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

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1. Notifying national authority and scope of the notification	
1.1 Name of the notifying authority	Norwegian Ministry of Finance
1.2 Categorisation of measures	The Ministry intends to implement a stricter national measure regarding risk weights for targeting asset bubbles in the commercial property sector, pursuant to Article 458 (10) of the CRR. A similar measure targeting the residential property sector is the subject of a separate notification
1.3 Request to extend the period of application of existing measures for one additional year **(Article 458(9) of the CRR)**	The measure would be new.
1.4 Notification of measures to which Article 458(10) of the CRR applies (‘notification only procedure’)	The intended measure is subject to the procedure set out in Article 458 (10) of the CRR, as it seeks to increase average risk weights by less than 25% for a period of two years, see section 2.3.
2. Description of the measure	
2.1 Draft national measures **(Article 458(2)(d) of the CRR)**	The intended measure comprises a floor for average risk weights of 35 % for Norwegian commercial real estate exposures. The floor concerns the exposure-weighted average risk weight in the commercial real estate portfolio. Where the exposure-weighted average risk weight is lower than the floor, the total risk-weighted assets (RWA) should be increased correspondingly. Each institution’s increase in risk-weighted assets would be the following: $\Delta RWA = \max(0, 35\% - RW_{CRE})*EAD_{CRE}$ Where RW_{CRE} and EAD_{CRE} are the exposure-weighted average risk weight and exposures at default, respectively, for the commercial real estate portfolio.

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	Norwegian commercial real estate exposures should be understood as corporate exposures collateralised by immovable property in Norway. The measure is intended to be adopted by the Ministry of Finance as an amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014. The legal basis is the Norwegian Financial Undertakings Act of 10 April 2015 § 14-2 (6).
2.2 Scope of the measure **(Article 458(2)(d) of the CRR)**	The risk weight floors would be applicable for all Norwegian institutions using the Internal Ratings Based Approach (IRB institutions). Moreover, the Ministry intends to request the ESRB to issue a recommendation to other Member States to reciprocate the measure, see section 5.3.
2.3 Calibration of the measure	The calibration of the risk weight floor for commercial real estate exposures is aligned with current IRB practices allowed by the Financial Supervisory Authority of Norway (Finanstilsynet). The Norwegian institution employing the most advanced modelling for such exposures, has an average risk weight just over 35 pct., while the other Norwegian IRB institutions have average risk weights of approximately 50-90 pct. Considering the potential losses associated with commercial real estate exposures (see sections 2.4 and 4), a risk weight floor of 35 pct. is considered appropriate, even though it is not expected to affect Norwegian institutions' risk-weighted assets in the short-term. However, it could potentially affect branches of foreign IRB institutions substantially. A risk weight of 35 pct. corresponds to an LGD of 20 pct., which is the minimum level for a fully secured loan under the foundation IRB approach as defined in the new Basel standards (effective from 2022), and a PD of 1 pct. The latter can be considered an absolute minimum level for a long-run PD, given a weight of at least 20 pct. on a crisis level PD of at least 5 pct. Since crises are rare events, there is a danger that institutions underestimate these risks (see section 4.1). Furthermore, a recent study suggests that the capital required with the proposed risk weight floor would be insufficient compared to losses on commercial real estate exposures during the Norwegian banking crisis in 1988-1993, but enough to cover losses incurred in the downturn of 2002-2003.[1] On the other hand, risk weight floors should not be set in a way that weaken banks' incentives to provide low-risk loans. This is of particular importance for lending segments where credit risk varies widely, such as the commercial real estate market. Overall, this suggests that the proposed risk weight floor is at a reasonable level. The measure should also be applicable for institutions established in other Member States (see sections 2.4 and 5.3).
2.4 Suitability, effectiveness and proportionality of the measure **(Article 458(2)(e) of the CRR)**	The calibration of the proposed measure is considered to be proportionate with the intensity of cyclical systemic risks associated with Norwegian property markets, and in particular with the risk of potential asset bubbles in the commercial immovable property sector (see section 4). The measure is suitable to ensure that domestic institutions meet a certain minimum standard as regards risk-weighting at the portfolio level, and would also be the most effective measure to target Norwegian branches of foreign IRB institutions. Reciprocation by other EEA States will be crucial to ensure appropriate treatment of such exposures by foreign institutions, as well as to avoid leakages and regulatory arbitrage (see section 5). Foreign IRB institutions in Norway are mostly Nordic. The five large banking groups domiciled In other Nordic countries (Nordea, Danske Bank and Handelsbanken SEB and Swedbank) that are operating in the Norwegian market, do not report publicly their average risk weights for commercial real estate exposures. However, a recent study from the Swedish FSA has found that the

