Notification template for borrower-based measures

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- macropru.notifications@ecb.europa.eu when notifying the European Central Bank (ECB);
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This notification will be made public by the ESRB once the relevant authorities have adopted and published the notified macroprudential measure[1].

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

1. Notifying national authority and scope of the notification		
1.1	Name of the notifying authority	Czech National Bank
1.2	Country of the notifying authority	Czech Republic
1.3	Type of borrower-based measure	☐ Debt-service-to-income (DSTI) ☐ Loan-to-value (LTV) ☐ Debt-to-income (DTI)
1.4	Type of notification	☐ Activation of a new measure (DTI and DSTI)

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authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

		☐ Change to an existing measure (LTV) [2]
2. Description of the measure		
2.1	Description of the measure	The upper limit on the ratio of the consumer's total debt arising from consumer credit secured by the same residential property to the value of the collateral (hereinafter the "**LTV ratio**") shall be set at: - 90% for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted, - 80% for consumer credit secured by residential property of the other applicants than referred above. The upper limit on the ratio of the consumer's outgoings arising from the consumer's total debt to the consumer's net income (hereinafter the "**DSTI ratio**") shall be set at: - 50% for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted, - 45% for consumer credit secured by residential property of the other applicants than referred above.

[2] At the same time there is a change of the legal regime of the measure, from now on is legally binding.

		The upper limit on the ratio of the consumer's total debt to the consumer's net income (hereinafter the "**DTI ratio**") shall be set at - 9.5 for consumer credit secured by residential property for financing the purchase of owner-occupied residential property of an applicant who is under the age of 36 at the time the loan is granted, or applicants living in a marriage or registered partnership, at least one of whom is not yet 36 at the time the loan is granted, ¨ - 8.5% for consumer credit secured by residential property of the other applicants than referred above. There is the statutory exemption allowing to exceed the upper limit on a credit ratio set by the CNB for consumer credit provided in the current calendar quarter and representing a maximum of 5% of total consumer credit secured by residential property provided by this provider in the previous calendar quarter.
2.2	Definition of the measure	The LTV ratio means the ratio of a consumer's debt in the context of a consumer credit secured by residential property to the collateral value. The DTI ratio means the ratio of a consumer's total to income. The DSTI ratio means the ratio of the average annual expenses arising from a consumer's total debt to income. - The amount of a consumer loan secured by residential property means the principal of the loan agreed in the loan agreement; - A consumer's debt in the context of a consumer credit secured by residential property means, for the purposes of the calculation of the LTV ratio, the sum of the loan provided and the outstanding amount of the principal of any existing loans secured by the same property. A deposit of the same consumer with the same provider or debt securities issued by the loan provider held by

		same consumer may be subtracted from the amount of the consumer's debt provided that the deposit/debt securities is a part of the collateral pertaining to the loan; - a consumer's total debt means, for the purposes of the calculation of the DTI and DSTI ratios, the sum of the loan provided and the consumer's other secured and unsecured loans from the relevant provider, as well as loans from another providers, including not drawn principal of these loans; - collateral value means the value of the property determined according to § 113/3 Act No. 257/216 Coll.; - a consumer's net income means the amount of annual after-tax income prudently assessed as permanent on the basis of a provably documented income history for a sufficiently long period., - Details regarding definitions are set by Decree No. 399/2021 Coll.
2.3	Legal basis and process of implementation of the measure	**Legal basis:** *Act on CNB 6/1993, § 45b*: established LVT, DTI, DSTI as legally binding macroprudential measure *Decree No. 399/2021 Coll., on credit ratios:* manner of, and rules for calculating ratios and definitions of items included in the calculation *Provision of a general nature on setting upper limits on credit ratios*: setting upper limits if decided **Process of implementation**: The CNB regularly assesses (at least twice a year) consumer credits secured by residential property and the overall situation on the mortgage market and the residential property market. Based on macroprudential analyses and the information it gathers in the course of the financial market supervision, the CNB issues: - Provision of a general nature on setting upper limits on credit ratios according to Act No. 6/1993

