Notification template for Articles 133 and 134(5) of the Capital Requirements Directives (CRD) – Systemic risk buffer (SyRB)

Template for notifying the European Central Bank (ECB)and European Systemic Risk Board (ESRB) of the setting or resetting of one or more systemic risk buffer rates pursuant to Article 133(9) CRD and to request that the ESRB issue a recommendation to other Member States to reciprocate the measure under Article 134(5) CRD

Please send/upload this template to

- macropru.notifications@ecb.europa.eu when notifying the ECB (under Article 5 of the Single Supervisory Mechanism (SSM) Regulation[1]);
- notifications@esrb.europa.eu when notifying the ESRB.

The ESRB will forward the notification to the European Commission, the European Banking Authority (EBA) and the competent and designated authorities of the Member States concerned without delay. This notification will be made public by the ESRB once the relevant authorities have adopted and published the notified macroprudential measure[2].

E-mailing/uploading this template to the above addresses constitutes official notification; no further official letter is required. 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	Bank of Lithuania
1.2 Country of the notifying authority	Republic of Lithuania
1.3 Type of measure (also for reviews of existing measures)	Which SyRB measure do you intend to implement? ☒ Activate a new SyRB ☐ Change the level of an existing SyRB ☐ Change the scope of an existing SyRB (incl. changes to a subset of institutions or exposures) ☐ De-activate an existing SyRB ☐ Reset an existing SyRB (review)

[1] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).
[2] 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authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

2. Description of the measure	
2.1 Institutions covered by the intended SyRB	Please indicate whether the SyRB applies to: ☒ All institutions authorised in the Member State *The intended SyRB applies to all banks and central credit unions authorised in Lithuania at the highest level of consolidation in Lithuania. In parallel, it applies to central credit union groups (which are not CRD/CRR entities) on a consolidated basis.* *Adhering to the principle of proportionality and for level playing field reasons, a materiality threshold of EUR 50 million is planned, i.e. institutions will not be subject to the SyRB requirement as long as their relevant sectoral exposure does not exceed EUR 50 million (corresponding to 0.5% of total relevant sectoral exposure of the banking sector as of Q2 2021). The details on the rule when the institutions become subject to the requirement will be adopted and published together with the formal decision on the measure.* *Note: for the purposes of this notification, "relevant sectoral exposure", "mortgage loan portfolio" and "mortgage exposures" are used interchangeably.* ☒ One or more subsets of credit institutions in the sector (please provide the names and identifiers (Legal Entity Identifier (LEI) code) of institutions covered) *The subset of the credit institutions authorised in Lithuania that were above the materiality threshold in Q2 2021:*

Name of institution	LEI code	Consolidation level
AB SEB bankas	549300SBPFE9JX7N8J82	sub-consolidated (highest level of consolidation in Lithuania)
„Swedbank", AB	549300GH3DFCXVNBHE59	sub-consolidated (highest level of consolidation in Lithuania)
AB Šiaulių bankas	549300TK038P6EV4YU51	highest level of consolidation
Lithuanian Central Credit Union group	Not applicable	highest level of consolidation
United Central Credit Union group	Not applicable	highest level of consolidation

☒ A subsidiary whose parent is established in another Member State. (Please provide the names and identifiers (LEI code) of subsidiaries)

Name of subsidiary	Name of the parent	LEI code of the subsidiary
AB SEB bankas	Skandinaviska Enskilda Banken AB	549300SBPFE9JX7N8J82
„Swedbank", AB	Swedbank AB	549300GH3DFCXVNBHE59

If the SyRB applies to a subset of institutions, please describe the criteria for selection of the relevant institutions.

Reasoning for the materiality threshold:

• Proportionality: the calculation of the requirement will require additional administrative efforts from the credit institutions using standardised approach for credit risk, as the data on the exact relevant sectoral exposure are not

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<td>provided in the harmonised reporting for the standardised approach. Those institutions will need to calculate the capital requirements based on an additional segment of exposures. At the same time, the increase in resilience for those institutions which have very small mortgage portfolios in Lithuania is non-essential, as they are not the main contributors to the risk, and the impact of the materialisation of risks would be less important to them. Based on the data for Q2 2021, two banks authorised in Lithuania will be excluded from the requirement because of having exposures below the materiality threshold. The combined exposure of those two banks is around EUR 30 million, i.e. 0.3% of the respective banking sector portfolio. 6 smaller banks established in Lithuania will not be subject to the requirement because they have not issued mortgage loans so far.

• <u>Level playing field considerations</u>: application of such a materiality threshold would help to ensure a level playing field in a sense that institutions with relative exposures of similar size are not subject to the requirement. The threshold would foster a level playing field among small banks and a few individual credit unions (for which macroprudential capital buffers are not applied in the Lithuanian legal system and which have mortgage portfolios of up to EUR 20 million) and, potentially, foreign bank branches (for which the de minimis threshold could be applicable in case of reciprocation).

