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]);
- DARWIN/ASTRA 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	Latvijas Banka
1.2 Country of the notifying authority	Latvia
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?

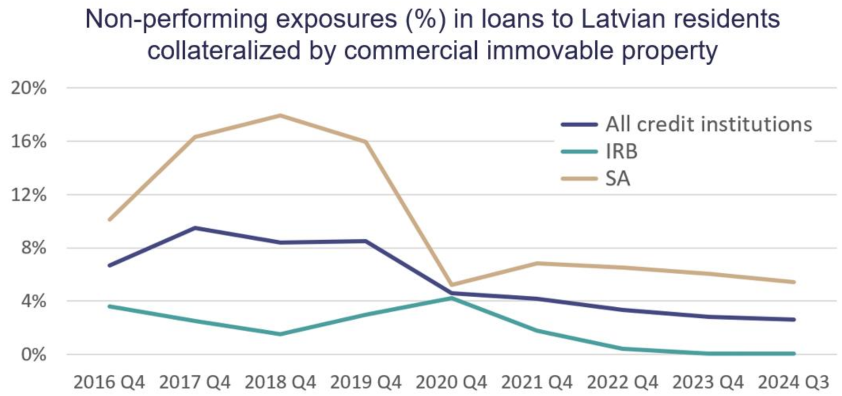
[1] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).
[2] On request by the notifying authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

	n/a
	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? **No** d) If yes, please specify: - What criteria you intend to add or tighten. - To which part(s) of your Member State territory the stricter criteria set out above will apply? - To which property segment(s) will the new risk weighting for exposures set out above apply? **n/a**
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** **According to Latvijas Banka administrative act no. 444/8 of 18 December 2023 (Latvian only) as of 30 June 2024 an 80% risk weight is set for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia. This administrative act is to be revoked effective as of 1 January 2025, whereon a higher risk weight will no longer be set for these exposures (i.e. standard CRR provisions will apply).** 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? **n/a**
2.3 Other relevant information	**Currently for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia a higher (80%) risk weight has been set than that set out in Article 126(1) CRR (50%). As of 1 January 2025 amendments to CRR (CRR3) will come into force, whereby relevant exposures will no longer be subdivided based on whether they fulfil the condition of being "fully and completely secured by mortgages on commercial immovable property". Instead, a new subdivision of**

	relevant exposures will be introduced, based on whether they fulfil the condition of being IPRE – "Income Producing Real Estate". Accordingly, it will no longer be possible for authorities designated by the Member States for the application of Article 124 CRR to set a higher risk weight for exposures "fully and completely secured by mortgages on commercial immovable property". **In light of these developments Latvijas Banka notifies that it plans to revoke the administrative act setting the risk weight at 80% for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia effective as of 1 January 2025. At this juncture Latvijas Banka does not intend to apply any of the measures set out in Articles 125 and 126 of the CRR3.** .
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. **09/12/2024**
3.2 Timing for publication	What is the date of publication for the notified measure? **12/12/2024**
3.3 Disclosure	Information about the strategy for communicating the notified measure to the market. Please provide a link to the public announcement, if any. **The public communication will be made available on the official website of Latvijas Banka following the decision on 09 December 2024.** **Press release on the official website of Latvijas Banka (Latvian only)** **Official Journal (Latvian only)** **Macroprudential measures section on the official website of Latvijas Banka**
3.4 Timing for application	What is the intended date for application of the measure? **The administrative act setting the 80% risk weight currently in force will be revoked effective as of:** **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? **As the decision concerns revoking the administrative act that sets a higher risk weight, it has no set expiry date. The relevant data will be monitored annually, and the risk weight calibration will be reviewed in the future if appropriate.**
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?

	From 2007 till 30 June 2024 a 100% risk weight for exposures secured by mortgages on commercial immovable property registered in Latvia was being applied. As of 30 June 2024 an 80% risk weight has been set. **For exposures secured by mortgages on residential property risk weight is in line with Article 125 (1) of the CRR.**
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 risk weight was originally set at 100% in 2007 due to the small size of the local real estate market that makes the commercial real estate objects less liquid and potentially subject to higher losses and longer recovery periods for credit institutions in case of foreclosure. While this rationale is still relevant, the market liquidity has generally improved and loss rates decreased compared to the period of the global financial crisis and its aftermath.** **Accordingly, in 2023 it was decided in a precautionary and gradual manner to decrease the risk weight for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia from 100% to 80% (effective as of 30 June 2024). Coming into force of CRR3 as of 1 January 2025 will, on one hand, raise the default minimum applicable risk weight for these exposures to 60% from 50% set in the current CRR. On the other hand, in our assessment risks in Latvian commercial property market are continuing to gradually decrease. Furthermore, in foreseeable future the composition of the pool of the exposures to which the risk weight is applied is expected to change, by means of migration of a portfolio of comparatively less risky exposures from internal ratings based (IRB) approach to standardised approach (SA) for the calculation of credit risk capital requirements, thus further reducing the rationale for applying it a higher risk weight.** **In light of these considerations the increased minimum risk weight of 60% (and embedded risk sensitivity in terms of higher applicable risk weight depending on LTV/ETV) for commercial property exposures that will be applicable under CRR3 is deemed proportional to the actual risks. Accordingly, it has been decided to discontinue application of higher risk weight (80%) for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia as of 1 January 2025.** **Should there be changes in the relevant loss experience data or the macrofinancial environment and its associated risks, the calibration of the risk weight will be reviewed in the future. In the majority of European Union countries (including peer Baltic countries of Estonia and Lithuania) the risk weight for exposures secured by mortgages on commercial immovable property remains set at 50% in line with Article 126 (1) of the CRR.**
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.