[1] Andersen, Henrik (2019), *How much CET1 capital must banks set aside for commercial real estate exposures?* Norges Bank Staff Memo 10/2019.

	overall average risk weight for these banking groups' commercial real estate exposures is around 23 pct.[2] If these banking groups employ similar levels for exposures in Norway, the proposed floor may on average imply a significant increase in capital requirements. The Swedish FSA has indicated however that the average risk weight for such exposures in Sweden should be increased, and has proposed Pillar 2 requirements for domestic banks corresponding to floors of 25-35 pct. for certain commercial real estate exposures.[3]
2.5 Other relevant information	N/A
3. Timing of the measure	
3.1 Timing of the Decision	The final decision will be made by the Ministry of Finance after the notification procedure has been completed.
3.2 Timing of the Publication	The final decision will be announced as soon as it is made by the Ministry of Finance. The Ministry did, however, announce its intention to adopt the measure on 11 December 2019.[4] The Ministry also published a consultation document on i.a. potential risk weight floors on 25 June 2019.[5]
3.3 Disclosure	In addition to the abovementioned consultation document, to which the public could submit comments until 30 September 2019, the Ministry will publish this notification on the same day as it is submitted.
3.4 Timing of Application (Article 458(4) of the CRR)	31 December 2020.
3.5 Phasing in	No phasing-in is planned.
3.6 Term of the measure (Article 458(4) of the CRR)	The measure is intended to be in effect for a minimum of two years. The Ministry of Finance will assess the need to renew the measure well before the term would expire. After implementation of the measure, the Ministry will monitor and regularly assess risk developments and the need to amend the measure, including the need for deactivation before the term expires.
3.7 Review (Article 458(9) of the CRR)	The appropriateness of the measure will be assessed regularly, and the measure will be reviewed with a view to renew or deactivate it well in advance of the expiration of the 2 year-term.

[2] Finansinspektionen's press release and report of 28 May 2019.
[3] Finansinspektionen's press release of 27 November 2019.
[4] The Ministry's press release of 11 December 2019.
[5] The Ministry's press release of 25 June 2019 (the consultation document is available in Norwegian only).

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)**	**Overview** The key vulnerabilities in the financial system in Norway are high household debt, high house prices and high commercial property prices. Residential real estate and commercial real estate represent the two largest lending segments for Norwegian institutions, and combined constitute more than ¾ of institutions' lending. The significant and prolonged increase in real estate prices have led to a build-up of financial imbalances, and an increase of systemic risk related to credit institutions' real estate exposures in Norway. Finanstilsynet and Norges Bank regularly carry out analyses of systemic risks in Norway. The evidence presented in this notification is based on these authorities' latest risk reports,[6] in addition to the Ministry's own analyses. **Risks stemming from the commercial property market** The prices of commercial properties, especially high-quality properties at prime locations in Oslo, have risen significantly over several years. At the same time, real estate companies' debt has risen. This has contributed to higher vulnerabilities for credit institutions in Norway. In the past, prices of commercial property have proven to be more cyclically sensitive than house prices. This is probably due to the fact that commercial properties are more of an investment object than residential properties. According to IMF there are signs of overvaluation in commercial property prices in Norway. A 2017 IMF report highlighted the fact that the price-to-rent ratio is close to the levels seen before the global financial crisis, and more so than in most other comparable countries.[7] The IMF also point to the continued and significant increase in commercial real estate prices as a vulnerability in its 2020 Financial Sector Assessment Program.[8] Losses on commercial real estate exposures have been low in normal times, but high during crises, both in Norway and other countries. Since crises are rare events, there is a danger that institutions underestimate these risks. Commercial real estate is the sector that has inflicted the most losses for Norwegian institutions during crises. Historically, a strong price rise for commercial property has often preceded a sharp price fall. Since yields are low, an interest rate increase or higher risk premium may lead to a sharp fall in commercial property prices. A downturn in the Norwegian economy could result in higher office vacancy rates. This will impair the debt servicing capacity of commercial real estate companies. If commercial property prices fall at the same time, bank losses may rise considerably. During the Norwegian banking crisis (1988-1993), residential real estate credit was initially affected, but the losses in this sector were relatively small. However, high interest rates and declining consumption led to large losses for banks in the commercial real estate sector. Stress tests conducted by Finanstilsynet imply that banks would suffer losses of more than 6 pct. with a price fall of 40 pct., but the loss estimates are highly sensitive of the size of the price fall. Banks' accumulated losses in the tests is a convex function of a fall in real estate prices. Risks related to developments in Norwegian commercial real estate markets are analysed in detail in a recent report from Finanstilsynet.[9] **Broadly unchanged risks after the Covid-19 pandemic** The Covid-19 outbreak led to a sharp downturn in the Norwegian economy. After the outbreak, commercial real estate prices fell, driven by lower rents. The decline can