We plan to publish and regularly review the list of institutions that are subject to the SyRB on the Bank of Lithuania website.</td>
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<td>2.2 Exposures covered by the SyRB

(Article 133(5) CRD)</td>
<td>Please indicate the exposures to which the SyRB applies:

☐ (a) all exposures located in the Member State that is setting the buffer;

☒ (b) the following sectoral exposures located in the Member State that is setting the buffer:

(i) ☒ all retail exposures to natural persons that are secured by residential property;
(ii) ☐ all exposures to legal persons that are secured by mortgages on commercial immovable property;
(iii) ☐ all exposures to legal persons excluding those specified in point (ii);
(iv) ☐ all exposures to natural persons excluding those specified in point (i);

☐ (c) subsets of any of the sectoral exposures identified in point (b). Please specify the subsets in Section 2.3;

☐ (d) all exposures located in other Member States;

☐ (e) exposures located in third countries.</td>
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<td>2.3 Subsets of sectoral exposures</td>
<td>Where the systemic risk buffer applies to subsets of any of the sectoral exposures identified (see point 2.2 (c)), please specify:

- The elements of the dimensions and subdimensions that were used to identify the subset(s) of sectoral exposures as laid down in the EBA Guidelines on the appropriate subsets of exposures in the application of SyRB:

<table>
<tr><th>Dimensions/subdimensions</th><th>Elements</th></tr>
<tr><td>1. Type of debtor or counterparty sector</td><td></td></tr>
<tr><td>1.a Economic activity</td><td></td></tr>
<tr><td>2. Type of exposure</td><td></td></tr>
<tr><td>2.a Risk profile</td><td></td></tr>
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	3. Type of collateral | *3.a Geographical area* | - Assessment conducted in accordance with Section 5 of the EBA Guidelines on the systemic relevance of the risks stemming from this subset, taking into account: (i) size (ii) riskiness (iii) interconnectedness. - Why it would not have been appropriate to set the systemic risk buffer at the level of a sector (as in point 2.2(b)) to cover the risk targeted? - *Not applicable, as the SyRB is set at the level of a sector in Lithuania as indicated in point 2.2 (b)(i).*
2.4 Exposures located in other Member States and in third countries	If the systemic risk buffer applies to exposures located in other Member States or third countries (see points 2.2(d) and (e)), please include the names of those countries. *Not applicable, as the SyRB is set at the level of a sector as indicated in point 2.2 (b)(i) and does not apply to exposures located in other Member States or third countries.*
2.5 Buffer rate **(Article 133(9)(e) CRD)**	Specify the intended SyRB rate. If different buffer requirements apply to different exposures or subsets of exposures, please specify for each exposure indicated under 2.2. Please indicate any changes to the list in 2.1 of institutions concerned and in the buffer rates given in point 2.5 as compared to the last notification, and provide an explanation, if applicable.

Exposures	New SyRB rate		Previous SyRB rate	
	All institutions (SyRB rate)	**Set of institutions** (range of SyRB rates)	**All institutions** (SyRB rate)	**Set of institutions** (range of SyRB rates)
(a) All exposures located in the Member State that is setting the buffer	N/A	N/A	N/A	N/A
(b) *The following sectoral exposures located in the Member State that is setting the buffer:*				
(i) All retail exposures to natural persons that are secured by residential property	2%	N/A	N/A	N/A
(ii) All exposures to legal persons that are secured by mortgages on commercial immovable property	N/A	N/A	N/A	N/A
(iii) All exposures to legal persons excluding those specified in point (ii)	N/A	N/A	N/A	N/A
(iv) All exposures to natural persons excluding those specified in point (i)	N/A	N/A	N/A	N/A
(c) All exposures located in other Member States	N/A	N/A	N/A	N/A
(e) Exposures located in third countries	N/A	N/A	N/A	N/A
(f) *Subsets of any of the sectoral exposures identified in point (b):*				

	(i) Please specify the subset [Dimension/subdimensions] | N/A | N/A | N/A | N/A If different buffer requirements apply to different subsets of institutions, please specify for each institution mentioned under 2.1. *Not applicable, as the same SyRB rate applies to all institutions subject to the SyRB.* **Set of institutions** **Exposures** | **Name of institution** | **LEI code** | **New SyRB rate** | **Previous SyRB rate** | | | % | | | | % | | | | % |
3. Timing for the measure	
3.1 Timing for the decision	What is the date of the official decision? <u>For SSM countries when notifying the ECB:</u> provide the date on which the decision referred to in Article 5 of the Single Supervisory Mechanism Regulation (SSMR) will be taken. 25/11/2021
3.2 Timing for publication	What is the proposed date of publication of the notified measure? 26/11/2021
3.3 Disclosure	Information about the strategy for communicating the notified measure to the market. Do you also intend to publish the justification for the SyRB? If not, why do you consider that publication could jeopardise the stability of the financial system? *The decision will be published on the Bank of Lithuania website in a press release and on the public legislation domain. The decision and the relevant information about the measure will also be published in a dedicated section for SyRB which will be available at https://www.lb.lt/en/financial-stability-instruments-1 on the intended date of publication. Justification for the SyRB will also be published.* *The market participants were informed about the intended measure in a press release by the Bank of Lithuania on 28 September 2021 (https://www.lb.lt/en/news/bank-of-lithuania-takes-measures-to-prevent-the-heating-up-of-the-real-estate-market). The same press release informed about another national measure (potential tightening of the LTV requirement for second and subsequent housing loans), as the Bank of Lithuania views these two measures as a set of measures to address the RRE risk at the current juncture. This press release mentioned that the planned decision on the sectoral SyRB would be notified in advance to the ESRB and other institutions in accordance with Section I of Chapter V of the Rules for the Formation of Capital Buffers and to the ECB in accordance with Article 5 of the Single Supervisory Mechanism Framework Regulation.* *Prior to that, the intention to introduce a sectoral SyRB for mortgage exposures, if buoyant trends in the RRE market and mortgage lending continued, was expressed in the public press conference of the annual Financial Stability Review of the Bank of Lithuania on 14 June 2021 (press release: https://www.lb.lt/en/news/economy-and-financial-system-gained-*

