ESRB
European Systemic Risk Board
European System of Financial Supervision

Assessment of the Belgian notification in accordance with Article 458 of Regulation (EU) No 575/2013 concerning the second extension of a stricter national measure for residential mortgage lending

Introduction

On 22 January 2021, Nationale Bank van België/Banque Nationale de Belgique (NBB/BNB) notified the European Systemic Risk Board (ESRB) of its intention to extend the period of application of its current macroprudential measure based on Article 458(2)(d)(iv) of the Capital Requirements Regulation (CRR)[1]. The measure imposes a macroprudential risk weight add-on on all domestic credit institutions applying the internal ratings-based (IRB) approach whose retail exposures are secured by residential immovable property located in Belgium. The measure has two components. The first imposes a 5 percentage point risk weight add-on for IRB banks' exposures to Belgian mortgage loans. The second, more targeted, component further increases the risk weights based on the risk profile of the IRB banks' mortgage portfolio, by applying a multiplier of 1.33 to the microprudential risk weight of the residential mortgage loan portfolio. This measure was first activated on 1 May 2018 and, in line with Article 458 of the CRR, remained applicable for two years, until 30 April 2020.[2] Due to the persistence of the systemic risks which had been identified in the financial system, the measure was extended on 1 May 2020 for one year, until 30 April 2021.[3]

Pursuant to Article 458(4) of the CRR, the ESRB must provide the Council, the European Commission and Belgium with an opinion within one month of receiving the notification. The opinion must be accompanied by an assessment of the national measure in terms of the points mentioned under Article 458(2) of the CRR. The procedural framework for providing opinions under Article 458 of the CRR is clarified in Decision ESRB/2015/4[4].

---

1 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

2 The ESRB issued an opinion on the measure, which it deemed to be justified, suitable, proportionate, effective and efficient. See **Opinion of the European Systemic Risk Board of 16 February 2018 regarding Belgian notification of a stricter national measure based on Article 458 of the CRR (ESRB/2018/2)**.

3 The ESRB issued an opinion on the extension of the measure, which it deemed to be justified, suitable, proportionate, effective and efficient. See **Opinion of the European Systemic Risk Board of 26 February 2020 regarding Belgian notification of an extension of the period of application of a stricter national measure based on Article 458 of the CRR (ESRB/2020/2)**.

4 Decision of the European Systemic Risk Board of 16 December 2015 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2.

The ESRB's assessment focuses on the net benefits of the national measure in terms of maintaining financial stability. In particular, the ESRB has assessed the rationale for and merit of the measure against the following criteria.

- Justification: Has there been a change in the intensity of systemic risk and does this risk pose a threat to financial stability at the national level? Could alternative instruments provided for under the Capital Requirements Directive (CRD)[5] and the CRR adequately and appropriately address the risk, taking into account the relative effectiveness of such instruments?
- Effectiveness: Is the measure likely to achieve its intended objective?
- Efficiency and suitability: Will the measure achieve its objective in a cost-efficient way, i.e. has the appropriate instrument been used and calibrated correctly?
- Proportionality and impact on the Internal Market: Is there an appropriate balance between the costs resulting from the measure and the problem it aims to address, taking into account any potential cross-border spillover effects?

The ESRB's assessment draws on the information provided by NBB/BNB as well as on discussions with the bank and its staff.

Section 1: Description of and background to the measure

1.1 Description of the measure

The measure proposed for extension imposes a macroprudential risk weight add-on on all domestic IRB credit institutions whose retail exposures are secured by residential immovable property located in Belgium. The measure consists of two components. The first imposes a 5 percentage point risk weight add-on for IRB banks' exposures to Belgian mortgage loans. The second, more targeted component further increases the risk weights based on the risk profile of the IRB banks' mortgage portfolios, by applying a multiplier of 1.33 to the microprudential risk weight of the residential mortgage loan portfolio.

The measure focuses on IRB banks, as their model-implied risk weights are relatively low compared with those implied by the standardised approach. The IRB banks within this scope cover approximately 94% of the Belgian mortgage market. Both non-defaulted and defaulted exposures are targeted.

[5] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

The extension of the measure is intended to apply from 1 May 2021, the day after its previous extension (from 1 May 2020 to 30 April 2021) expires. NBB/BNB will announce the extension of the current measure in a press release on its website. This decision, including an NBB/BNB regulation and the enacting Royal Decree, will be published in April 2021. As the extension concerns a measure already in force, no phasing-in stage is planned – the current measure will continue to be fully applicable to the Belgian residential mortgage loan portfolios held by all Belgian IRB banks.

The measure is to be extended for a period of one year, until 30 April 2022. NBB/BNB intends to reassess the need for capital-based macroprudential measures in December 2021 and will also decide whether it may be appropriate to activate the sectoral systemic risk buffer (sSyRB) to replace the current measure.

