Notification template for Article 124 of the Capital Requirements Regulation (CRR) – Risk Weights

Template for notifying the European Banking Authority (EBA), European Central Bank (ECB) and European Systemic Risk Board (ESRB) of higher risk weights being set for immovable property pursuant to Articles 125(1) and 126(1) CRR or on applying stricter criteria than those set out in Articles 125(2) and 126(2) CRR

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;
- eportal.eba.europa.eu when notifying the EBA.

The ESRB will publish the risk weights and criteria for exposures referred to in Articles 125, 126 and 199(1)(a) of the CRR as implemented by the relevant authority. This notification will be made public by the ESRB after 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 submit the notification template in a format that allows the information to be read electronically.

1. Notifying national authority	
1.1 Name of the notifying authority	Croatian National Bank (HNB).
1.2 Country of the notifying authority	Croatia (HR).
2. Scope of the notification and description of the measure	
2.1 Exposures secured by mortgages on residential property	**a)** Do you intend to set a higher risk weight than that set out in Article 125(1) CRR for exposures fully and completely secured by mortgages on residential property? **NO.** b) If yes, please specify: - Which risk weight you intend to change. Please specify the new risk weight to be set (between 35% and 150%). - To which part(s) of your Member State territory will the new risk weight for exposures set out above apply? - To which property segment(s) will the new risk weight for exposures set out above apply?

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authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

	c) Do you intend to apply stricter criteria than those set out in Article 125(2) CRR for exposures fully and completely secured by mortgages on residential property? **YES** d) If yes, please specify: **Croatian National Bank will continue to exercise NCA discretion given by Article 124 of CRR and applicable since 2014, with necessary adjustments for the provisions of CRR3. Credit institution may consider exposure secured by mortgages on residential property located in the territory of the Republic of Croatia to be eligible for the treatment referred to in Article 124 paragraph 2 of the Regulation (EU) no. 575/2013 only if it, in addition to the conditions specified in Article 124 paragraph 3 of Regulation (EU) no. 575/2013, meets the following criteria:** - **the owner of the residential property located in the territory of the Republic of Croatia that is securing the exposure is the owner of not more than two residential properties** - **residential property located in the territory of the Republic of Croatia that is securing the exposure is not a holiday home.** **The stricter criteria were in Croatia applied since 2014, and are only adjusted to the new definition of the residential real estate in CRR3.**
2.2 Exposures secured by mortgages on commercial immovable property	**e)** Do you intend to set a higher risk weight than that set out in Article 126(1) CRR for exposures fully and completely secured by mortgages on commercial immovable property? **NO.** **Since 2016, Croatian National Bank exercised NCA discretion given by Article 124 of CRR and assigned a higher 100% risk weights for exposures secured by mortgages on commercial immovable property. With CRR3 implementation this national discretion will no longer be exercised.** f) If yes, please specify: - What risk weight you intend to set. Please specify the new risk weight to be set (between 50% and 150%). - To which part(s) your Member State territory will the new risk weight set out above apply? - To which property segment(s) will the new risk weight set out above apply?
	g) Do you intend to apply stricter criteria than those set out in Article 126(2) CRR for exposures fully and completely secured by mortgages on commercial immovable property? **NO.** h) If yes, please specify: - What criteria you intend to add or tighten. - To which part(s) of your Member State territory will the stricter criteria set out above apply? - To which property segment(s) will the new risk weight set out above apply?
2.3 Other relevant information	**Since 2014, the Croatian national bank has exercised NCA discretions granted by Article 124 of the CRR, establishing stricter criteria for exposures secured by mortgages on residential properties, and, since 2016, applying a higher risk weight (100%) for exposures secured by mortgages on commercial properties. These measures were outlined in the Decision implementing the part of regulation (EU) no 575/2013 pertaining to the valuation of assets and off-balance sheet items and the calculation of own funds and capital requirements, Art. 7 (RRE) and 8 (CRE).**