	immunity-yet-new-challenges-await), as well as dedicated meetings with market participants in August–September 2021.
3.4 Timing for application	What is the intended date of application of the measure? 01/07/2022
3.5 Phasing in	What is the intended timeline for phase-in of the measure (if applicable)? *The 2% SyRB rate will apply from the intended date of application.*
3.6 Review/deactivation of the measure	Until when will the measure presumably be in place? What are the conditions for its deactivation? On what indicators would the decision be based? Please specify whether you intend to review the measure before the maximum period of two years foreseen in Article 133(8)(b) CRD. *The duration or the review of the measure will depend on the developments of the RRE risk to the banking sector, the significance of banks' exposure to this risk and on potential overlaps with the CCyB in case the CCyB rate is increased in the future in Lithuania, thus covering part of the RRE risk.* *The SyRB rate would be reduced to a lower level, if the economy experienced a shock with the potential to induce a correction in the housing market or due to a significantly worsening ability of housholds to service their mortgage loans, or if the housing market and mortgage market imbalances significantly decreased. The SyRB rate could also be increased if the RRE risk to the banking sector significantly increased further. In addition, in order to avoid double-counting of risks, the SyRB rate could be recalibrated when the CCyB rate is changed.* *The measure is to be reviewed at least every two years. However, it is intended to assess the appropriateness of the SyRB rate together with the quarterly assessment of the appropriateness of the CCyB rate in Lithuania (which is currently equal to 0%), and the SyRB rate might be reviewed before the maximum period of two years, if necessary.*
4. Reasons for the notified SyRB	
4.1 Description of the macroprudential or systemic risk in your Member State **(Article 133(9)(a) of the CRD)**	Where applicable, please classify the risks targeted by the notified SyRB under the following categories: (i) risks stemming from the structural characteristics of the banking sector - Size and concentration of banks - Ownership structure - Other structural risks (ii) risks stemming from the propagation and amplification of shocks within the financial system - Exposure concentration/asset commonality *The intended measure addresses macroprudential risk stemming from the increased concentration of the banking sector's exposure to mortgage loans.* - Commonality in bank business models - Financial interconnections and contagion (iii) risks to the banking system stemming from either the real economy or specific sectors - Economic openness

	- Sectoral risks from the private non-financial sector, households and the public sector *The intended measure addresses macroprudential risk stemming from the household sector, namely the banking sector's exposure to the RRE sector risk via mortgage loans to households.* (iv) Other risks Please specify: - Whether these risks are widespread across the whole financial sector? - Or whether they are concentrated only in one or more subsets of the sector? *Description of risks:* *The intended measure addresses macroprudential risk stemming from the household sector, namely the banking sector's exposure to the RRE sector risk via mortgage loans to households, in the light of continued rapid growth of housing loan portfolio, accelerated growth of housing prices and their potential overvaluation, as well as the risk due to the concentration of the banking sector's exposures to mortgage loans as the share of mortgage loans in banks' loan portfolios has increased significantly.* *The ratio of annual flow of new mortgages to GDP began to outpace the economy at the end of 2020 and increased to 3.9% in Q2 2021, the highest since Q4 2009. As the flow of new mortgage loans remains elevated, and GDP growth will likely continue to be outpaced by mortgage lending growth.* *The annual growth of the mortgage portfolio has been strong already since 2016, with the average of 8.4% between 2016 and 2021. With an increased amount of new loans for housing purchase (e.g. in the first eight months of 2021, the sum of pure new loans was respectively 56% and 50% higher than in the corresponding periods in 2020 and 2019), the mortgage loan portfolio accelerated to the fastest rate since the 2008–2009 financial crisis and one of the fastest among the EU countries (annual growth of 11.1% as of August 2021).* *The annual housing price growth has picked up since the end of 2020 reaching 13.3 % in Q2 2021, and initial data suggests that price growth continued to accelerate in Q3. At the same time, housing sales are at historical heights. Signs of overvaluation of housing prices have appeared for the first time after the global financial crisis as the median of a set of 6 relative and model-based indicators used by the Bank of Lithuania in the assessment of housing price overvaluation suggest slight overvaluation of around 7%. Rapid price growth, excessive expectations of further price growth and speculative investments in the RRE increase the risk of housing becoming significantly overvalued.* *Despite the increased activity in the housing market, bank lending standards remain robust (for new loans, average LTV deviates around 77–78% and DSTI – 28%), and the share of housing purchases with a mortgage has remained rather stable (42% by number and 58% by transaction value). However, there has been increased activity in issuing second mortgages that typically carry more risks.* *The exposure of the Lithuanian banking sector to the RRE risks is significant and continues to grow. Mortgage loans accounted for about a third of the total portfolio of loans to the private non-financial sector in 2011–2018, however, with the onset of the pandemic, strong growth of mortgage loan portfolio, and the contraction of non-financial corporations' (NFCs') loan portfolio, it reached 44% in August 2021. Thus, formation and materialisation of imbalances in the RRE sector could have a negative impact on the whole financial system.*

