Template for notifying national macroprudential measures not covered by CRR/CRD

Please send this template to

- notifications@esrb.europa.eu when notifying the ESRB;
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1. Notifying national authority and scope of the notification		
1.1	Name of the notifying authority.	Comité du Risque Systémique (Systemic Risk Committee – SRC)
1.2	Name of the macroprudential measure that is notified.	Legally binding requirements for new mortgage loans on residential immovable property located in Luxembourg: loan-to-value (LTV) limits.
2. Description of the measure		
2.1	Description of the measure.	The measure comprises the activation of legally binding LTV limits for new mortgage loans on residential immovable property located in Luxembourg. Following the Recommendation of the Systemic Risk Committee (SRC), the LTV limits are differentiated across different categories of borrowers (see CRS/2020/005). Three categories are considered, with the following calibration: - LTV limit of 100% for first-time buyers acquiring their primary residence; - LTV limit of 90% for other buyers (i.e. not first-time buyers) acquiring their primary residence. This limit is implemented in a proportional way via a portfolio allowance. Specifically, lenders may issue 15% of the portfolio of new mortgages granted to these borrowers with an LTV above 90% but below the maximum LTV of 100%. - LTV limit of 80% for other mortgage loans (including the buy-to-let segment).

		The legally binding LTV limits described above enter into force on 1 January 2021.
2.2	Legal basis and process of implementation of the measure.	The Law of 4 December 2019 established the legal framework for borrower-based measures (BBMs) in Luxembourg. The legal text can be found at: http://legilux.public.lu/eli/etat/leg/loi/2019/12/04/a811/jo The legal framework foresees that, in case of a sustained and persistent increase of residential real estate (RRE) prices and of the volume of mortgage loans, coupled with a significant deterioration in lending conditions, the SRC is to evaluate whether these developments indicate a malfunctioning of the national financial system or pose risks to financial stability. Furthermore, the BBMs can only be applied on the condition that the measures, either individually or in combination, defined in the Law of 5 April 1993, Regulation (EU) No 575/2013 or their implementing regulations, would not be sufficient or adequate to address the risks. The law provides that the CSSF (as designated authority), may implement BBMs pertaining to the credit granting conditions applied to new residential mortgage loans for which the immovable property is located in Luxembourg only after having consulted the BCL in order to reach a common position and following a Recommendation of the SRC. The BBMs include limits to the loan-to-value (LTV) ratio, loan-to-income (LTI) ratio, debt-to-income (DTI) ratio, debt service-to-income (DSTI) ratio, as well as to the initial mortgage loan maturity. These measures can be activated either individually or in combination, and they can apply to the total portfolio of new mortgage loans or only a part of it. Moreover, they apply to new mortgages granted by credit institutions, insurance corporations and professionals engaged in lending activities.

2.3	Coverage	The LTV limits apply to new residential real estate mortgage loans. Regarding institutions covered, they include all relevant lenders in Luxembourg, i.e. they apply to new mortgages granted by credit institutions, insurance corporations and professionals carrying on lending activities. Regarding borrower coverage, the concept of borrower ("*emprunteur*") includes both households and other *ad-hoc* legal structures such as non-trading real estate companies.
2.4	Any other relevant information.	The activation of differentiated LTV limits needs to be assessed in the context of recent strong measures taken by the Luxembourg Government. In the spirit of sub-Recommendation C of the ESRB Recommendation on medium-term vulnerabilities in the residential real estate sector in Luxembourg (ESRB/2019/6), which recommends Luxembourg to review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified, several measures have been taken. First, important fiscal measures were decided in 2020. In particular, the 2021 state budget Law contains a number of tax elements relating to persons and investment funds investing in the Luxembourg RRE market that will render such investments less attractive. By decreasing fiscal advantages and incentives to real estate speculation, the measures should contribute to decelerating the growth of housing demand. Notable measures in this context are the decrease of the rate of accelerated amortization applicable to new property being rented (i.e. buy-to-let segment) from 6% to 5% and the decrease of its duration period from 6 to 5 years. For the cases where the sum of the property-amortizing base surpasses 1 EUR million, the rate is further decreased to 4%. These changes apply to new properties acquired after 1 January 2021. Second, the Government also recently took measures targeting housing supply. In relation to the current year, the total budget allocated to the Ministry of housing ("*Ministère du Logement*") in 2021 will be increased by 11%. This exceptional increase relates to the newly created "*Fonds spécial de soutien au développement du Logement*". The fund will benefit from a total budget of 150 EUR million in