Belgium has requested reciprocation of the existing measures by other Member States under Article 458(8) of the CRR and the General Board of the ESRB has decided to recommend reciprocation.[6] The ESRB's recommendation in respect of reciprocation of the existing measure will continue to apply to the measure in its extended form. NBB/BNB has emphasised that this reciprocity remains relevant given the systemic nature of the risks identified and the international nature of the Belgian banking sector. In particular, the banking sectors of other Member States may – now or in the future – be exposed directly or indirectly through their branches to the risks related to the residential real estate (RRE) market in Belgium.

Article 458(10) of the CRR does not apply to the extension of the measure, as the (continued) increase in average risk weights is expected to be higher than 25%. According to calculations performed by NBB/BNB, the proposed extension of the measure is expected to continue increasing targeted banks' average risk weight by more than 25%.

1.2 Background to the measure

The primary aim of the proposed extension of the measure is to ensure that Belgian IRB banks are resilient to RRE risks. NBB/BNB has decided that it is necessary to extend the period of application of this measure by one year, because the systemic risks identified when it was first introduced still persist. The extension is necessary to maintain the resilience of the banking sector and to ensure sufficient loss-absorbing capacity from a macroprudential perspective, commensurate with IRB banks' exposure to the Belgian RRE sector.

The measure is complementary to the supervisory expectations of NBB/BNB, which were introduced in January 2020 following an ESRB Recommendation in respect of Belgium in 2019[7]. The measure, according

---

[6] See **Recommendation ESRB/2018/5 of 16 July 2018 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures**.

[7] See **Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Belgium (ESRB/2019/4).**

to Article 458 of the CRR, aims to address the systemic risks which are related to the stock of existing mortgage loans and which have accumulated over the years. By contrast, the supervisory expectations of NBB/BNB target the risks related to the flow of new mortgage loans. By focusing on measures that address risks arising from new loans, the ESRB's 2019 Recommendation acknowledged that the current measure was necessary to address the prevailing risks related to the stock of mortgage loans and confirmed the complementarity of the two measures.

The proposed extension of the measure comes at a time of a severe economic crisis triggered by the impact of the coronavirus (COVID-19) pandemic, and NBB/BNB stands ready to discontinue the measure should RRE risks materialise. NBB/BNB acknowledges that at present its macroprudential policy is no longer to build capital buffers – it aims, instead, at preserving the buffers for the purpose they were initially created. In March 2020, BNB/NBB decided to lower the CCyB rate from 0.5%, with intended effect from July 2020, to 0% in order to help banks maintain their critical financial intermediation function and to deal with possible loan losses resulting from the COVID-19 pandemic. In July 2020, NBB/BNB issued forward guidance related to the loosening of macroprudential policy in times of crisis[8], explaining that the release of the CCyB was intended to be the first broad-based action in the early phases of the economic crisis. At the same time, NBB/BNB communicated that it stood ready to discontinue the measure under Article 458 of the CRR (and to free up the capital accumulated through this measure) as soon as RRE risks started to materialise.

Section 2: Analysis of the underlying systemic risks

In recent years, the ESRB has been monitoring risks related to the RRE sector in Belgium as well as in all other EU Member States.[9] These assessments have enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to warnings and recommendations being issued in 2016 and 2019 to several countries.

Medium-term vulnerabilities in the RRE sector in Belgium have led the ESRB to issue a Warning (2016)[10] **and a Recommendation (2019)**[11] **to Belgium.** In 2016, the main vulnerabilities in the RRE market in Belgium concerned the rapid growth in house prices and mortgage loans, as well as already high and increasing household indebtedness, with an increasing share of mortgagors potentially vulnerable to adverse economic

---

[8] See Financial Stability Report 2020, Nationale Bank van België/Banque Nationale de Belgique, Brussels, 1 July 2020.

[9] For further details see "**Vulnerabilities in the EU residential real estate sector**", ESRB, November 2016 and "**Vulnerabilities in the residential real estate sectors of the EEA countries**", ESRB, September 2019.

[10] See **Warning of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (ESRB/2016/6).**

[11] See **Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Belgium (ESRB/2019/4).**

developments in the RRE market in Belgium. The subsequent assessment, concluded in June 2019, revealed that since 2016 in Belgium: (i) house price growth had decelerated but the previous dynamics still gave rise to concerns about potential overvaluation; (ii) strong growth in housing credit had continued to fuel household indebtedness; and (iii) a significant share of mortgage loans had continued to be granted to households that were potentially vulnerable to adverse economic or financial conditions or adverse developments in the RRE market.[12] The ESRB also acknowledged that the IRB banks' average risk weights for RRE portfolios, without taking into account the macroprudential measure in place, were relatively low by cross-country comparison.

Since the last ESRB monitoring exercise in 2019, some of the vulnerabilities related to the RRE sector have increased further in Belgium. House price growth accelerated in the course of 2020, raising concerns that residential property is becoming increasingly overvalued. Household indebtedness has increased further, driven by the growth in mortgage credit. Even though lending standards for new loans improved following the application of the NBB/BNB supervisory expectations, increasingly overvalued house prices as well as the growing vulnerability of indebted households may start to dampen the effects of these measures.

The following sections provide further details of the assessment of vulnerabilities, including those affecting the RRE sector (Section 2.1), the household sector (Section 2.2) and the banking sector (Section 2.3).