	At the same time, lending to NFCs remains at a very early recovery stage. MFI loans to NFCs portfolio have been decreasing since mid-2019 due to various reasons and plummeted by 13% during the pandemic; it ceased decreasing since the beginning of 2021 but is still 7% below its pre-pandemic level. In addition, the NFC sector remains more vulnerable than the household sector due to the uncertainty related to the pandemic situation, especially as most ample state support measures (i.e. short-time working schemes and tax deferrals) had expired as of August 2021. Such developments suggest that broad cyclical risk is at a low level and therefore targeted measures addressing the RRE risk would be more appropriate and efficient than the CCyB. Applying a broad cyclical measure such as the CCyB at the current juncture could disproportionately affect the recovering NFC lending.
4.2 Reasons why the dimension of the macroprudential or systemic risks threatens the stability of the financial system in your Member State **(Article 133(9)(b) CRD)**	Reasons why the macroprudential or systemic risks threaten financial stability and justifying the systemic risk buffer rate. *Signs of overvaluation of housing prices are becoming more apparent with the median value of key overvaluation indicators reaching the highest value since 2008. The housing market remains very active and housing prices continue to rise, adding to greater household expectations towards further price growth. As a result, the overvaluation is likely to increase further. As overvaluation increases, the probability of a price correction is higher, especially if the economy faces a shock. A price correction would reduce the value of collateral posed at banks and contribute to a risk weight increase (for IRB exposures). More importantly, given the high importance of housing market and taking into consideration the contagion and second round effects, the financial problems induced by housing price correction could split to other sectors of the economy as well. If these risks materialise, the losses incurred by the banking sector would significantly increase the need for capital. Therefore, it is crucial to ensure that banks are prepared to withstand the shock without violating their capital requirements and at the same time able to maintain the vital credit supply to the real economy.* *Furthermore, bringing up the fact that the annual flow of new mortgage loans has recently begun to outpace the GDP, further lending growth could contribute to growing housing demand and fuel housing price growth. Should housing prices continue to grow rapidly, households would need to borrow more, higher indebtedness would make them more vulnerable to interest rate increases and unexpected shocks to their incomes, increasing the riskiness of mortgage lending.* *At the same time, the exposure of the banking system to mortgage loans is historically high with such loans making up around 44% of the total loan portfolio to the private non-financial sector. Thus, due to the increased exposure concentration, the banking system is becoming increasingly vulnerable to the deterioration of mortgage loan quality.* *In addition, loans to construction and real estate operations corporations made up 35% of all MFI loans to non-financial corporations in Q2 2021, the highest share since the beginning of 2015. Therefore, if the housing market overheats and this leads to a significantly reduced housing market activity and price correction, real estate and construction corporations could face substantial financial losses, and due to the contagion effect, risks could spread to financial institutions, thereby impairing financial stability.* *Finally, the rapidly growing mortgage loan portfolio and the contraction of loan portfolio to non-financial corporations in the past several years, which has only recently started to grow again, mean that loan portfolio diversification has decreased and exposure to mortgage loans has grown. As a result, the*

	potential impact on financial stability of a shock, which would lead to a housing price correction and household inability to meet their financial obligations, increases. *Based on a stress test, in a sufficiently severe adverse scenario (identical as in Financial Stability Review 2021: https://www.lb.lt/en/publications/financial-stability-review-2021#_Toc75506484), banks' credit losses from mortgage loans would amount to approximately 6,9% of risk-weighted mortgage exposures and, in our view, capital requirement on mortgage exposures should approximately cover these losses. Current average combined buffer requirement for the banking sector is 4,2% (capital conservation buffer and O-SII buffer), thus, an additional 2,7% capital requirement on mortgage exposure would be needed to provide a combined buffer for mortgage exposures that covers the credit losses from mortgage loans in an adverse scenario. Taking into account the potential effect on economy of a higher than 2% buffer rate provided in Table 1 (see section 4.4) and the fact that imbalances in the housing market only start to appear, while the stress test results are subject to some uncertainty, the SyRB rate has been set at 2% in the current juncture. The 2% rate is expected to cover risks stemming from emerging vulnerabilities in the RRE market amidst increasing housing price overvaluation and bank exposures to mortgages.*
4.3 Indicators used for activation of the measure	Provide the indicators triggering activation of the measured. When notifying the ECB, please provide the data on which the decision is based, if possible (preferably in an Excel file). *The combination of indicators triggering the activation of the intended measure are as follows:* • *annual growth in mortgage loan portfolio by MFIs,* • *ratio of mortgage loan portfolio by MFIs and the GDP and its annual change,* • *annual growth of pure new loans for house purchase (12-month sum),* • *ratio of pure new loans for house purchase to the GDP and its annual change,* • *annual growth in housing price index,* • *a measure of the potential overvaluation of housing prices (median of a set of 6 relative and model-based indicators),* • *share of loans for house purchase in MFI loan portfolio,* • *internal forecasts of annual growth in loan to households portfolio and housing prices,* • *projected growth in mortgage loan portfolio by banks (reported in line with the ESRB Recommendation of 20 December 2012 on funding of credit institutions (ESRB/2012/2)).* *The output gap, profitability of the credit institutions sector and the size of voluntary capital buffers are also taken into account as buoyant economic conditions, and sufficient capital and capital-generation capacity would mitigate the negative effect of increasing capital requirements on the real economy.* ***The preliminary principles of the application of the intended measure:*** *1. The SyRB for mortgage exposures is a more appropriate measure than the CCyB when credit to the NFCs is subdued or at an early recovery stage and has not reached the levels observed before the downturn, while mortgage credit is booming.* *The SyRB and the CCyB target different risks: the sectoral SyRB addresses specifically RRE risks, while the CCyB addresses broad cyclical risks (including the RRE cyclical risk). However, there is an interaction between the*