	Due to implementation of Regulation (EU) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR3), Croatian National Bank reviewed these discretion decisions, and based on that review proposed adjustments to those Articles in a way to (1) drop 2 out of 4 stricter criteria for RRE due to new changed CRR3 definition of "residential property", and (2) drop the higher RW for CRE. **Article 7 of the aforementioned national Decision currently reads as:** **Criteria for exposures secured by mortgages on residential property** Article 7 (1) When assigning a risk weight of 35% to exposures or any part of an exposure fully and completely secured by mortgages on residential property located in the territory of the Republic of Croatia, credit institutions shall, in accordance with Article 125 of Regulation (EU) No 575/2013, apply the criteria prescribed by paragraphs (2) to (6) of this Article. (2) A credit institution may assign a risk weight of 35% only to those exposures or a part of an exposure secured by mortgages on residential property which is or shall be occupied or let for residential purposes by the owner who is a natural person, under a property leasing contract. (3) A credit institution may assign the risk-weight referred to in paragraph (2) of this Article provided the owner of the residential property is the owner of not more than two residential properties. (4) Residential property, in accordance with paragraph (2) of this Article, means a house, a flat or associated parts of the flat in flat ownership intended to be used as a dwelling and a building plot intended to be used for construction of a house. (5) A garage or a parking spot, in accordance with paragraph (2) of this Article, is considered residential property only if the mortgage on or fiduciary transfer of ownership of a garage or a parking spot is connected with the mortgage on or fiduciary transfer of ownership of a house, flat or associated parts of the flat in flat ownership that are intended to be used as a dwelling. (6) Holiday homes, in accordance with paragraph (2) of this Article, are not considered residential property. **Due to new changed CRR3 definition of "residential property", Article 7 is proposed to be amended to read:** Credit institution may, exposure secured by mortgages on residential property located in the territory of the Republic of Croatia, consider to be eligible for the treatment referred to in Article 124 paragraph 2 of the Regulation (EU) no. 575/2013 only if it, in addition to the conditions specified in Article 124 paragraph 3 of Regulation (EU) no. 575/2013, meets all the following criteria: 1. the owner of the residential property located in the territory of the Republic of Croatia that is securing the exposure is the owner of not more than two residential properties 2. residential property located in the territory of the Republic of Croatia that is securing the exposure is not a holiday home. **Article 8 pertaining to the exposures secured by mortgages on immovable commercial property is deleted**.

3. Timing for the measure	
3.1 Timing for the decision	What is the date of the official decision? For SSM countries when notifying the ECB: provide the date on which the decision referred to in Article 5 of the Single Supervisory Mechanism Regulation (SSMR) will be taken. 16/12/2024
3.2 Timing for publication	What is the date of publication for the notified measure? 23/12/2024
3.3 Disclosure	Information about the strategy for communicating the notified measure to the market. **The public consultation on the Amendments to the Decision implementing the provisions of Regulation (EU) No 575/2013 related to the valuation of assets, off-balance sheet items, and the calculation of own funds and capital requirements was open from November 5 to December 5.** **During this period, a presentation followed by a Q&A session was held for all credit institutions.** **Once the consultation process concludes and all comments and questions received during the procedure are addressed, the final decision will be published in the Official Gazette and on the HNB website**.
3.4 Timing for application	What is the intended date for application of the measure? 01/01/2025
3.5 Frequency/review	Does your decision to set higher risk weights have an expiry date? When will the decision be reviewed? **Decision will be reviewed annually in accordance with the Article 124 paragraph 9 of the CRR as amended by CRR3.**
4. Reason for setting higher risk weights or stricter criteria than those set out in Articles 125(2) or 126(2) CRR	
4.1 Regulatory context	What are the current risk weights applied to exposures secured by mortgages on residential property and on commercial immovable property? **For exposures secured by residential property 35% only if stricter national criteria are met (please see 2.3); for exposures secured by commercial immovable property applicable risk weight is 100%. From 1 January 2025 risk weights will be applied according to CRR3.**
4.2 Risk weights versus actual risks	Specify the reasons why the risk weights for exposures to one or more property segments fully secured by mortgages on residential property or on commercial immovable property located in one or more parts of your Member State territory do not reflect the actual risks of these exposures and put your answers in perspective vis-à-vis the real estate markets of other European Member States. **The stricter measures under the Art. 124 of CRR applied by the HNB were during its regular annual review assessed as appropriately reflecting existing risks and contributing to strengthening capital protection against risks associated with the real estate market.**