[6] See Finanstilsynet's *Risk Outlook June 2019* (chapter 2) and *Risk Outlook June 2020* and Norges Bank's *Financial Stability 2019* (chapter 1).
[7] See *Norway: 2017 Article IV Consultation-Press Release; and Staff Report* (in particular Figure 7), IMF Country Report No. 17/181.
[8] See *Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director for Norway*, IMF Country Report No. 2020/259
[9] See Finanstilsynet's *Risk Outlook June 2019* (theme chapter II).

	largely be explained by the economic downturn. Rents are expected to fall somewhat further in 2020, before rising again as a result of a rebound in the Norwegian economy. Losses ahead on banks' CRE exposures remain uncertain. There is both uncertainty related to how large losses will be under the economic outlook assumed and greater uncertainty than in normal times surrounding the economic outlook. In general, financial imbalances are assessed as approximately unchanged since the outbreak of Covid-19.
4.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b) of the CRR)**	Norwegian and foreign IRB institutions are crucial for the credit supply to households and corporates in Norway. The IRB institutions have a combined market share of approximately ¾ in the Norwegian credit market. A disruption of the credit supply could have severe consequences for the real economy. For example, a negative shock in domestic property markets or tightened consumption may cause a significant increase in credit losses, and in turn constrain institutions' capacity to provide new credit. The negative dynamic that could develop between the institutions and the real economy, may destabilise the financial system and amplify a downturn in the Norwegian economy. As institutions established in other Nordic countries have significant operations in Norway, turbulence in the Norwegian financial system may easily spread to neighbouring systems.
4.3 Indicators prompting use of the measure	The main indicators are: • Institutions' commercial real estate lending relative to all lending • Commercial real estate prices • Office rental prices • Banks' losses on commercial property loans in percent of gross lending • Loan-to-value ratio on commercial property loans • Average risk weights for real estate exposures in IRB institutions Data files are available upon request.
4.4 Justification why the stricter national measure is necessary **(Article 458(2)(c) of the CRR)**	**Objective** The measure will ensure that all Norwegian IRB institutions continue to employ appropriate risk weights at the portfolio level for their commercial real estate exposures in Norway, given the prevailing systemic risks associated with these exposures. The proposed measure may also function as a backstop accounting for uncertainty in IRB models, stemming i.a. from data largely being collected over periods of positive economic development. **The inadequacy of other measures** *Article 124 of the CRR* concerns risk weights under the Standardised Approach, which in Norway remains at 100 pct. This level is considered adequate for institutions using the Standardised Approach. Increasing the risk weight for these institutions would not address the concerns regarding the IRB institutions. *Article 164 of the CRR* enables authorities to increase the LGD floor for IRB institutions' retail exposures, which is not applicable to commercial real estate exposures. *Article 101 of the CRD* concerns the Financial Supervisory Authority's review of institutions'' compliance with their permission to use the IRB Approach. Measures in accordance with this article would not be effective vis-à-vis foreign IRB institutions in Norway. *Articles 103, 104 and 105 of the CRD* allow for addressing the relevant risk in Pillar 2 requirements and other supervisory measures, but general risks should as a rule