	sectoral SyRB and the CCyB – depending on the situation, they replace or supplement each other in addressing cyclical risks. For example, if a 2% sectoral SyRB rate is in place and the RRE risk remains at the same level, the SyRB rate might be reduced upon the increase of the CCyB rate by the portion of the requirement that overlaps with the CCyB. *2. The SyRB rate for mortgage portfolio could be activated to increase resilience in the early stage of the housing credit cycle and when favourable economic conditions are prevalent, namely when:* • *the mortgage credit market is active (also even though there are no significant imbalances observed);* • *the housing market is active;* • *the output gap is close to 0 or positive;* • *the banking sector is profitable.* *In such circumstances it is appropriate to set an additional capital requirement on mortgage exposures (i.e. CCyB rate+SyRB rate) of around 1%. For example, if the CCyB is 0%, the sectoral SyRB rate of around 1% would be appropriate (corresponding to a similar positive neutral component in the Bank of Lithuania approach to the CCyB setting).* *3. If the risk of the formation of imbalances in housing and/or mortgage markets appears or becomes elevated, additional capital requirement on mortgage exposures (i.e. CCyB rate+SyRB rate) of or higher should be in place. This stage of application relates to a more mature stage of a housing cycle.* *Higher share of mortgage loans in credit institutions' loan portfolios indicates increased importance of mortgage credit to the financial system and poses additional structural risk that the financial sector might act as an amplifier of the shock, if housing market undergoes a correction or households' ability to service their mortgages significantly deteriorates.* *The size of the rate is calibrated based on the impact assessment of the measure on mortgage interest rates, mortgage credit, housing prices, the GDP and potentially other variables taking into account that the increase in the overall resilience should be appropriate for the level of risks.* *4. The SyRB rate is reduced to a lower level if the economy experiences a shock with the potential to induce a correction in the housing market or significantly worsening the ability of households to service their mortgage loans, or housing market and mortgage market imbalances significantly decrease.*
4.4 Effectiveness and proportionality of the measure **(Article 133(9)(c) CRD)**	Explanation why the draft measures are deemed likely to be effective and proportionate to mitigate the risk. E.g. how will the effectiveness of the measure be assessed? Based on which indicators? What are the expected transmission mechanisms? *The intended measure is applied in a situation when there is an increased probability of the formation of imbalances in the housing market and housing credit and increased exposure concentration to mortgage loans, which poses risk to the financial system and financial stability.* *The objectives of the intended measure are:* • *to increase the resilience of the financial system, i.e. to have a sufficient capital buffer to cover potential bank losses and increased capital needs (due to increases in risk weights) in case the RRE risk materialises or in economic downturn events, to be able to better mitigate a possible decline in the supply of credit to the economy;*

- *to contribute to the deceleration of mortgage credit growth and help prevent imbalances in the mortgage market.*

The intended measure is deemed to be proportionate and effective to mitigate the risk because it strengthens the resilience of the financial system by increasing capital adequacy requirements. The 2% SyRB rate on mortgage exposures is equivalent to a 0.3 p.p. increase in capital adequacy requirements (in terms of total risk weighted exposure) for the credit institutions authorised in Lithuania (0.1–0.5 p.p. for individual credit institutions). Such increase in a sectoral requirement and corresponding increase in the general requirement is deemed as proportionate to the observed level of RRE risks. In addition, it is intended that the requirement will not be applied to those credit institutions which have very small mortgage portfolios in Lithuania. The increase in resilience for those institutions which have very small mortgage portfolios is non-essential, as they are not the main contributors to the risk and the impact of the materialisation of risks would be less important to them.

The measure has some potential to mitigate mortgage credit growth and possibly, housing price growth. Our assessment based on several approaches indicates that the increase of capital requirement on the mortgage exposures by 2 p.p. could increase lending margins by up to 2–7 basis points. Based on a FAVAR model and compared to a no-policy scenario, the impact on the amount of new loans could be up to –1,5% in the short term and –3,1% in the medium term, and on the house price –1,6% in the short term and –2,6% in the medium term. The real GDP could be 0.2% lower in the short term and 0.3% in the medium term if compared to a no-policy scenario.

Medium-term impact is almost identical in both scenarios where the SyRB is introduced in 2 steps or at once. Credit institutions in Lithuania already have relatively large voluntary capital buffers and those that are subject to the SyRB continued to earn positive profit in the first half of 2021, therefore, they will not need to raise additional capital due to the increase in the requirements. Therefore, the actual impact on credit and other variables could be smaller that estimated. However, the intended requirement would allocate a small share of the excess capital towards potential losses due to the growing RRE risk and ensure that this capital would not be used for dividend payments or other distributions.

Table 1. Impact assessment of different SyRB rates on different variables

	Interest rate for mortgage loans, %			***New mortgage loans, %***		***Housing price index, %***		***GDP, %***	
	Medium term			*Short term*	*Medium term*	*Short term*	*Medium term*	*Short term*	*Medium term*
SyRB rate	*Empirical model*	*DSGE model*	*Back-of-the-envelope calculation*	*FAVAR model*					
1%	*0.012*	*0.031*	*0.034*	*–0.59; –0.77*	*–1.53; –1.55*	*–0.65; –0.81*	*–1.31; –1.32*	*–0.07; –0.11*	*–0.15; –0.15*
2%	***0.023***	***0.062***	***0.069***	*–1.18; **–1.54***	*–3.06; **–3.10***	*–1.30; **–1.62***	*–2.62; **–2.64***	*–0.15; **–0.22***	*–0.30; **–0.31***
3%	*0.035*	*0.094*	*0.104*	*–1.77; –2.31*	*–4.59; –4.65*	*–1.95; –2.43*	*–3.93; –3.96*	*–0.23; –0.33*	*–0.44; –0.46*

Source: Bank of Lithuania calculations.
Note: intervals in columns 5-10 mean: 1) phase-in of the requirement in 2 steps, increasing the rate after first half-year; 2) introduction of the full requirement at once.