2.1 Vulnerabilities in the RRE sector

Since 2000, property prices for RRE in Belgium have increased substantially in both nominal (+262%) and real terms (+84%). In contrast to the situation in most Member States, in Belgium the financial crisis did not trigger a major downward correction of nominal prices in the RRE market. In fact, prices continued to rise fast in the decade after the global slowdown. The reference price index for RRE has continued to grow in recent years and currently stands at an all-time high both in nominal and in real terms. Moreover, house price growth has accelerated even faster in recent quarters. In the second quarter of 2020, the year-on-year growth rate of the reference price index was 5.2% in nominal and 4.7% in real terms, compared with average nominal and real growth rates in 2019 of 3.7% and 2.4% respectively. A NBB/BNB analysis shows that the COVID-19 pandemic has not yet impacted the Belgian RRE market in terms of either prices or transactions. Recent developments in prices could, however, be driven by temporary demand and supply factors.

The fundamentals do not seem to justify this prolonged surge in RRE prices and many of the benchmark valuation measures point to persistent overvaluation in the Belgian RRE market. NBB/BNB uses a model-based time series approach to explain real house price developments based on a number of key determinants, including interest rates, real disposable income, characteristics of mortgage loans, the tax regime applicable to

[12] For further details see "**Vulnerabilities in the residential real estate sectors of the EEA countries**", ESRB, September 2019, pp. 76-78.

residential property, and demographic developments. According to NBB/BNB valuations, Belgian RRE prices were overvalued by 14.6% in the second quarter of 2020, compared with 7.3% in the third quarter of 2019, while the model estimated an overvaluation of RRE prices in the range of 5-10% between 2015 and 2020. Even though there has been a considerable increase, it should be considered in the context of the current COVID-19 pandemic. In particular, recent estimates may have been impacted by temporary decreases in some of the key variables and by temporary mismatches between supply and demand in the RRE market.

Changes to the current level of the fundamentals or unexpected severe shocks to these variables could result in substantial downward price corrections towards new equilibriums. In addition to the uncertainty that is intrinsic in any model, these overvaluation estimations are highly dependent on the current level of the fundamentals. For instance, future increases in the level of interest rates could push the equilibrium price of the Belgian RRE market to a much lower level. Similarly, abrupt changes to climate change policy could have a significant impact on the value of old and unrenovated residential properties, which account for a large proportion of the overall market.[13] Furthermore, under severe economic scenarios the price corrections may be significantly higher then those predicted by the models – this should be taken into consideration, in particular, in the current context of the COVID-19 pandemic.

2.2 Vulnerabilities in the household sector

Belgium has recorded some of the biggest increases in household indebtedness since the financial crisis by euro area comparison. Household debt vis-à-vis GDP has been steadily increasing and reached 65.3% in the second quarter of 2020 (up from 55.3% in 2012). These dynamics have been raising concerns about the sustainability of household debt, especially with regard to households which are less resilient to withstanding negative economic shocks (e.g. low-income households). Compared with other euro area countries, Belgium has seen some of the biggest increases in household indebtedness since the financial crisis and its debt ratio now exceeds the euro area average. Mortgage credit growth has been contributing to these developments, standing persistently above the euro area average.

Until recently, Belgian households were experiencing the looser lending standards set by mortgage lenders. Between 2014 and 2019, new loans were increasingly granted with higher loan-to-value (LTV) ratios and debt service-to-income (DSTI) ratios, and extended maturities. During these years, the share of new loans carrying LTVs greater than 90% gradually expanded from 28% in 2014 to 33% in 2019. Notwithstanding further reductions in interest rates in the same period of time, the share of new mortgage loans with DSTI ratios above 50% stood at 19.6% in 2019. Despite recent improvements in credit standards for new mortgage loans (following

[13] For further details, see Bourtembourg, J., Dumont, L., Francart, A. and Van Tendeloo, B, “Climate-related risks and sustainable finance“, *Financial Stability Report*, Nationale Bank van België/Banque Nationale de Belgique, Brussels, 3 June 2019, pp. 107-127.

the introduction of the supervisory expectations), NBB/BNB still believes that the share of already existing mortgage loans to riskier segments is too high (as the supervisory expectations apply to new mortgage loans so their impact on the overall stock of mortgage loans can only be gradual). In particular, while the share of new loans with LTVs of more than 90% decreased to 24% in the first half of 2020, the share of loans with LTVs above 90% in the stock of outstanding loans still amounts to 13% (i.e. €28 billion) when the current (indexed) LTV is considered. Similarly, there has been no marked reduction in the share of mortgage loans that combine several risk characteristics (i.e. high LTV and/or DSTI and/or maturity levels at origination), when the total mortgage stock is considered. Furthermore, other indicators suggest there are still some vulnerabilities in relation to new mortgage loans. In particular, the share of new lending with debt service (to income) ratios above 50% recorded a high figure of 21% in the first half of 2020, having shown no major improvement since 2016. Banks have also been granting more mortgage loans with a longer maturity – in the first half of 2020 the share of new mortgage loans granted with a maturity of more than 20 years was 33%. This was lower that the share of 40% recorded in 2019, although it is still above the figure for 2016 (29%).[14]