Available data on loss experience at the current juncture is of limited value, as the relevant COREP reporting does not cover a full financial cycle and contains data only for few credit institutions. As the chart below illustrates, available supervisory data on the proportion of non-performing exposures in a wider exposure subset of all loans to Latvian residents collateralized by commercial immovable property suggests increasing credit quality of underlying exposures in recent years, especially in case of SA banks. Our analysis of granular exposure data in the national credit register also supports this narrative of an overall decreasing risk of exposures that in our assessment could be classified as fully and completely secured by mortgages on immovable property.



*Sample includes branches of credit institutions registered in other Member States and is divided into credit institutions using standardised approach (**SA**) and internal ratings based approach (**IRB**) for calculation of credit risk capital requirements.*

Source: FINREP F 20.04, Latvijas Banka calculations

- Which of the data referred to in Article 430a CRR were considered in your assessment?

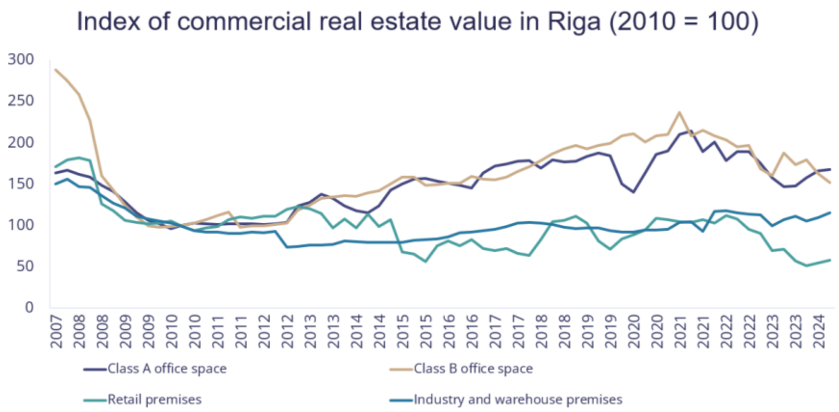
  Credit institutions shall report losses in accordance with Article 430a (1)(d) of CRR and the exposure value in accordance with Article 430a (1)(f) of CRR as part of their supervisory reporting obligations in COREP C 15.00. However, as the 100% risk weight requirement has been in force since 2007 up till 30 June 2024, when it was decreased to 80%, there have been scarce incentives for SA banks to classify their commercial immovable property exposures as exposures fully and completely secured by mortgages on commercial immovable property - as of 2023Q4 only 4 out of 9 local credit institutions reported any such exposures (and only 3 credit institutions reported losses) in COREP C 15.00.
  Accordingly, as the supervisory reporting provides only a limited value for the loss experience analysis, in addition to it we also employ the data from the national credit register, where granular information is available for each exposure regarding its size, location, provisions etc.

- 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).

b) Forward-looking real-estate market developments

- 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.

  The chart below displays commercial property market developments for various segments in the capital city (which accounts for the majority of the total exposures) based on the index of commercial real estate value calculated by Latvijas Banka. We can observe a significant negative fluctuation around the period of global financial crisis and its aftermath in 2007-2009. The volatility has decreased since then, with the exception of few recent years affected by Covid-19 pandemic. Credit institutions have so far displayed resilience against developments affecting the commercial property market and recent changes in the interest rate environment have improved the future outlook. While we still identify vulnerabilities affecting this subset of credit institutions exposures, they are becoming less pronounced.



Source: Colliers International Advisors, LATIO, Latvijas Banka calculations

  Currently there is a comparatively low activity in the commercial real estate market which slightly hinders price discovery. Similarly as in the wider region, a market segmentation is observable wherein demand for Class A (more energy efficient) office space outpaces Class B. While a further price correction is possible, the price growth in years since the global financial crisis has been overall moderate, therefore severe market downturn is unlikely. Nevertheless, as it takes some time for the effects of price changes to fully manifest themselves in credit institution balances, we will continue to monitor the situation closely and adjust the risk weight if appropriate.