	The measure is also seen as a signal drawing the credit institutions' attention to the risks posed by mortgage exposures amidst increased competition in the market, encouraging careful evaluation of mortgage loans and keeping relatively stringent lending standards intact. *The effectiveness of the measure will be assessed by monitoring the developments in mortgage lending rates and lending standards, new mortgage loans, loan portfolio growth (at the banking sector and institution level) and house prices, and by employing various in-house empirical assessment tools. The potential impact on other lending segments will also be monitored.* *The limited impact of the measure is deemed effective in the current juncture and proportionate to the observed level of RRE risks.*
4.5 Reason why the systemic risk buffer is not duplicating the functioning of the O-SII buffer provided for in Article 131 CRD **(Article 133(9)(f) CRD)**	Where the systemic risk buffer rate applies to all exposures, please justify why the authority considers that the systemic risk buffer is not duplicating the functioning of the O-SII buffer provided for in Article 131 CRD. *Not applicable, as the SyRB applies to sectoral exposures located in Lithuania.*
5. Sufficiency, consistency and non-overlap of the policy response	
5.1 Sufficiency of the policy response	For a macroprudential policy to be 'sufficient', the policy responses must be deemed to significantly mitigate, or reduce the build-up of, risks over an appropriate time horizon with a limited unintended impact on the general economy. Note that the ESRB will use this assessment of the macroprudential stance as relevant input in assessing the sufficiency of the macroprudential policy in the Member States. Please provide any additional information that the ESRB should consider in assessing the sufficiency of the policy response. *The Bank of Lithuania considers the intended measure sufficient and appropriate for the observed level of the systemic RRE risk. The intended measure will complement the existing borrower-based measures and the planned tightening of LTV for secondary loans in addressing the RRE sector risks by increasing financial sector's resilience.* *The intended measure is targeted, applied to the mortgage portfolios only, and should not negatively affect other financial products. The expected impact on main variables is described in detail in section 4.4. In our assessment, negative impact of mortgage interest rates and GDP should be contained. The estimates provided should be viewed as the larger limit for the impact, as the economic environment is favourable (the output gap is projected to be positive in 2022), credit institutions have voluntary buffers and, moreover, should be able to accumulate the capital for the requirement from their profits.*
5.2 Consistency of application of the policy response	For a macroprudential policy to be 'consistent', the policy instruments must be deemed to meet their respective objectives as outlined in ESRB/2013/1[3] and must be implemented in accordance with the common principles set out in the relevant legal texts.

[3] Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1) (OJ C 170, 15.6.2013, p. 1).

	Note that the ESRB assessment of consistency will consider whether the same systemic risks are addressed in a similar way across and within the Member States over time. Please provide any additional information that the ESRB should consider in assessing the consistency of the policy response. *The Bank of Lithuania considers its intended application of the sectoral SyRB as consistent with the intermediate objectives recommended by the ESRB (namely, mitigating and preventing excessive credit growth and leverage, as well as limiting direct and indirect exposure concentration).* *The Bank of Lithuania adheres to the common principles set out in relevant legal acts (CRD Art 133), namely that the measure may be introduced 'in order to prevent and mitigate macroprudential or systemic risks not covered by CRR and by Articles 130 and 131 of CRD, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy' in Lithuania:* • *The Bank of Lithuania does not apply (and so far has seen no need to apply) any of the CRR measures targeting the RRE risks.* • *The intended sectoral SyRB does not target risks covered by Article 131 of CRD (which defines the use of O-SII and G-SII buffers).* *The intended sectoral SyRB also does not target broad cyclical risk covered by Article 130 of CRD (which defines the use of the CCyB), even though the cyclical element of the targeted RRE risk is part of the broad cyclical risk. The Bank of Lithuania considers that the case for not applying a broad cyclical instrument such as the CCyB is reasonable and valid (as explained in section 4.1), and the SyRB is the most appropriate tool to prevent and mitigate the RRE risks which have both a cyclical and structural element in our case, which pose a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in Lithuania. Once the CCyB is applied, the overlap of the measures and double-counting of risks would be avoided by recalibrating the sectoral SyRB rate.*
5.3 Non-overlap of the policy response	For a policy instrument to be 'non-overlapping', it should aim to address a systemic risk that either differs to the risk addressed by other active tools in the same Member State, or to be complementary to another tool in that Member State which addresses the same systemic risk. - Are other policy instruments used to address the <u>same</u> systemic risk? - If yes, please explain the need for more than one instrument to address the same systemic risk and how the different instruments interact with each other. *The intended sectoral SyRB would complement the existing borrower-based measures (LTV, DSTI, stressed-DSTI and maturity limits, and the newly planned tightening of LTV for secondary mortgages) by increasing financial sector's resilience and making mortgage lending more capital-costly for the credit institutions. The borrower-based measures reduce the risk of mortgages, making both mortgage-bearing households and credit institutions more resilient to adverse shock scenarios, limit household indebtedness and promote responsible lending practices. The intended sectoral SyRB affects the RRE risk though different channels. The emergence of signs of house price overvaluation together with increased exposure concentration to mortgage*