		Coll., on the Czech National Bank (since 2021), setting the specific values for the upper limits of the LTV, DSTI and DTI credit ratios (actual version see here: link) applicable by providers from 1.4.2022, and - **Recommendation** on the management of risks associated with the provision of consumer credit secured by residential property (since 2015, hereinafter the "Recommendation"). Until 2021, the Recommendation contained a summary of recommended limits for selected credit ratios and a set of other rules, the observance of which constituted prudent behaviour when conditions on the financial market are taken into account. Since December 2021 Recommendation (link) contains selected conditions related to the provision of consumer credit secured by residential property, which are not regulated by the Act on the Czech National Bank and specified by the provision of a general nature, e.g. maximum maturity, acceptable methods of principal repayment, prudential practices regarding increasing the principal of an existing mortgage loan.
2.4	Coverage	**Loan providers:** The measure applies to entities authorised as an entrepreneur to provide consumer credit under Act No. 257/2016 Coll., on Consumer Credit.
		Loan applicants: The measure applies to natural persons applying for a consumer credit secured by residential property.

		Loan product: It applies to consumer credit secured by residential property provided to natural persons (individuals) and to consumer credit provided to natural persons (individuals) who have a consumer credit secured by residential property.
2.5	Calibration	The degree of **overvaluation of apartment prices reached around 25%** in the second quarter of 2021 by the CNB's estimation. The observed trend reflected optimistic expectations of future growth in the value of property in an environment of insufficient supply, increased motivation of some debtors to maintain the purchasing power of their financial reserves amid rising inflation and low returns on alternative assets, and still relatively favourable debt financing conditions. **The record-high volume of new consumer credit secured by residential property provided in 2021** in an environment of continued growth in residential property prices is fostering growth in the ratio of household debt to disposable income. The ratio of residential property prices to household income is also rising. Average apartment prices are currently safely affordable for only around 15% of households. The trend of easing credit standards has been intensifying during 2021. It has been reflected in an **increase in the share of new consumer credit secured by residential property with significantly risky characteristics**. In the second quarter of 2021, banks provided over 48% of the relevant reference amount of loans with a DSTI of over 40%, 26% of loans with a DSTI of over 45%, and 10% of loans with a DSTI of over 50%. Similar tendencies could be seen for the DTI ratio. Loans with a DTI of over 8 accounted for almost 40% and loans with a DTI of over 9 for almost 22% of the reference volume of loans in the second quarter of 2021. These trends intensified further in July and August 2021. The numbers of vulnerable debtors in lenders' balance sheets are thus growing.

		At the same time, **banks' balance sheets still contain risks taken on in previous years, the materialisation of which may have been delayed by the economic policies adopted during the pandemic**. Combined with adverse shocks from the real economy (such as a sharp rise in energy prices), this is causing systemic risks to increase. At the same time, credit standards have differed significantly across lenders. This is creating a risk of more conservative lenders reacting to a potential loss of market share by easing their standards to the levels of their less conservative competitors. Mutually enforced relaxing of credit standards would be reflected in more rapid accumulation of systemic risks.
3.	**Timing for the measure**	
3.1	Timing for the decision	26/11/2021
3.2	Timing for publication	26/11/2021
3.3	Disclosure	The provision of a general nature disclosed on 26 November 2021 on the CNB website (link). Recommendation on the management of risks associated with the provision of consumer credit secured by residential property disclosed on 10th December on the CNB website (link).
3.4	Timing for the application	01/04/2022
3.5	End date (if applicable)	The measure is not time-limited. However, the Czech National Bank will review the reasons for setting upper limits on credit ratios at least once every six months and will assess them with regard to the existence and expected further evolution of the systemic risks. If there