	The HNB conducted a quantitative impact study (QIS) to assess the implications of CRR3. While some reservations remain regarding the quality and accuracy of the data collected from credit institutions on a best-effort basis, the QIS results suggest a potential decrease in the average risk weight for exposures secured by residential real estate (RRE). This reduction does not appear justified in light of systemic risk developments in the RRE market, where accumulated vulnerabilities persist, particularly given the potential transition into a downturn phase of the RRE cycle. The regulatory changes introduced by CRR3 may lead to an unwarranted erosion of capital requirements for RRE-secured exposures. This risk arises if the current national discretion, which limits the application of the preferential risk weight to a subset of RRE, ceases to apply. In light of this, the HNB has opted for a conservative and prudential approach by maintaining the current stricter national criteria for exposures secured by residential property mortgages, adjusted to CRR3 changes. The list of criteria has been adjusted to reflect the changed definition of residential property in CRR3 (Article 1, point 75). **On the contrary, the evaluation of the CRR3 impact on the exposures secured by mortgages on immovable commercial property proved more challenging. The QIS revealed a sharp increase in the volume of these exposures, from 740 million EUR to approximately 2.7 billion EUR, attributed to portfolio reclassification under the CRR3 assumption. This inconsistency in classification of exposures as well as the recognition of the ADC exposures (around 900 million EUR) hinders the comparison between average risk weight on the CRE secured portfolio under the current and forthcoming regulatory provisions. Preliminary analysis showed that the structure of the CRE and ADC exposures reported in QIS, using applicable risk weights prescribed in CRR3, would lead to the average risk weight on these exposures of 99% (please see also 4.3). These results are significantly influenced by the accuracy and reliability of the data reported during the QIS process. Based on the reported structure of CRE and ADC exposures, it was challenging to conclude that CRR3 provisions would lead to a loosening of capital requirements that would justify the conditions stated in Article 124 CRR for exercising national discretion (specifically, that the risk weights outlined in Article 126 do not adequately reflect the actual risks associated with CRE exposures and that this inadequacy could adversely affect financial stability). Given the unclear impact of CRR3's more granular approach to credit risk treatment for exposures secured by immovable commercial property and ADC exposures, the HNB has decided to remove the stricter national risk weight of 100% for these exposures, for the purpose of required CRR3 adjustment. This decision will be revisited in 2025 based on official reporting data collected under CRR3.**
4.3 Motivation	<u>a) Loss experience</u> - Provide details about the loss experience in the real estate market of your Member State that has led you to conclude that higher risk weights must be set or stricter criteria applied than those set out in Articles 125(2) and 126(2) CRR. - Which of the data referred to in Article 430a CRR were considered in your assessment? - Provide any other indicators and other relevant information on the basis of which the assessment was made. If possible, please provide the data (preferably in an Excel file).