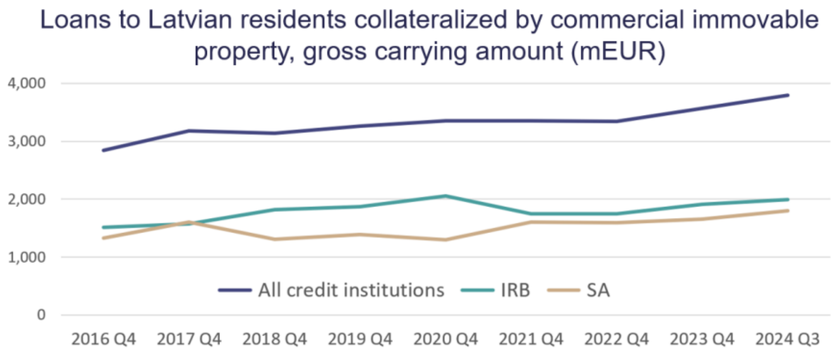
- Provide the indicators and any other relevant information on the basis of which the assessment was made. If possible, please provide the corresponding data (preferably in an Excel file).

c) Financial stability considerations

- What are the financial stability considerations that were taken into account?
- Please include:
  - the factors that could 'adversely affect current or future financial stability' as referred to in Article 124(2)(2) CRR; and,

- the indicative benchmarks that you took into account in determining the higher risk weights.

Commercial real estate constitutes a significant share of the local lending – as of 2024Q3 credit institutions (incl. branches of credit institutions registered in other Member States) had issued in terms of the total gross carrying amount 3.8bn EUR (SA banks - 1.8bn EUR) in loans to Latvian residents collateralized by commercial immovable property representing 54% (SA banks - 55%) of the total resident non-financial corporations loan portfolio.
As the chart below illustrates, for an exposure subset of all loans to Latvian residents collateralized by commercial immovable property there has been a limited growth in recent years.



*Sample includes branches of credit institutions registered in other Member States and is divided into credit institutions using standardised approach (**SA**) and internal ratings based approach (**IRB**) for calculation of credit risk capital requirements.*
Source: FINREP F 20.04, Latvijas Banka calculations

- 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).

Latvijas Banka regularly performs stress tests to assess the ability of credit institutions to withstand adverse macroeconomic developments and unexpected losses. The recent exercise based on the end-2023 data (see pages 35-42 of *Latvijas Banka 2024 Financial Stability Report* for more details) included, among other parameters, an assumption for stress scenario of 40% haircut applied to commercial real estate (vs. 20% haircut in the baseline scenario). The results of the stress test, in light of conservative choice assumptions for both scenarios, demonstrate an overall good resilience of credit institutions to withstand economic shocks. Under the stress scenario the losses were estimated at 3.1% of credit institutions assets (vs. 0.6% under the baseline scenario – respective figures for 2023 stress test were 3.6% and 0.9%), with losses from the credit portfolio constituting 60.3% of the total (45.7% in 2023).

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 the assessment of the macroprudential stance as relevant input in assessing the sufficiency of the macroprudential policy in the

	Member State. Please provide any additional information that the ESRB should consider in assessing the sufficiency of the policy response. **No longer being able to set an 80% risk weight for exposures fully and completely secured by mortgages on commercial immovable property registered in Latvia from 2025 going onward due to coming into force of amendments to the CRR will in effect slightly lower the loss absorbency requirements for this particular subset of exposures. This has to be regarded against the backdrop of a higher minimum risk weight (60% compared to 50% before) and increased risk sensitivity of the relevant new risk weight requirements set out in the amended CRR.** **Furthermore, a positive neutral countercyclical capital buffer (PN CCyB) is being implemented for the relevant Latvian exposures that will amount to 0.5% as of 18 December 2024 and 1% when fully phased-in from 18 June 2025. While PN CCyB targets a broader scope of credit exposures, both of these measures in principle aim to build up the loss absorbing capacity to protect the banking sector from the negative effects of downturns in property market and/or financial cycle. When considered together with the parallel implementation of PN CCyB, the combined effect represents an overall tightening of our macroprudential stance.**
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 they must be implemented in accordance with the common principles set out in the relevant legal texts. 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. **N/A**
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 <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 **N/A**
6. Cross-border and cross-sector impact of the measure	

[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).

6.1 Assessment of cross-border effects and the likely impact on the Internal Market **(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: ○ 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 **N/A** ○ .
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)? **N/A** Is there scope for "leakages and regulatory arbitrage" in other jurisdictions? **N/A**
7. Miscellaneous	
7.1 Contact person(s)/mailbox at notifying authority	Contact person(s) (name, phone number and e-mail address) and mailbox for further inquiries. **Arnis Jankovskis** **+371 67022704** **arnis.jankovskis@bank.lv**
7.2 Any other relevant information	
7.3 Date of the notification	Please provide the date on which this notification was uploaded/sent. **16/12/2024**

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