Overall, there may be risk pockets of overindebted households, which are more vulnerable in the event of a crisis. In the event of a negative shock, such as that currently represented by the COVID-19 pandemic, household vulnerabilities may lead to loan defaults or adjustments in consumption to meet loan repayments, with second-round effects on financial stability. NBB/BNB monitors developments in the Belgian real estate market as well as the sustainability of household indebtedness. The results of this monitoring suggest that in the event of a major RRE price correction and/or a significant shock to unemployment, there could be major credit losses in the mortgage portfolios of banks. Even if credit standards remain in line with supervisory expectations, NBB/BNB expects that they will only contribute to a gradual reduction of risk in these portfolios.

2.3 Vulnerabilities in the banking sector

The Belgian banking sector continues to increase its exposure to the RRE sector. Total outstanding mortgage loans granted by Belgian banks to Belgian households grew from €169 billion at the end of 2014 to €229 billion in September 2020, which corresponds to an increase from 15% to around 20% of banks' total assets. Moreover, Belgian banks are also exposed to the RRE market through exposures to construction and real estate firms, which are also vulnerable to developments in the RRE market.

Intense competition between credit institutions in the mortgage loan market might lead to further risk-taking. According to NBB/BNB, Belgian banks are expecting sustained new mortgage lending in the coming years, despite the current COVID-19 pandemic. In the current low interest rate environment, expanding mortgage

[14] However, there are also a number of mitigating factors. These include, in particular: (i) the high share of loans with a fixed interest rate; (ii) legal limits on the interest rate variability of mortgage loans; (iii) the fact that mortgage loans are generally amortising, with maturities of no more than 25 years at origination; and (iv) the high level of financial assets held by households relative to their debt.

portfolios may be a common strategy for sustaining profitability. This may further induce competition between mortgage providers, with the potential for greater risk-taking behaviour (even though such behaviour would, to some extent, be constrained by the recently implemented NBB/BNB supervisory expectations).

The vulnerabilities posed by the above-mentioned developments have not been reflected in the developments in risk weights for mortgage loans in IRB banks, which are among the lowest in the EU. Notwithstanding the loose credit standards that pertained until 2019, the average risk weight for mortgage loans calculated by internal models (i.e. before taking macroprudential measures into account) is 9.8%, firmly at the lower end of the EU distribution. This implies that a small amount of capital is allocated against these exposures relative to the systemic risks present. At the same time, NBB/BNB has observed that the microprudential risk weights have remained broadly stable over time and have not been affected by the current economic uncertainty.

Section 3: Effectiveness and efficiency of the measure

3.1 How the measure addresses an identified risk

The measure proposed for extension aims to maintain the resilience of Belgian IRB banks to potential severe downward corrections in RRE markets in Belgium. The systemic risks identified when the measure was first introduced still persist. In 2019, the ESRB assessment of medium-term vulnerabilities in the RRE sector in Belgium concluded that: (i) house price growth had decelerated but the previous dynamics still gave rise to concerns about potential overvaluation; (ii) strong growth in housing credit had continued to fuel household indebtedness; and (iii) a significant share of mortgage loans had continued to be advanced to households that were potentially vulnerable to adverse economic or financial conditions or adverse developments in the RRE market. Since then, some of the vulnerabilities related to the RRE market have continued to increase.

The need to maintain the measure arises from the low microprudential risk weights applied to real estate exposures by IRB banks against a background of substantial vulnerabilities at the macro level. Given the macro-financial nature of the vulnerabilities described in the previous section, the impact of a potential crisis at the macro level might not be accurately reflected in the internal models, especially since Belgium has not experienced any major real estate crisis in the recent past. For this reason, an estimation of risk weights under the IRB approach, which takes a backward-looking perspective, cannot fully incorporate the potential outcome of such a major crisis.[15] As such, the vulnerabilities posed by the developments described in the previous section have not been reflected in the developments in risk weights for mortgage loans in IRB banks.

[15] The ESRB acknowledges that the EBA Guidelines on PD estimation, LGD estimation and treatment of defaulted exposures should help to address some, but not all concerns going forward. However, given that they will be applied from 31 December 2021, they are outside the extension period of the proposed measure.

The measure remains complementary to the supervisory expectations of NBB/BNB with regard to mortgage credit standards. These supervisory expectations target the credit quality of new mortgage loans, whereas the existing measure under Article 458 of the CRR is designed to ensure that sufficient capital has been allocated against the risks already accumulated in the mortgage portfolios. Despite recent improvements in credit standards for new mortgage loans, NBB/BNB still believes that the share of existing mortgage loans is too high in the riskier segments. Even if credit standards remain in line with supervisory expectations, their effect on risk reduction in banks' mortgage portfolios will only be gradual and any significant improvements will only be observed in the medium term.

