rate similarly applies to all credit exposures to the non-financial private sector located in the Member State concerned. Applying a buffer rate to all exposures in Belgium would equally penalise credit and other exposures to SMEs and corporates in Belgium, which is not the purpose of the current measure. Belgium has recently activated the CCyB (0.5%), binding from July 2020 onwards. This CCyB measure, however, targets the observed acceleration of the Belgian credit cycle (driven mainly by corporate credit) and does not specifically target risk in real estate markets.
5. Cross-border and cross-sector impact of the measure	
5.1 Assessment of cross-border effects and the likely impact on the internal market **(Article 458(2)(f) of the CRR and Recommendation ESRB/2015/2)**	The extension of the measure is intended to maintain the solvency position of Belgian credit institutions active in the residential real estate market and as a result, the overall resilience of the financial system. In addition, it provides an incentive to banks to reduce the share of riskier loans. The current measure applies only to the Belgian residential market and there is no indication that it has any significant impact on individuals or companies outside Belgium. Since the implementation of the current measure, the NBB has not observed any signs of negative impact on the Internal Market that would outweigh the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified. There is no reason to expect this observation to change during the one-year period of extension of the measure. In view of the persistent vulnerabilities and the cross-border dimension of the Belgian financial sector, not allowing for the extension of the macroprudential measure – especially in the current low interest rate environment – might in fact negatively affect the Internal Market, given the potential effect on financial stability in Belgium (reduction of the capital buffers, reducing asset quality, etc.).
5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	Following the extension of the current macroprudential measure, the impact on other sectors of the financial system will continue to be closely monitored, especially among insurance companies, as capital requirements are lower for this type of exposure for insurance companies, raising the risks of leakages in the context of financial conglomerates in Belgium. The current measure has not led to any observation of substantial leakage to the non-bank sector.
5.3 Reciprocation by other Member States **(Article 458(8) of the CRR and Recommendation ESRB/2015/2)**	In view of the systemic nature of the identified risks and the international character of the Belgian banking sector, the NBB asks the ESRB to recommend that other Member States recognise the measure, as their banking sector may be (or may become) exposed directly or indirectly (through their branches) to the risks related to the residential real estate market in Belgium. The NBB asks the ESRB to recommend reciprocation once the extension of the measure has been enacted and implemented.

	In order to avoid disproportionate implementation costs for reciprocating Member States, the NBB proposes an institution-level maximum materiality threshold of € 2 billion to be applied when reciprocating the measure.
6. Miscellaneous	
6.1 Contact person(s) at notifying authority	• Dewachter Hans, hans.dewachter@nbb.be, +32 2 221 56 19 • Francart Alexandre, alexandre.francart@nbb.be, +32 2 221 52 09 • Reginster Alexandre, alexandre.reginster@nbb.be, +32 2 221 35 03
6.2 Any other relevant information	/