	loans by the financial sector requires measures that increase the resilience of credit institutions should the risks materialise and the quality of existing mortgage portfolios deteriorate. *Other currently active measures in Lithuania – O-SII buffer and capital conservation buffer – address different risk than the intended measure.*
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 **(Article 133(9)(d) of the CRD and Recommendation ESRB/2015/2[4])**	Assessment of the cross-border effects of implementation of the measure. a. Assessment of the spillover channels operating via risk adjustment and regulatory arbitrage. The relevant indicators provided in Chapter 11 of the ESRB Handbook on Operationalising Macroprudential Policy in the Banking Sector[5] and the Framework to assess cross-border spillover effects of macroprudential policies of the ECB Task Force on cross-border spillover effects of macroprudential measures can be used. b. Assessment of the: o cross-border effects of implementation of the measure in your own jurisdiction (inward spillovers); o cross-border effects on other Member States and on the Single Market of the measure (outward spillovers); o overall impact on the Single Market of implementation of the measure. *Based on the available information, the Bank of Lithuania does not foresee any significant impact on the internal market.* *Inward effects through cross-border risk adjustment are likely, if the measure is not applied to foreign bank branches that are active in the Lithuanian mortgage market. Based on the data which is readily available, mortgage portfolio (similar to relevant exposures for the intended SyRB) of foreign bank branches comprises 25.5% of the total mortgage portfolio in Lithuania (as of Q2 2021).* *Outward effects through cross-border risk adjustment are likely to be negligible. Lithuanian banks are universal banks focused on domestic lending, do not have foreign branches or subsidiaries and do not engage in cross-border activity. Based on the data which is readily available, only 1% of the banks' relevant exposure is cross-border (0.5% to EEA and 0.5% to third countries as of Q2 2021).* *The banks have significant reserves above the current capital requirement and are profitable, the economic outlook is positive, despite the ongoing pandemic. Therefore, the banks should be able to meet the SyRB requirement from their current resources, without weighing on the capital needs of the group, containing potential indirect effect on other countries where those banking groups are active. As the SyRB requirement, which is planned to be announced at the end of November 2021, will become effective after a 7-month period, on 1 July 2022, any potential negative effects are further reduced.*

[4] 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).
[5] Available on the ESRB's website at www.esrb.europa.eu.

	In general, our assessment shows that an increase of capital requirement applied to the mortgage portfolio by 2 p.p. could raise the average cost of borrowing for house purchase by up to 7 basis points and reduce the flow of new mortgage loans by up to 3% (compared to a no-policy scenario). In addition, the increase in credit institutions' resilience to increased RRE risk in Lithuania would contribute to mitigating systemic risk in Lithuania and the Single market.
6.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	Referring to your Member State's specific characteristics, what is the scope for "leakages and regulatory arbitrage" in your own jurisdiction (i.e. circumvention of the measure/leakages to other parts of the financial sector)? Is there scope for "leakages and regulatory arbitrage" in other jurisdictions? *In our assessment, the risk of circumvention of the measure in our own jurisdiction is minimal, as the measure would be applied at the highest consolidation level in Lithuania. Also, fundamentally, only credit institutions issue mortgage loans to households in Lithuania (there are a few other financial institutions that provide mortgage lending, but their exposure size is negligible).* *Mortgage loan exposures of the financial institutions that are below the materiality threshold will be monitored and the measure will automatically become binding if their mortgage portfolios become significant. Currently mortgage portfolios of such institutions comprise only 0.3% of the respective total banking sector portfolio.* *There are 4 separate credit unions that have mortgage portfolios of a limited size (0.6% of the respective total banking sector portfolio in total) and significantly below the set materiality threshold. They are subject to a specific regulation and macroprudential buffers are not applied to single credit unions. However, the legal status of separate credit unions will be abolished from 1 January 2023; each of them will either become a bank or join a central credit union group and will be in the scope for the SyRB.* *The Bank of Lithuania sees the potential of leakages and regulatory arbitrage in other jurisdictions which could be prevented with reciprocity of the intended measure by other Member States:* • *A significant share of total mortgage positions (25.5% as of Q2 2021) is held by foreign bank branches operating in Lithuania, for which the Bank of Lithuania cannot set the intended requirement.* • *The banks that are subsidiaries of foreign banks (namely AB SEB bankas and "Swedbank", AB), hold 67.2% of the total mortgage portfolio and are the two largest participants in the mortgage market. There could be potential incentives to shift a part of activities or transfer mortgage portfolios to other entities in the same banking group, thus reducing or avoiding the new requirement.*