The design of the measure is intended to ensure it increases resilience and is risk sensitive. The measure combines an add-on that affects all banks equally, with a risk multiplier that aims to adjust the impact of the measure to the risk profile of the banks. NBB/BNB is of the view that the microprudential risk weight obtained from internal models reflects the risk profile and credit quality of borrowers.[16] For this reason, it believes that banks with lower risk weights contribute less to the overall build-up of systemic risk and should therefore be affected to a lesser extent by the implementation of the RRE measure. This is irrespective of the macroprudential concerns that justify the use of the measure, i.e. concerns that the current levels of risk weights do not reflect developments in all macro-financial risks and vulnerabilities that have been building up in recent years.

The existing calibration of the measure should ensure the banks are sufficiently resilient, even to the potential consequences of the COVID-19 pandemic. The calibration of the current measure was based on the severe (macroprudential) stress scenario in the original 2018 notification. This scenario accounts for the possibility of severe downturns in the Belgian RRE market and remains sufficiently meaningful and severe even in the current circumstances of the COVID-19 pandemic, according to NBB/BNB. At the same time, it is worth mentioning that according to NBB/BNB there is no scenario that would currently lead it to recalibrate the measure upwards, considering the procyclical effects such an action might have. An update of the sensitivity/scenario analysis performed indicates that, on the one hand, microprudential capital requirements (implied by microprudential risk weights) remain insufficient to cover all potential (macroprudential) losses under severe (macroprudential) stress scenarios and, on the other hand, that the current macroprudential measure (with the existing calibration) is sufficient to cover the simulated losses, at the sector level. At the level of individual institutions, the distribution of losses projected under the stress scenario corresponds to the differences in capital buffers implied by the current measure. This confirms the previous conclusion that mortgage loans with higher risk weights tend to be associated with larger risks, and hence confirms the appropriateness of the measure in place.

[16] NBB/BNB found cross-sectional evidence of a strong correlation between the banks' risk weights and risk parameters, such as probability of default and share of risky loans (in terms of LTV, DSTI or maturity).

The total impact of the proposed measure on IRB banks' CET1 capital is estimated at €2,056 million, equivalent to approximately 3.72% of IRB banks' total CET1 capital. The measure pushes up the risk weights on mortgage exposures from approximately 9.8% to 18.0% on average, broken down into an increase of 5 percentage points for the first component and 3.2 percentage points for the second component. Such an increase in risk weights implies an additional €2,056 million of CET1 capital (3.72% of IRB banks' total CET1 capital) to be held by the banks, broken down into €1,250 million (2.26% of total CET1 capital) due to the 5 percentage point add-on and €806 million (1.46% of total CET1 capital) due to the second component. This is more than the additional CET1 capital which the IRB banks had to hold in 2018, when the measure was first introduced (€1,486 million), and in 2020, when the measure was first extended (€1,802 million), reflecting the growing size of Belgian IRB banks' exposures to the RRE market.

The extension of the measure is in line with the NBB/BNB strategy of preserving capital buffers for the purpose for which they were initially created. NBB/BNB recognises that the COVID-19 pandemic has increased the probability that the risks targeted by the current measure will materialise in the coming quarters. Given temporary income and other support measures, however, the timing of the potential materialisation remains uncertain. For this reason, NBB/BNB considers an extension of the measure to be necessary, so that the capital accumulated through the measure is not released prematurely.

3.2 How the measure relates to possible alternatives

a) Increasing the risk weights for banks following the standardised approach to credit risk (Article 124 of the CRR as amended by CRR II)

With regard to exposures secured by mortgages, the relevant authorities can impose higher risk weights on credit institutions which follow the standardised approach, on the basis of financial stability considerations. The relevant authorities can set a risk weight for exposures secured by mortgages on residential immovable property – from 35% to up to 150% – or impose stricter criteria than those set out in Article 125 (2) of the CRR.

Article 124 of the CRR would not be effective in addressing the systemic risk identified, given that banks applying the standardised approach account for only a small proportion (around 6%) of mortgage lending by banks in Belgium. Moreover, the average risk weights of banks using the standardised approach are considerably higher than those of IRB banks.

b) Increasing the loss given default (LGD) floor for banks following the IRB approach to credit risk (Article 164 of the CRR as amended by CRR II)

The relevant authorities can set higher minimum values of exposure-weighted average LGD for exposures secured by property, on the basis of financial stability considerations. The exposure-weighted average LGD for all retail exposures secured by residential property and not benefiting from guarantees from central governments must not be lower than 10%.[17] The LGD is one of the parameters used in the risk weight function – increasing the LGD indirectly increases the risk weight and the resulting capital requirements.