<table>
<tr><td></td><td>The data considered correspond to those specified in Article 430a, paragraph 1 of the CRR. Losses arising from exposures secured by residential property remain stable at a low level. As of the end of 2023, the proportion of losses associated with lending up to the reference percentages, relative to total exposures collateralized by residential property, stood at 0.14% (CRR Article 430a, paragraphs 1a and 1c). The overall share of losses in total exposures collateralized by residential property was 0.24% (CRR Article 430a, paragraph 1b). This low level of losses reflects favourable economic conditions and rising wages during the expansionary phase of the residential real estate (RRE) cycle. However, losses could increase significantly if downside risks in RRE markets materialize, particularly in the event of an economic slowdown, which could lead to higher unemployment and a deterioration in households' debt-servicing capacity. Data on experienced losses for the entire CRE portfolio as reported in QIS is currently unavailable. Please see attached Excel file for data.</td></tr>
<tr><td></td><td><u>b) Forward-looking real-estate market developments</u>
- Describe the forward-looking real-estate market developments that led you to conclude that higher risk weights should be set or stricter criteria applied than those set out in Articles 125(2) and 126(2) CRR.
- Provide the indicators and any other relevant information on the basis of which the assessment was made. If possible, please provide the corresponding data (preferably in an Excel file).
The residential real estate market in Croatia appears to be at a turning point, signalling the end of a strong expansionary phase. The accumulated vulnerabilities remain moderately elevated. This shift is characterized by a decline in both foreign and domestic demand, as evidenced by the decreasing number of transactions over the past two years. While real estate prices continue to grow at a faster rate than euro area average, the pace of growth has moderated compared to previous years (10.0% year-on-year in Q2 2024, down from a peak of 17.3% in Q4 2022). This trend is expected to persist given elevated borrowing costs, weakening demand, and the gradually widening gap between realized and asked residential real estate prices.
The risks for financial stability stemming from the commercial real estate market are currently assessed as moderate. Regarding cyclical risks, CRE market in Croatia is considered to be in a stable phase, characterised by a shortfall in the supply and continued slowdown in the growth of asking prices. All market segments recorded a rise in rents, with a slight increase in the number of purchase and sale transactions, signalling a favourable outlook for the CRE market. In addition, banks' loans related to CRE are mostly subject to relatively tight credit standards while the quality of loans related to the CRE market continued to improve (in 2023, the share of non-performing loans related to CRE market went down by 0.5 p.p. and stood at 6%). It is assessed that the potential realization of CRE risks would not pose a significant threat to financial stability at this stage. However, the market remains relatively shallow and faces poor liquidity, which makes it susceptible to economic shocks and warrants careful monitoring of evolution of systemic risks in relation to banks' resilience.
Please see attached Excel file for data.</td></tr>
</table>

	<u>c) Financial stability considerations</u> - What are the financial stability considerations that were taken into account? - Please include: o the factors that could 'adversely affect current or future financial stability' as referred to in Article 124(2)(2) CRR; and, o the indicative benchmarks that you took into account in determining the higher risk weights. - Provide the indicators and any other relevant information on the basis of which the assessment was made. If possible, please provide the data (preferably in an Excel file). **So far, moderate bank exposure to housing loans has mitigated the risks to financial stability associated with the residential real estate market. However, accumulated vulnerabilities in the RRE market could lead to the materialisation of the downside risks for financial stability if higher borrowing cost increase debt burden of the households, especially vulnerable households, and in case of worsened economic conditions that would cause an increase in unemployment.** **Although mortgage lending continues to expand, with growth rates stabilizing just below 10% annually, it reflects only the impact of increasing RRE prices, while the number of new loans granted continues falling. Higher interest rates and RRE prices in 2024 lead to the increase in the average value of the loan and its duration, and despite the strong increase in wages, the average debt service-to-income ratio for newly-granted housing loans slightly increased.** **Relaxation of the current stricter national criteria due to the application of CRR3 might lead to a sudden increase of exposures secured by residential property eligible for the application of the 20% risk weight, causing a decrease of risk weighted assets of the most substantial part of banks' RRE secured portfolio (exposures secured by non-IPRE RRE make almost 3/4 of total real estate secured exposures based on the data collected in QIS). This could in turn undermine the basis for capital requirements for these exposures and result in lower resilience of banks to potential shocks in the RRE market.** **Relaxation of the current higher risk-weight for the exposures secured by commercial immovable property should not have a material impact on the total capital ratio. According to the data provided in QIS, about 760 million EUR out of total 2.7 billion EUR CRE exposures were reported as eligible for an application of the 60% RW. The estimated effect of applying a 60% RW instead of a 100% RW to eligible non-IPRE exposures was found to be minimal. Specifically, this adjustment is estimated to decrease RWA by 304.5 million EUR, resulting in an estimated total capital ratio of 22.74%, compared to 22.54% if these exposures were weighted at 100% RW. Taking into account all CRE exposures jointly with ADC exposures based on the QIS data, the total RWA remains basically unchanged. Please note that these estimates are based on the assumption that the structure of CRE exposures reported during the QIS will remain consistent in the official reporting.**
5. Sufficiency, consistency and non-overlap of the policy response	
	We currently assess that the continued application of stricter criteria for RRE-secured exposures, in combination with other macroprudential measures aimed at enhancing the resilience of the