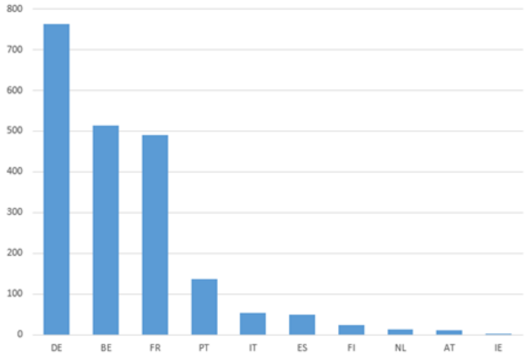
		order to finance social housing and to help achieving the objectives of the "*Pact Logement* 2.0" in coordination with local municipalities. Moreover, the differentiated LTV limits are complementary to other macroprudential measures already in place. By directly targeting the level of household mortgage indebtedness, the LTV limits are complementary to the risk-weight floor of 15% for banks using the internal ratings based approach (as announced on 1 July 2016, and effective from 30 August 2016, see CRS/2016/004), as well as to the increase of the countercyclical capital buffer rate from 0.25% to 0.5% (as announced on 20 December 2019 and effective from 1 January 2021, see CSSF Regulation N.19-10). In the context of these strong fiscal and supply-side measures, complemented with the macroprudential measures in place, national authorities deem the differentiated LTV limits appropriate and sufficient to address the current risks.
3. Timing		
3.1	Timing of the decision	The official decision date of the measure is 9 November 2020, following the SRC Recommendation CRS/2020/005.
3.2	Timing of the publication	The date of publication of the measure is 03 December 2020, following the CSSF Regulation n° 20-08.
3.3	Disclosure	The SRC issued a Recommendation to the CSSF to apply legally binding LTV limits on 9 November 2020 (see CRS/2020/005). According to the Law of 4 December 2019, the SRC Recommendation was taken after close concertation with the BCL in order to find a common position, and following the SRC Recommendation, the CSSF has issued Regulation n° 20-08, which implements the LTV limits.
3.4	Timing of the application	The LTV limits described in point 2.1 enter into force on 1 January 2021, with no phase-in period.

3.5	End date (if applicable)	Not applicable.
	4. Reason for the activation of the measure	
4.1	Description of the macroprudential risk to be addressed.	The main vulnerabilities identified in the RRE market in Luxembourg are the combination of high levels of household debt with high housing prices, and a sustained growth of mortgage credit coupled with a tendency towards loosening lending conditions according to bank lending surveys. Therefore, the application of LTV limits aims at curbing mortgage growth and household debt levels, ensuring the application of prudent lending standards in the residential real estate mortgage market. The differentiated limits are expected to enhance the resilience of both borrowers and lenders. By curbing household mortgage debt, the LTV limit helps to ensure that borrowers are able to service their debt and maintain consumption in adverse times; from the lender's perspective, the measure lowers credit risk associated with the portfolio of new mortgage loans (e.g. via lower probability of default and loss-given-default rates).
4.2	Description of the indicators on the basis of which the measure is activated.	The assessment carried out by the SRC is based on a comprehensive analysis of RRE vulnerabilities, including: (1) the latest housing price developments; (2) the level and growth of household indebtedness; (3) the dynamics of mortgage credit; (4) the loosening of credit lending conditions; and (5) potential banking sector fragilities, in particular during periods of adverse shocks. Regarding (1), the analysis looks at the dynamics of housing prices, including growth and overvaluation measures. The overvaluation is assessed with statistical indicators (RRE price-to-income, price-to-construction cost and price-to-rent) and models (vector error correction models and quantile regressions). With respect to (2), the level of household indebtedness is assessed with several macro indicators, such as (mortgage) debt to GDP or (mortgage) debt to disposable income. National authorities consider the change in the indicators over time, as well as the relative ranking of LU