The ESRB is of the view that, given the narrower focus of Article 164 of the CRR, which only targets LGD, such a measure would not sufficiently address the intended purpose of the draft measure and could potentially have unintended consequences. Assuming that internal models are correctly calibrated, setting a higher LGD would penalise more conservative banks, while the capital add-on implied by this measure would also vary according to the risk profile of the portfolio. Furthermore, acting through the LGD would also affect other microprudential parameters, such as the calculation of expected loss amounts under Articles 158 and 159 of the CRR, which is not the intended purpose of the measure. Finally, LGD estimates have increased over the years in Belgium. The low level of risk weights applied by IRB banks does not reflect developments in LGD estimates – it is the result, instead, of a fall in probability of default (PD) estimates. Therefore, raising the average LGD floor would not be effective and would be a way of increasing risk weights that would introduce bias.

c) Using the sSyRB (Article 133 of the CRD, as amended by CRD V[18])

Member States may introduce a sSyRB in order to prevent and mitigate macroprudential or systemic risks not covered by the CRR. The sSyRB can be applied to all or a subset of retail exposures which are secured by mortgages on residential immovable property in the Member State setting the buffer.

While the sSyRB represents a further alternative to the current measure, its application might have procyclical effects given the current economic circumstances. Replacing the current measure by the sSyRB, applied to retail exposures secured by immovable property for which the collateral is located in Belgium, would lead to a similar level of capital buffers at the sectoral level. However, the impact on individual institutions would be uneven. This is due to differences in design between the two measures, since the current measure consists of two components (the linear and the multiplicative components referred to by BNB/NBB), while the sSyRB can be calculated using only the multiplicative component. This means that IRB banks with lower risk weights for their RRE portfolio will be less affected by the sSyRB than IRB banks with higher risk weights. Under the current measure, the CET1 macroprudential capital requirements range from 0.8% to 1.3% of exposure at default at the level of individual institutions. On the other hand, if a sSyRB of 9.7% were used (in order to produce an effect that would be as close as possible to that of the current measure at the sectoral level), the individual CET1 macroprudential capital requirements would range from 0.4% to 1.9% of exposure at default. For five banks the CET1 capital buffers would be lower under the sSyRB, while for two banks accounting for nearly 40% of the

[17] Article 164(4) of the CRR.

[18] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (OJ L 150, 7.6.2019, p. 253).

residential banking mortgage loan market, the replacement would require additional CET capital buffers to be raised. Against this background, and given the economic uncertainty related to the COVID-19 pandemic, there are two main reasons why using a sSyRB instead of the current measure is not warranted. First, the two banks in need of additional CET1 capital buffers might start deleveraging. However, other banks might not be willing to take over their market share due to the size of the exposures, the impact of such a takeover on their own CET1 capital buffers, or the current economic uncertainty, which would lead to undesirable disruptions in the market. Second, the five banks for which the CET1 capital buffers would decrease might start releasing the capital surplus. This, in turn, would be regarded as an unintended reduction in their loss absorption capacity, ahead of the potential materialisation of risks targeted by the current measure.

At the end of 2021, and if the current measure has not been terminated by then, NBB/BNB stands ready to assess the need to introduce a sSyRB to replace the current measure. This assessment will include a recalibration of the required macroprudential capital buffer on the basis of (i) the two-year experience of NBB/BNB supervisory expectations for mortgage loans, as banks' compliance with these expectations should gradually lower the systemic risk in the IRB banks' portfolios; (ii) the level of losses that have materialised by then in the context of the COVID-19 crisis; and (iii) the situation in the Belgian residential mortgage and real estate market.

d) Using the countercyclical capital buffer (Article 136 of Directive 2013/36/EU)

The countercyclical capital buffer (CCyB) can be used to address some of the procyclicality in the financial system. The CCyB addresses cyclical risks and is a requirement applicable to domestic exposures.

The CCyB is not an appropriate tool for addressing systemic risks linked to a subset of exposures and may not be applied to a subset of institutions. The CCyB rate is applied as a percentage of the total amount of risk exposures calculated in accordance with Article 92(3) of the CRR – it is therefore not possible to apply the CCyB requirement to a specific subset of exposures such as mortgage loans. Moreover, the CCyB is applied to all institutions, whereas the proposed measure targets only IRB credit institutions.

In March 2020, Belgium lowered the CCyB from 0.5%, with intended effect from July 2020, to 0% as a response to the outbreak of the COVID-19 pandemic. A CCyB of 0.5% was aimed at targeting the observable acceleration of the Belgian credit cycle (driven mainly by corporate credit) and did not specifically target risks in the real estate market. The release of the CCyB was intended to help banks maintain their critical financial intermediation function and to deal with possible loan losses resulting from the COVID-19 pandemic, confirming the broad-based focus of the measure.

e) Using other measures

In January 2020, NBB/BNB introduced supervisory expectations regarding sound credit standards in mortgage lending.[19] Issued in response to the ESRB Recommendation of September 2019, these borrower-based measures target the flow of new mortgage loans, whereas the current Article 458 measure is designed to ensure there is sufficient capital against the stock risks in banks' RRE mortgage portfolios. Both measures are therefore complementary.

The supervisory expectations regarding sound credit standards in mortgage lending may, in the medium term, improve credit quality, thereby limiting any additional build-up of credit risk in future mortgage portfolios. However, even if credit standards remain in line with the supervisory expectations, they will contribute to a steady but only gradual reduction of the stock risks in banks' existing portfolios. For this reason, the proposed measure is still considered to be necessary to address the risks related to the stock of mortgages already on the bank's balance sheet, unless these risks start to materialise, in which case NBB/BNB stands ready to discontinue the measure.