6.3 Request for reciprocation by other Member States **(Article 134(5) CRD and Recommendation ESRB/2015/2)**	Does the authority intend to ask the ESRB to issue a recommendation to other Member States to reciprocate the measure in accordance with Article 134(5) CRD? Choose an item. - If yes, please provide in Section 6.4. the justification for that reciprocity. - If no, what are the reasons for not requesting reciprocation? *Yes, we intend to ask the ESRB to issue a recommendation to other Member States to reciprocate the measure in accordance with Article 134(5) of CRD.*
6.4 Justification for the request for reciprocation by other Member States **(Article 134(5) CRD and Recommendation ESRB/2015/2)**	To request reciprocation, please provide the following: - a concise description of the measure to be reciprocated; - the financial stability considerations underlying the reciprocity request, including the reasons why the reciprocity of the activated measure is deemed necessary for its effectiveness; - the proposed materiality threshold and justification for that level. If the ESRB deems the request for reciprocation to be justified, the description provided will form the basis for translation into all EU official languages for the purposes of an update of Recommendation ESRB/2015/2. *The measure on which reciprocity is sought is:* ***a. The 2% Systemic Risk Buffer rate on all retail exposures to natural persons in Lithuania, which are secured by residential property (in line with Part 5(b)(i) of Article 133 of CRD V).*** *The intended SyRB rate is 2%, equal for all institutions subject to the requirement.* *All banks, central credit unions and central credit union groups authorised in Lithuania are in the scope of the measure, however, a materiality threshold of EUR 50 million is applied, i.e. institutions will not be subject to the SyRB requirement as long as their relevant sectoral exposure does not exceed EUR 50 million. (The details on the rule when the institutions become subject to the requirement will be adopted and published together with the formal decision on the measure.)* *The SyRB will become effective on 1 July 2022.* *Calculation of the exposure size for reciprocity purposes and the buffer size could be based on:* • *For IRB exposures:* *COREP C 09.02 – Geographical breakdown of exposures by residence of the obligor: IRB exposures (CR GB 2), Lithuania, row 090, columns 010, 105 and 125* • *For SA exposures and institutions which do not report in accordance with C 09.02:* *FINREP F 20.04 – Geographical breakdown of assets by residence of the counterparty, Lithuania, row 230, column 010. If gross carrying amount is equal or higher than the materiality treshold, the institution should check the size of its retail exposure to natural persons in Lithuania, which are secured by residential property, and if it is not lower than the materiality threshold, the institution would be subject to the requirement.* ***b. The Bank of Lithuania considers that the reciprocation of the measure by other Member States is necessary for the effectiveness of the measure.***

A significant share of total mortgage positions (25.5% as of Q2 2021) is held by foreign bank branches operating in Lithuania, therefore, reciprocity of the measure by other EU countries would help foster a level playing field and ensure that all significant market participants take into account the increased RRE risk in Lithuania and increase their resilience.

The banks that are subsidiaries of foreign banks (namely AB SEB bankas and "Swedbank", AB), hold 67.2% of the total mortgage portfolio and are the two largest participants in the mortgage market. Application of the measure at the consolidated group level would reduce potential incentives to shift a part of activities or transfer mortgage portfolios to other entities in the same banking group, thus reducing or avoiding the new requirement.

The Bank of Lithuania does not have sufficient information on direct cross-border mortgage lending to Lithuania, however, it is likely to be minimal. Financial Account Statistics suggest that household long-term loans vis-à-vis the rest of the world is around EUR 0.1 million.

a. ***We propose a materiality threshold of EUR 50 million (which is approximately 0.5% of the relevant exposures of the total credit institution sector in Lithuania)****. Justification for such a threshold:*

- *It would minimise the potential for regulatory fragmentation, as the same materiality threshold will also apply to credit institutions authorised in Lithuania.*
- *Application of such a materiality threshold would help to ensure a level playing field in a sense that institutions with exposures of similar size are subject to the requirement.*
- *The threshold is relevant for financial stability, as the further development of the RRE risk will mainly depend on the activity in the housing market which also partly depends on the amount of new loans issued for house purchase. Therefore, the measure should apply to those market participants who are active in this market even though their mortgage loan portfolios are not as large as those of the largest loan providers.*

7. Combination of the SyRB with other buffers

7.1 Combination with G-SII and/or O-SII buffers

(Article 131(15) CRD)

Is the sum of the systemic risk buffer rate and the higher of the O-SII/G-SII buffer rates to which the same institution is subject above 5%?

The sum of the SyRB rate and the O-SII buffer rate for any institution does not exceed 4%.

Please provide a list of the institutions subject to a G-SII or an O-SII buffer, indicating the G-SII or O-SII buffer and the sum of the G-SII/O-SII and SyRB buffers (a combined buffer rate of over 5% requires authorisation by the Commission).

Name of institution	G-SII/O-SII buffer rate	O-SII consolidation level	Sum of G-SII/O-SII and SyRB rates
AB SEB bankas	2%	Sub-consolidated (highest level of consolidation in Lithuania)	4%
„Swedbank", AB	2%	Sub-consolidated (highest level of consolidation in Lithuania)	4%

AB Šiaulių bankas	1% (effective from 31 December 2021; until then – 0.5%)	Highest level of consolidation in Lithuania (consolidated)[4]	3%
	%		%
	%		%
	%		%
	%		%

7.2 Combination with other systemic risk buffers **(Article 133(11) and (12) CRD)**	Indicate all sets or subsets of exposures that would be subject to one or more systemic risk buffers with a combined systemic risk buffer rate in the ranges below: - above 3% and up to 5% - above 5% Indicate whether any subsidiaries of a parent in another EU Member State would be subject to a combined systemic risk buffer rate above 3%. *There will be no sets or subsets of exposures that would be subject to a combined SyRB rate of more than 3%. No other SyRB rates are applied by the Bank of Lithuania, except for the intended SyRB rate as notified in this notification, which is 2%*.
8. Miscellaneous	
8.1 Contact person(s)/mailbox at notifying authority	Nijolė Valinskytė, Head of the Macroprudential Policy Division, +370 650 40 605 (nvalinskyte@lb.lt) Milda Stankuvienė, Principal Economist, Macroprudential Policy Division, +370 659 36 954 (mstankuviene@lb.lt)
8.2 Any other relevant information	
8.3 Date of the notification	Please provide the date on which this notification was uploaded/sent. 26/10/2021