		has been a material change in these risks, the Czech National Bank will issue a new provision of a general nature or will amend or abolish the existing one.
4. Reason for activation of the measure		
4.1	Description of the macroprudential risk	The persistent lead of growth in housing prices over growth in households' disposable income is being reflected in an increase in the loan amounts needed to buy a house and, in turn, in the relative debt of households with loans. The numbers of vulnerable borrowers in lenders' balance sheets are therefore growing. Combined with adverse shocks from the real economy (such as a sharp rise in energy prices), this is causing macrofinancial risks to increase.
4.2	Indicators used for activation of the measure	Besides general indicators about the development of residential property price, its overvaluation, consumer credit growth and household indebtedness, is the main source of information for analyses/decisions the semi-annual Survey of consumer credits secured by residential property. It provides information about the development of the share of the loans with risky levels of credit ratios. The evaluation of risks associated with new housing loans is based, among other things, also on regular stress testing of households.
4.3	Effects of the measure	Credit ratios are macroprudential instruments aimed at ensuring that the banking sector is sufficiently resilient to adverse shocks. Capping them will prevent excessive growth in the share of loans with highly risky characteristics in banks' balance sheets, which could lead to failures and systemic stress in the domestic banking sector in the event of highly adverse economic developments. Together with the ongoing monetary policy normalisation, the upper limits should reduce the risk of a continued spiral between apartment price growth and growth in loans for financing apartment purchases. A positive side effect of introducing the caps is that they will reduce the vulnerability of recipients of new

		consumer credits secured by residential property to adverse shocks. According to CNB analyses conducted using DTI and DSTI data, rising share of consumers that recently acquired loan spend a very large proportion of their income on servicing their debt and may not have sufficient financial reserves. An adverse shock to their income situation or living costs, or a marked increase in interest rates upon refixation, may jeopardise their ability to repay the loan or cause them to cut back significantly on other spending, which may have an adverse effect on domestic demand. Activated DTI/DSTI measures can ease these effects.
5.	**Sufficiency, consistency and non-overlap of the policy response**	
5.1	Sufficiency of the policy response	Setting legally binding LTV to 80 % (resp. 90 for applicants under 36) sufficiently cover risks of residential property overvaluation (via impact on LGD). Setting legally binding DTI and DSTI sufficiently mitigate risks to resilience of the banking sector posed by growing share of the loans with risky DSTI/DTI characteristics (via impact on PD).

5.2	Consistency of application of the policy response	The CNB has responded to the risks to the banking sector stemming from a spiral of rising amounts of consumer credit secured by residential property and property prices related to relaxed credit standards and over-optimistic expectations of economic agents with the same instruments in the past. The CNB started to apply an LTV cap at the beginning of the expansionary phase of the financial cycle in mid-2015. It gradually lowered this cap to 80% with effect from 1 October 2018. The amount of new consumer loans secured by residential property loans in the LTV range of 80%–90% was not allowed to exceed 15%. As of the same date, it set a DTI cap of 9 and a DSTI cap of 45%, in both cases giving banks the option of providing 5% of the total amount of loans with higher ratios in the current calendar quarter. In response to the pandemic, the LTV cap was lowered to 90% and the DTI cap abolished on 1 April 2020. Subsequently, on 1 July 2020, the DSTI cap was also cancelled, mainly as a result of expectations of more cautious behaviour by consumers and lenders and more conservative expectations by them about the future economic development. Current policy response react on the actual development of the systemic risk and is consistent with past policy actions/risks development.
5.3	Non-overlap of the policy response	There are no other policy instruments used to address the same systemic risk.
6. Cross-border and cross-sector impact of the measure		

6.1	Assessment of cross-border effects and the likely impact on the Internal Market (Recommendation ESRB/2015/2[3])	Cross-border effects are not expected since the mortgages in CZ are provided by local banks in CZK only.
6.2	Assessment of leakages and regulatory arbitrage within the notifying Member State	The reintroduction DSTI/DTI and amendment of LTV as legally binding diminish potential for regulatory arbitrage and leakages. The Czech National Bank will monitor potential circumventions of the measures.
6.3	Request for reciprocation	No

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

6.4	Justification for the request for reciprocation	-
7. Miscellaneous		
7.1	Contact person(s)/mailbox at notifying authority	Libor Holub, +420 224 412 502, libor.holub@cnb.cz Lukáš Pfeifer, +420 224 412 638, lukas.pfeifer@cnb.cz
7.2	Any other relevant information	Please visit the following webpage for more information: https://www.cnb.cz/en/financial-stability/macroprudential-policy/requirements-for-ltv-dsti-and-dti-limits/
7.3	Date of the notification	10/01/2022