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 residential property sector, pursuant to Article 458 (10) of the CRR. A similar measure targeting the commercial 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 20 % for Norwegian residential real estate exposures. The floor concerns the exposure-weighted average risk weight in the residential 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: $\Delta RWA = \max(0, 20\% - RW_{RRE}) * EAD_{RRE}$ Where RW_{RRE} and EAD_{RRE} are the exposure-weighted average risk weight and exposures at default, respectively, for the residential real estate portfolio.

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	Norwegian residential real estate exposures should be understood as retail 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 floor would be applicable for all Norwegian institutions with the relevant exposures and using the Internal Ratings Based Approach (IRB institutions). This includes one subsidiary whose parent is established in another Member State.[1] 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 residential real estate exposures is aligned with existing requirements imposed by the Ministry of Finance and the Financial Supervisory Authority of Norway (Finanstilsynet) on models used by IRB institutions to estimate residential mortgage risk. The floor on average Loss Given Default (LGD) estimates was increased from 10 to 20 pct. in 2014, pursuant to Article 164 of the CRR. Moreover, Finanstilsynet imposed stricter requirements in 2014 detailing how default data from the Norwegian banking crisis are to be taken into account, extra safety margins in the best risk classes and levels of loss ratios.[2] Finanstilsynet said: "Safety margins must be included to allow for the uncertainty inherent in models and data. Finanstilsynet previously made it clear that model estimates should reflect the default and loss experience during the banking crisis in the early 1990s. However, data quality from that period is highly uncertain. Uncertainty about the models' long-term predictive ability is compounded by the fact that other data used in the models reflect boom years for the Norwegian economy. Hence Finanstilsynet is now outlining assumptions on which models are to be based, detailing how default data from the banking crisis are to be taken into account, extra safety margins in the best risk classes and levels of loss ratios." In 2014, Finanstilsynet estimated that the requirements would increase risk weights assigned to residential mortgage portfolios to around 20-25 pct. Furthermore, a 2013 study applying data going back to the banking crisis in the early 1990s, suggested that such risk weights should be around 20 to 30 pct.[3] Provided that the systemic risk is not above levels experienced before the Norwegian banking crisis, this indicates that the calibration of the 20 pct. floor is appropriate. This level corresponds to the portfolio-average LGD and PD minima imposed by the MoF and Finanstilsynet, respectively. Today, Norwegian IRB institutions' average risk weights for residential real estate exposures vary between approximately 18-23 pct. The intended measure would therefore increase the institutions' average risk weights by a maximum of (20 - 18)/18 = 11 pct. Considering the potential losses associated with such exposures (see sections 2.4 and 4), a risk weight floor of 20 pct. is considered appropriate. 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	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 residential property sector

[1] Nordea Eiendomskreditt AS.
[2] Finanstilsynet's press release of 1 July 2014 provides further information.
[3] Andersen, Henrik (2013), *How high should risk weights be on Norwegian residential mortgages?* Norges Bank Staff Memo 10/2013.

measure **(Article 458(2)(e) of the CRR)**	(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. The stricter 2014 IRB measures described in section 2.3 are targeted and generally proportionate with risks associated with Norwegian residential real estate exposures, but do not ensure that all institutions' average risk weights for such exposures will be above 20 pct. Moreover, data from low-loss years may over time feature more prominently in institutions' models, while at the same time the probability of a negative shock in domestic property markets may be increasing. 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. Nordic authorities have reciprocated the stricter 2014 IRB measures described in section 2.3, as facilitated by a MoU signed by Nordic supervisors.[4] Such reciprocation does not however guarantee that the institutions' average risk weights for residential real estate exposures will be above 20 pct. Moreover, the authorities' methods of reciprocation vary. While Danish and Finnish banks are obliged by their authorities to employ risk-weighing in accordance with the 2014 Norwegian measures, Swedish banks are subject to Pillar 2 add-ons corresponding to the estimated effect of the measures.
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.[5] The Ministry also published a consultation document on i.a. potential risk weight floors on 25 June 2019.[6]
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.

[4] *Memorandum of understanding between Finansinspektionen (Sweden), Finanstilsynet (Norway), Finanstilsynet (Denmark), Finanssivalvonta (Finland) and the European Central Bank on prudential supervision of significant branches in Sweden, Norway, Denmark and Finland*, published on the Danish FSA website on 2 December 2016.
[5] The Ministry's press release of 11 December 2019.
[6] The Ministry's press release of 25 June 2019 (the consultation document is available in Norwegian only).

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.
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,[7] in addition to the Ministry's own analyses. **Risks associated with high household debt** Norwegian household debt corresponds to approximately 120 pct. of GDP for Mainland Norway. This is a very high level, both historically and in an international context. Household debt has long risen faster than household income, increasing household leverage. As of June 2020, the average debt burden of Norwegian households was approximately 230 pct. Credit institutions' loans to households are mainly residential mortgage loans. The institutions' losses on loans to households have been low, but the high level of debt makes the households vulnerable to increases in interest rates or loss of income. Households' debt service ratio is close to a historically high level despite the low interest rates, and only a small proportion of household debt carries fixed interest rates. Higher interest rates will quickly be reflected in households' debt service. The danger that a large number of households will tighten consumption at the same time, constitutes a systemic risk. This may reduce earnings in the corporate sector and impair their debt-servicing capacity. This may in turn lead to a fall in the economic activity and increase unemployment, and higher losses on banks' corporate exposures. The debt is very unevenly distributed, and many households have raised their debt level considerably during the protracted period of low interest rates. For the most vulnerable households, an increase in interest rates will significantly impair their finances. The IMF noted in its Technical Note on systemic risk oversight and macroprudential policy framework, that household debt in Norway is at or close to an all-time high relative to disposable income, and high relative to other countries.[8]