Section 4: Analysis of the net benefits of the measure

4.1 Effects on financial stability, financial system resilience and economic growth

The proposed extension of the measure is expected to contribute to the resilience of the Belgian banking system, thereby potentially enhancing the resilience of the economy as a whole. Given the growing size of residential mortgage loan portfolios on the balance sheets of Belgian credit institutions (around 20% of total assets and 415% of CET1 capital), a severe downturn in the Belgian RRE market could have a substantial impact on Belgian credit institutions' solvency positions. Banks would be particularly affected, not only because of their direct exposure to mortgages, but also indirectly owing to the high indebtedness of Belgian households. This would, in turn, bring about unfavourable consequences for the Belgian real economy. As experienced in other countries, the stress could also spill over to the CRE market, with second round effects on financial stability.

The targeted nature of the measure enhances its proportionality by aiming to avoid spillovers to overall credit extension and the real economy, particularly under the current conditions of economic uncertainty. The measure only targets exposures secured by RRE. NBB/BNB has not seen any signs that the measure currently in place and proposed for extension has had a strong impact on overall credit supply (in terms of either pricing or volume) or, indirectly, on the real economy.

---

19 Circular NBB_2019_27 – Expectations of the Belgian macroprudential authority on internal management of Belgian mortgage credit standards as applied by banks and insurance undertakings operating in the Belgian residential property market, and Annex 1 to circular NBB_2019_27.

The risk sensitivity of the measure also enhances its proportionality. The measure combines an add-on that affects all banks equally with a risk multiplier that seeks to adjust the impact of the measure to the risk profile of the banks' portfolios. NBB/BNB considers the microprudential risk weight obtained from internal models to reflect the risk profile and credit quality of borrowers.[20] For this reason, it believes that banks with lower risk weights contribute less to the overall build-up of systemic risk and should therefore be subject to a lower requirement in respect of their risk weight increase. This is irrespective of the macroprudential concerns that justify the use of the measure, i.e. concerns that current levels of risk weights do not reflect developments in all macro-financial risks and vulnerabilities that have been building up in recent years.

Macroprudential stress tests show that banks' expected mortgage loan losses could surge in an adverse scenario. The calibration of the current measure was based on the severe (macroprudential) stress scenario in the original 2018 notification. This scenario allows for the possibility of severe downturns in the Belgian RRE market and remains meaningful and sufficiently severe, even in the current circumstances of the COVID-19 pandemic, according to NBB/BNB. At the same time, it is worth mentioning that according to NBB/BNB, no scenario would currently lead them to recalibrate the measure upwards, considering the procyclical effects such an action might have. An update of the sensitivity/scenario analysis performed indicates that, on the one hand, microprudential capital requirements (implied by microprudential risk weights) remain insufficient to cover all potential (macroprudential) losses under severe (macroprudential) stress scenarios and, on the other hand, the current macroprudential measure (with the original calibration) is sufficient to cover the simulated losses, at the sector level. At the level of individual institutions, the distribution of losses projected under the stress scenario corresponds to the differences in capital buffers implied by the measure. This confirms the previous conclusion that mortgage loans with higher risk weights tend to be associated with greater risks, and hence confirms the appropriateness of the measure in place.

The resilience of Belgian banks to adverse developments in the Belgian RRE market is crucial to financial stability. Residential mortgage loan portfolios represent a significant share of banks' balance sheets (around 20% of total assets and 415% of CET1 capital), so it is important to ensure banks are resilient. The total impact of the proposed measure on IRB banks' CET1 capital is estimated at €2,056 million, which is equivalent to approximately 3.72% of IRB banks' total CET1 capital. This is more than the additional CET1 capital the IRB banks had to hold in 2018, when the measure was first introduced (€1,486 million), and in 2020, when the measure was first extended (€1,802 million), reflecting the growing size of the exposures of Belgian IRB banks to the RRE market.

In the event that RRE risks start to materialise, NBB/BNB stands ready to discontinue the measure and, in this way, release the capital accumulated through the measure. With regard to the conditions that would

[20] NBB/BNB found cross-sectional evidence of a strong correlation between the banks' risk weights and risk parameters (such as probability of default) and the share of risky loans (in terms of LTV, DSTI or maturity).

justify such a release, NBB/BNB issued forward guidance on 1 July 2020[21], specifying that the measure would be discontinued if banks started to incur substantial losses in the event of rising defaults or significant amounts of debt restructuring, or if further developments exerted long-term pressure on banks' profitability. However, the exact modalities of the release would be based on specific market developments. In the meantime, NBB/BNB is monitoring the materialisation of credit risk very closely. Information from the Central Credit Register, which facilitates the early detection of default developments, has been complemented by additional regulatory reports at the beginning of the crisis, including the monitoring of the payment arrears.