5.1 Sufficiency of the policy response	**banking system, remains sufficient. The overall macroprudential stance is unchanged. This measure, along with the broader policy mix, will be subject to regular review going forward.** **The higher risk weight for exposures secured by mortgages on commercial immovable property will be discontinued, as there is insufficient evidence to justify maintaining this national discretion. The overall macroprudential stance is expected to remain unchanged. This decision will also be reviewed periodically in the future**.
5.2 Consistency of application of the policy response	**We consider the continued application of stricter criteria for RRE-secured exposures since 2014 to be effective in ensuring prudent credit risk assessment and appropriate loss absorbency capacity of credit institutions for a subset of RRE-secured exposures.**
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 from a risk addressed by other active tools in the same Member State, or be complementary to another tool in that Member State which addresses the same systemic risk. - Are other policy instruments used to address the same 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. **In parallel to this measure, CCyB is used to address cyclical risks that currently stem mostly from the ongoing robust lending to households, especially in the consumption financing segment, but also from the cyclical real estate market developments. The CCyB rate is 1.5% as of 30 June 2024.** **Both instruments are considered necessary. The application of stricter criteria for the use of preferential risk weighting for exposures secured by RRE strengthens the basis for the calculation of the capital buffers (total risk exposure amount – TREA) and increases the loss absorbency capacity of credit institutions in relation to these exposures. The application of the CCyB increases the resilience of credit institutions against broader cyclical systemic risks and downturns affecting overall exposures.**
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])**	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[4] 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: ○ cross-border effects of implementation of the measure in your own jurisdiction (inward spillovers); ○ cross-border effects on other Member States and on the Single Market of the measure (outward spillovers); ○ overall impact on the Single Market of implementation of the measure **We do not expect extending of the application of the stricter criteria for RRE-secured exposures will have a significant impact on the internal market. As the scope of the stricter criteria is limited to the residential property located in the Republic of Croatia, the potential cross-border effects of this measure are likely to be negligible**. ○ .
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? **We do not expect any leakages and regulatory arbitrage. The measure was applicable since 2014 and is adjusted only to reflect CRR3 changes**.
7. Miscellaneous	
7.1 Contact person(s)/mailbox at notifying authority	Ms Lana Ivičić, Macroprudential Policy and Financial Stability Department, lana.ivicic@hnb.hr; +385 1 4565 009
7.2 Any other relevant information	https://www.hnb.hr/en/core-functions/financial-stability/cnb-s-macroprudential-policy/real-estate-market-related-measures https://www.hnb.hr/en/-/decision-implementing-the-part-of-regulation-eu-no-575-2013-pertaining-to-the-valuation-of-assets-and-off-balance-sheet-items-and-the-calculation-of-own-funds-and-capital-requirements
7.3 Date of the notification	Please provide the date on which this notification was uploaded/sent. 04/02/2025

[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/2015/2) (OJ C 97, 12.3.2016, p. 9).
[4] Available on the ESRB's website at www.esrb.europa.eu.