[7] Finanstilsynet's *Risk Outlook June 2019* (chapter 2) and Norges Bank's *Financial Stability 2019* (chapter 1).
[8] See the IMF's report *Norway: Financial Sector Assessment Program-Technical Note-Systemic Risk Oversight and Macroprudential Policy Framework*, IMF Country Report No. 2020/265

	Owing to high household indebtedness and house price overvaluation, the ESRB issued a warning to Norway in June 2019, in which it points out that the vulnerabilities are a source of systemic risk to the financial system.[9] **Risks stemming from the housing market** Developments in household debt are strongly linked to price developments in the housing market. Higher house prices give a rise in housing wealth, and increase the collateral value of the real estate, which in turn provides scope for increased borrowing secured on residential property. Over time, this interdependence has contributed to strong growth in both house prices and debt. Since the banking crisis at the start of the 1990s, house prices have grown considerably more than disposable income per capita. Analyses from the IMF, OECD and others indicate that residential real estate prices in Norway are overvalued. A 2017 IMF study found that house prices as of year-end 2016 were overvalued by about 16 pct., one of the highest valuation gaps among the countries in the sample.[10] The growth in house prices has softened significantly since 2016, but overvaluations remain, according to a 2019 IMF study.[11] The study estimates the overvaluation as of 2018 to be in the range of 0-10 pct. at the national level, and between 5 and 20 pct. in Oslo. In its 2020 FSSA of Norway, the IMF says that real estate prices has risen strongly over past decades. This is, as the IMF highlights, a continuation of an uptrend that started in the 1990s. Residential real estate prices have increased by 70 pct. over the last decade, while rising more in large cities (particularly in Oslo, where they doubled).[12] Although house price developments have been more moderate over the past two years, high house prices remain a key vulnerability in the financial system in Norway. Sharp and sudden declines in house prices may trigger tightening of household consumption and result in increased losses on banks' loan portfolios. The covered bond market may also be weakened, which may cause funding shocks. **Broadly unchanged risks after the Covid-19 pandemic** The Covid-19 outbreak led to a sharp downturn in the Norwegian economy. After the outbreak, house prices fell for two months consecutively, but rebounded quickly. House prices had reverted to their pre-pandemic level already one month later, and house price inflation and turnover in the housing market remained high through the summer. Household credit growth has levelled off in recent months, after having gradually slowed over the last three years. 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.

[9] See *Warning of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector of Norway*.
[10] See *Selected issues* (Chapter: "Are house prices overvalued in Norway?"), IMF Country Report No. 17/181.
[11] See *Norway: 2019 Article IV Consultation-Press Release; and Staff Report*, IMF Country Report No. 19/159.
[12] See *Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director of Norway*, IMF Country Report No. 2020/259

4.3 Indicators prompting use of the measure	The main indicators are: • Institutions' residential real estate lending relative to all lending • Household debt-to-income ratio • Household debt service ratio • Share of floating-rate residential mortgage loans • Housing prices relative to disposable income • Institutions' losses on retail market loans in percent of gross retail market lending • 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 employ appropriate risk weights at the portfolio level for their residential real estate exposures in Norway, given the prevailing systemic risks associated with these exposures. Until now, Norwegian institutions' RWAs have been held up by the Basel I floor. The floor was abolished at year-end 2019. The RWAs will then be determined only by the model-produced risk-weights (except any such exposures subject to the Standardised Approach), and it is therefore more important than before to ensure that all institutions meet a certain minimum standard at the portfolio level. 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 35 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' residential real estate exposures. In Norway this provision has been employed to increase the LGD floor to 20 pct., see section 2.3 above. This is, however, not considered sufficient, as it still enables some institutions to operate with average risk weights below 20 pct. *Article 101 of the CRD* concerns the Financial Supervisory Authority's review of institutions'' compliance with their permission to use the IRB Approach. As described in section 2.3 above, stricter requirements have indeed been imposed on the use of models for residential real estate risk, but this has not ensured that all institutions produce average risk weights of at least 20 pct., which is the level the Ministry considers appropriate. Also, measures in accordance with Article 101 of the CRD 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 residential 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 residential real estate exposures, namely a build-up of financial imbalances in the household sector and high house prices. 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 residential 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 residential 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 five large banking groups domiciled in other Nordic countries (Nordea, Danske Bank, Handelsbanken, SEB and Swedbank), total 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. 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".[13]
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 do 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 system, owed to a consistent adherence to the principle of "same risk, same regulation". In the last few years, however, insurance companies have increased their holdings of residential mortgage loans somewhat, which may in part be a response to relatively low capital requirements for low-risk loans in the Solvency II framework. The Ministry has therefore adopted an amendment to the Norwegian implementation of the Solvency II framework, which better aligns insurance companies' capital

[13] *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.

	requirements with the banking requirements. The amendment was adopted on 5 December 2019, based on an EEA adaptation to the Solvency II framework.[14] 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 EEA States to reciprocate the measure. IRB institutions established in other EEA States have significant exposures and activities in the Norwegian residential real estate lending market, and should be subject to the same macroprudential policy measures as Norwegian IRB institutions. Since Nordic authorities already have reciprocated the stricter 2014 IRB measures described in section 2.3, reciprocation of the new risk weight floor should not have a significant impact for Nordic institutions. If institutions operate with average risk weights for residential real estate exposures below 20 pct., any increase is not expected to exceed the 25 pct. threshold mentioned in Article 458 (10) of the CRR. If the current reciprocation is achieved via Pillar 2 add-ons, however, the increase in Pillar 1 average risk weights may exceed 25 pct.
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 *commercial* 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.

[14] The Ministry's press release of 5 December 2019.