	be mitigated by Pillar 1 measures. Pillar 2 measures are also less suited for reciprocation, and may therefore be less effective tools in this context. *Article 133 of the CRD* allows for requiring a systemic risk buffer to target long-term systemic risks. The Ministry of Finance intends to set a buffer requirement at a level which is commensurate with the level and intensity of such risks in the Norwegian financial system, see a separate notification. While structural and cyclical systemic risks may not always be easily distinguishable, the proposed risk-weight floor for commercial real estate exposures is primarily intended to mitigate risks associated with potential asset bubbles and financial imbalances, which have been increasing in recent years. The systemic risk buffer would also apply to exposures in general, and not target real estate exposures specifically. As cyclical systemic risks are particularly present and elevated in regards to real estate exposures, IRB risk weight floors would be the more efficient tools to apply in the current environment. *Article 136 of the CRD* requires the setting of a countercyclical capital buffer to address time-varying systemic risks. The buffer rate in Norway has been increased to 2.5 pct. over the last few years, justified to a certain extent by the same developments that necessitates IRB risk weight floors for commercial real estate exposures. On 13 March 2020, the buffer was reduced to 1 % in response to the Covid-19 pandemic. Moreover, the countercyclical capital buffer does not target commercial real estate exposures in particular, and does not promote an adequate level of average risk weights across all IRB institutions in Norway.
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 measure will promote domestic financial stability in Norway by contributing to an average risk-weighting of commercial real estate exposures that is considered appropriate in the current risk environment. If authorities of other EEA states reciprocate the measure, it may have a positive impact on other EEA markets where the relevant institutions have activities, since it could increase institutions' loss-absorbing capacity related to Norwegian credit exposures. A misalignment of risks and loss-absorbing capital associated with the Nordic institutions' Norwegian operations may have repercussions for the institutions' ability to serve other markets. For several institutions domiciled in other Nordic countries, lending in the Norwegian market constitutes a significant portion of their total lending. For the large banking groups domiciled in other Nordic countries (Nordea, Danske Bank, Handelsbanken, SEB and Swedbank), lending in Norway accounts for between 15 and 4 pct. of their total lending. They have market shares in the Norwegian lending market of between 13 and 1½ pct., and their operations in the Norwegian commercial real estate market are significant. Foreign institutions' overall market share in the corporate lending market amounts to 37 pct., while their share of the "sale and management of real property" segment (which accounts for 40 pct. of all corporate lending) exceeds 40 pct. Reciprocity in the Nordic region is particularly facilitated by a MoU signed by the relevant Nordic ministries in 2016, which acknowledges ESRB recommendations as a "minimum standard for reciprocity in macro-prudential matters".[10]
5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	The measure is not expected to contribute to leakages or regulatory arbitrage within the Norwegian financial system. Experiences with current capital levels in Norwegian institutions does not suggest that there is significant potential for migration to "shadow banking" or other sectors of the financial system. The scope for regulatory arbitrage is generally very limited within the Norwegian financial

[10] *Memorandum of understanding between the Finnish, Norwegian and Swedish Ministries of Finance and the Danish Ministry of Business on cooperation regarding significant branches of cross-border banking groups*, published on the Ministry of Finance website on 19 December 2016.

	system, owed to a consistent adherence to the principle of “same risk, same regulation”. If domestic macroprudential policy measures are not reciprocated, however, there may be risks associated with leakage from the domestic financial system to other EEA systems. The effectiveness of the measures would then be undermined.
5.3 Reciprocation by other Member States **(Article 458(8) of the CRR and Recommendation ESRB/2015/2)**	The Ministry of Finance intends to request the ESRB to issue a recommendation to other Member States to reciprocate the measure. IRB institutions established in other Member States have significant exposures and activities in the Norwegian commercial real estate lending market, and should be subject to the same macroprudential policy measures as Norwegian IRB institutions. As described in this notification, reciprocation is crucial for the effectiveness of the measure. The study mentioned in section 2.4 indicates that the five large Nordic banking groups’ average risk weights for commercial real estate exposures may be significantly lower that the proposed 35 pct. floor. However, it is not known to which extent the Swedish 23 pct. average is comparable to the banks’ treatment of Norwegian exposures, or how the average risk weights may vary between the banks. It is in any event to be expected that reciprocation of the proposed floor may imply increases in average risk weights in excess of the 25 pct. threshold mentioned in Article 458 (10) of the CRR for at least a subset of the five institutions.
6. Miscellaneous	
6.1 Contact person(s) at notifying authority	Tormod Fauske Tho, Advisor Phone: +47 22 24 45 11 / +47 22 24 45 21 E-mail: tho@fin.dep.no
6.2 Any other relevant information	The Ministry of Finance has submitted three other notifications together with this notification. They notify the intended use of measures in accordance with Article 458 (10) of the CRR (a floor for average risk weights for *residential* real estate exposures), Article 133 of the CRD (a systemic risk buffer for exposures in Norway) and Article 131 of the CRD (O-SII buffers). The systemic risk buffer notification is supplemented by a memo published on the website of the Ministry of Finance on 11 December 2019. The memo details the justification for the buffer and the need for reciprocation by other EEA states, which is also relevant for the measure described in this notification