		in the group of euro area countries. Furthermore, a regression-based analysis (relating the level of household debt with average LTVs at a macro level) complements the assessment by the national authorities. The regression model indicates, given certain assumptions, by how much the average LTV would need to be reduced in order to achieve a certain level of household debt-to-disposable income. For (3), the dynamics of mortgage debt is assessed via growth rates and credit-to-GDP gaps in the context of an early warning model. The model produces risk thresholds and conditional probabilities of "crisis" associated with the mortgage credit growth or gap measure. Other statistical indicators are also considered, such as information on the share of variable- and fixed-rate loans on total new credit flows. In terms of (4), the results of the Bank Lending Survey are complemented with the information collected via the CSSF bi-annual RRE Survey. The CSSF survey provides evidence on the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, and maturities. This survey also provides breakdowns of the new lending by borrower-based indicators and income buckets. The data are used to conduct simulation exercises, which *ex-ante* assess the impact on new lending of implementing individual or joint measures for specific banks or the aggregate RRE domestic market. The survey evidence is complemented with BCL's DSGE model results on the optimal LTV ratio in Luxembourg. Potential vulnerabilities under (5) are assessed with banking sector indicators, such as capital ratios, profitability, exposure to the mortgage market, market concentration and the BCL macro stress-testing model. Besides the specific developments in the RRE market, the choice and calibration of the borrower-based measure also took into account the position of Luxembourg in the economic and financial cycles, as well as the international context. To this end, the analysis above is complemented with financial cycle estimates, relevant macroeconomic

		variables (domestic and European), and expert judgement.
4.3	Effects of the measure.	The measure is expected to increase the resilience of households, by curbing their amount of mortgage debt in relation to the value of the underlying property. It is also expected to increase the resilience of the banking sector, in particular of the domestic banks more active in the RRE market, by decreasing the credit risk in the (new) mortgage portfolio. In this context, the measure addresses important risks to financial stability related to household over-indebtedness and loosening of lending standards over time, in a context of low interest rate environment. Overall, national authorities estimate that 14.2% of current new lending by the top RRE banks would not be granted under the LTV limits. As the calibration takes into account current market conditions and the international crisis context, the measure also aims at avoiding large market disruptions while contributing to the adoption of prudent lending standards.
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 133(11)(d) of the CRD IV and Recommendation ESRB/2015/2)	The activation of legally binding LTV limits for new mortgage loans on residential immovable property located in Luxembourg will apply to new mortgages granted by credit institutions, insurance corporations and professionals carrying on lending activities to households and *ad-hoc* structures such as non-trading real estate companies. The general scope of application aims at minimizing the potential cross-sectoral circumvention of the measure. Besides cross-sectoral adjustments, another potential source of concern is cross-border circumvention. While foreign branches in Luxembourg fall under foreign supervision, they comply with the national regulation and are, therefore, covered by the LTV limits being activated. Nonetheless, direct cross-border lending by foreign banks and by branches of Luxembourg banks abroad remain a

		potential channel for circumvention of the measure. Hence, without reciprocity, there may be negative inward spillovers (if the effectiveness of the LTV limits is decreased) and/or negative outward spillovers (if the resilience of the country whose institutions circumvent the measure is diminished). In its Handbook, the ESRB proposes a framework to assess cross-border effects, which is based on different economic and financial transmission channels. In the case of the LTV limits entering into force on 1 January 2021, the channels of transmission via cross-border lending and regulatory arbitrage are considered the most relevant, due to concerns of increased competition from abroad and diminished level-playing field. Given the geographical location of Luxembourg, in short distance to main cities in neighbouring countries, the measure may lead domestic borrowers to easily shift to lending from abroad. For instance, borrowers who do not meet the LTV limits in Luxembourg may apply for a residential mortgage loan in other neighbouring Member State, particularly if the country does not have the same requirements in place. The increased cross-border lending would then imply that foreign providers increase their exposure to the Luxembourg domestic mortgage market and circumvent the measure, decreasing its effectiveness. In order to assess the importance of cross-border spillovers, evidence from the Balance Sheet Indicators (BSI) database shows the stock of credit to households in Luxembourg that originates from other countries. Although the stock does not refer to mortgage credit only, it provides a good indication of cross-border channels that can be expected for the mortgage market. Figure 2 below presents the country breakdown for 2020Q2, focusing on the ten largest counterparties.