4.2 Cross-border effects and the impact on the Internal Market

NBB/BNB does not expect the measure to have a significant negative impact on the EU Internal Market. Since the current measure was first implemented, NBB/BNB has not observed any signs of a negative impact on the Internal Market that would outweigh the financial stability benefits resulting from a reduction of the macroprudential or systemic risk identified. Neither does it expect this observation to change during the additional one-year period of extension of the measure. Furthermore, in view of the importance of cross-border banking groups in Belgium and the degree of openness of the Belgian economy, safeguarding financial stability in Belgium will also have positive effects on financial stability in Europe.

Belgium requested reciprocation of the existing measures by other Member States under Article 458(8) of the CRR and the General Board of the ESRB decided to recommend reciprocation.[22] The ESRB's recommendation for reciprocation of the existing measure will continue to apply to the measure in its extended form. NBB/BNB emphasised that this reciprocity remains relevant given the systemic nature of the risks identified and the international character of the Belgian banking sector. In particular, the banking sectors of other Member States may – now or in the future – be exposed directly or indirectly through their branches to the risks related to the RRE market in Belgium.

4.3 Domestic cross-sector effects and regulatory arbitrage

As the ESRB has emphasised, it is important to ensure that stricter measures in one part of the financial system are not circumvented by the transfer of exposures to other financial intermediaries. In countries such as Belgium in particular, where non-banks' share of mortgage loans is not insignificant, the close monitoring of developments is paramount.

---

21 See Financial Stability Report 2020, Nationale Bank van België/Banque Nationale de Belgique, Brussels, 1 July 2020.

22 See **Recommendation ESRB/2018/5 of 16 July 2018 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures**.

NBB/BNB has not detected any substantial leakage to the non-banking sector stemming from the current measure, but will continue to monitor the situation closely. The current measure has not led to the detection of any substantial leakage to the non-banking sector. However, following the extension of the current macroprudential measure, the impact on other sectors of the financial system will continue to be closely monitored, particularly with regard to insurance companies. This is especially warranted, as capital requirements are lower for part of the exposures for insurance companies and therefore there is a risk of leakages in the context of financial conglomerates in Belgium.

Conclusions

The ESRB supports NBB/BNB's intention to extend the period of application of its current macroprudential measure and to keep risk weights for IRB banks' exposures to the Belgian RRE sector at a higher level. The extension of the measure is necessary to maintain the resilience of Belgian IRB banks to potentially severe downward corrections in RRE markets in Belgium.

The assessment is based on the view that the systemic risks identified when the measure was first introduced still persist. In 2019, the ESRB assessment of medium-term vulnerabilities in the RRE sector in Belgium concluded that: (i) house price growth had decelerated but the previous dynamics still gave rise to concerns about potential overvaluation; (ii) strong growth in housing credit had continued to fuel household indebtedness; and (iii) a significant share of mortgage loans continued to be granted households that were potentially vulnerable to adverse economic or financial conditions or adverse developments in the RRE market. In the assessment, the ESRB also acknowledged that IRB banks' average risk weights for RRE portfolios, without taking into account the macroprudential measure in place, were relatively low by cross-country comparison. Since then, IRB banks' microprudential risk weights for RRE portfolios have remained broadly unchanged, while some of the vulnerabilities related to the RRE markets have continued to increase.

The ESRB is of the view that the proposed extension of the measure will not have any procyclical effects on the real economy and the financial system. Even though the COVID-19 pandemic has increased the probability of systemic risks materialising in the forthcoming quarters, the potential materialisation of RRE risks is conditional on the further economic impact of the pandemic. For this reason, it would not be appropriate to prematurely release the capital accumulated through the measure, i.e. before the risks targeted by the current measure have potentially materialised. Against this backdrop the decision to lower, from March 2020, the CCyB to 0% may help to facilitate the provision of credit to all sectors. Finally, clear communication from NBB/BNB with regard to releasing the capital buffers in times of crisis has been very important and has helped to anchor expectations in the market.

The ESRB is also of the view that the alternative macroprudential instruments listed in Article 458 of the CRR, which must be considered before any stricter national measure can be implemented, would not be adequate to address the risks identified. The sSyRB, which has recently become available to the macroprudential authorities, represents a close alternative to the current measure under Article 458 of the CRR.

However, its application would imply upward changes to capital requirements for some institutions, which could cause disruption in the current context. On the other hand, for other institutions replacing the existing measure by a sSyRB would lead to an easing of capital requirements, which could result in capital reductions. Both of these effects should be avoided in the current situation of economic uncertainty.

The ESRB is also of the view that the introduction of borrower-based measures through supervisory expectations from January 2020 does not constitute a reason for terminating or downwardly recalibrating the measure under Article 458 of the CRR. While the measure aims to address the systemic risks which have already accumulated in banks' mortgage portfolios, the borrower-based measures apply to the flow of new loans and therefore they may contribute only gradually to the reduction of these existing risks. Until there have been noticeable improvements in this respect, both types of measure should be regarded as complementary.

The ESRB is therefore of the view that the stricter measure is justified, suitable, proportionate, effective and efficient for the purpose mentioned above. This assessment has been produced for the specific purposes of the procedure set out in Article 458 of the CRR and does not prejudge the outcome of the review of the Recommendation of 27 June 2019.