		Figure 2. Credit to households in LU by geographical counterparty (in million EUR)  Source: BSI data. Period: 2020Q2. As Figure 2 shows, there is important cross-border lending from the neighbouring countries (DE, BE and FR) to Luxembourg. These numbers reflect the geographical position of Luxembourg and suggest that, in the absence of reciprocity, the scope to cross-border leakages can be large. In this context, the effectiveness of the LTV limits in ensuring household resilience might be decreased (negative inward spillover) and other countries might increase their exposure to the risks of the domestic mortgage market (negative outward spillover). The combination of these two effects makes the request for reciprocity particularly warranted.
5.2	Assessment of leakages and regulatory arbitrage within the notifying Member State	Leakage effects and regulatory arbitrage within Luxembourg are not expectable. The LTV limits apply to all new residential mortgages granted by credit institutions, insurance corporations and professionals carrying on lending activities, therefore covering all type of relevant mortgage lenders in Luxembourg. Regarding borrower coverage, the concept of borrower ("*emprunteur*") includes both households and non-trading real estate companies, therefore ensuring that there are no loopholes in the application of the limits so that civil companies are covered. Finally, while foreign branches in Luxembourg fall under foreign supervision, they comply with the national regulation and are, therefore, covered by the LTV limits being activated.

5.3	Request for reciprocation	In order to avoid leakages and regulatory arbitrage, to ensure a level-playing field, and to contribute to the effectiveness of the LTV limits in ensuring household resilience by avoiding a relocation of business across borders, national authorities request the ESRB to recommend reciprocation by other Member States. The reciprocation request should also be understood in the context of the small relative size of the Luxembourg RRE market in comparison to other EU countries' lending markets (in particular neighbouring Member States), as well as the relative ease of access of these foreign lending markets by Luxembourg residents, which can contribute to the amplification of negative inward spillover effects on household resilience. The measure to be reciprocated is the application of LTV limits to new mortgage loans for residential immovable property located in Luxembourg, as from 1 January 2021. LTV limits should be differentiated according to the borrower type: - LTV limit of up to 100% for first-time buyers acquiring their primary residence; - LTV limit of 90% for other buyers (i.e. not first-time buyers) acquiring the primary residence. This limit is implemented in a proportional way via a portfolio allowance. Lenders may issue 15% of the portfolio of new mortgages granted to these borrowers with an LTV above 90% but below the maximum LTV of 100% ; - LTV limit of 80% for the buy-to-let segment. Although LTV limits fall under national law and are not harmonized across Member States, national authorities note that the ESRB voluntary reciprocity framework foresees this possibility. In particular, indent 12 of the ESRB Recommendation ESRB/2015/2 states that it "*is intended to also cover measures that have not been harmonized under Union law*". Furthermore, the ESRB Handbook lists LTV limits as an example of instruments that require a strong reciprocity assumption (Table 11.5, p. 246).

		In order to ensure the efficiency of the measures aimed at curbing household indebtedness, national authorities propose that any and all credit granted for the acquisition of residential real estate located in Luxembourg should be subject to reciprocity in order to avoid circumvention of the measure and insure a level playing field. This is all the more important given the small size of the country and its RRE market as fixing any threshold will circumvent the measure through access to more advantageous credit conditions from neighboring countries or other EU member states.
6. Miscellaneous		
6.1	Contact person(s) at notifying authority.	Mr Abdelaziz Rouabah (+352) 47 74 42 67 ; abdelaziz.rouabah@bcl.lu ; secretariat_crs@bcl.lu
6.2	Any other relevant information.	Not applicable.