

## I

*(Resolutions, recommendations and opinions)*

## RECOMMENDATIONS

## EUROPEAN SYSTEMIC RISK BOARD

## RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

**of 1 December 2022**

**on vulnerabilities in the commercial real estate sector in the European Economic Area**

**(ESRB/2022/9)**

(2023/C 39/01)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to the Agreement on the European Economic Area <sup>(1)</sup>, in particular Annex IX thereof,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board <sup>(2)</sup>, and in particular Article 3(2)(b) and (d) and Articles 16 and 18 thereof,

Having regard to Decision ESRB/2011/1 of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board <sup>(3)</sup>, and in particular Article 18 to 20 thereof,

Whereas:

- (1) The commercial real estate (CRE) sector is important for financial stability in the European Economic Area (EEA). In some EEA countries, exposures to the CRE sector (hereinafter 'CRE exposures') represent a significant share of gross domestic product, as well as of credit institutions' and other financial institutions' balance sheets. CRE has strong interconnections with both the real economy and the financial system. In addition, the sector is important to many financial market actors, such as investment funds, insurance undertakings, pension funds and credit institutions. Adverse developments in the CRE sector can have a systemic impact on both the real economy and the financial system.
- (2) Vulnerabilities related to CRE exposures may vary between different CRE sub-sectors and segments. The European Systemic Risk Board (ESRB), in its assessment of vulnerabilities related to CRE in EEA countries, distinguishes primarily between the industrial, office, retail and residential CRE sub-sectors, and the prime and non-prime CRE segments. Furthermore, the nature of the vulnerabilities varies between the EEA countries, due to, inter alia, the

<sup>(1)</sup> OJ L 1, 3.1.1994, p. 3.

<sup>(2)</sup> OJ L 331, 15.12.2010, p. 1.

<sup>(3)</sup> OJ C 58, 24.2.2011, p. 4.

differences in importance of the respective CRE sub-sectors and segments in those countries. This ESRB Recommendation is addressed to relevant authorities at European Union and national level in all EEA countries as they are best positioned to analyse the importance of the respective CRE sub-sectors and segments, and the related risks to financial stability, including the risk of spillovers from other countries.

- (3) The ESRB has been monitoring the CRE sector closely on a continuing basis and, in 2016, issued a recommendation on closing real estate data gaps <sup>(4)</sup>. In addition, the ESRB has published reports in 2015 and 2018 on vulnerabilities in the EU CRE sector, <sup>(5)</sup> and has also provided concrete guidance for a consistent assessment of systemic risks that may stem both from developments in the CRE markets and from related macroprudential policies <sup>(6)</sup>. In its recent report on vulnerabilities in the EEA CRE sector <sup>(7)</sup>, the ESRB identified vulnerabilities in the EEA CRE sector as well as potential policy actions to address them. Additionally, in September 2022 the ESRB issued Warning ESRB/2022/7 of the European Systemic Risk Board on vulnerabilities in the Union financial system <sup>(8)</sup>. Without neglecting the overriding importance of other sources of systemic risk highlighted in Warning ESRB/2022/7, the ESRB acts in accordance with its mandate by issuing a recommendation that identifies CRE-related systemic risks and specifies the remedial actions to be taken in response to those systemic risks.
- (4) The CRE sector is currently vulnerable to materialisation of cyclical risks in relation to heightened inflation and the pronounced deterioration in the growth outlook following the Russian invasion of Ukraine, as well as other geopolitical tensions. Generally, cycles in the CRE sector have larger amplitudes than overall economic cycles. Decreasing property values and rental income streams may incentivise investors to sell CRE assets, adding further downward pressure on CRE asset prices and possibly resulting in negative effects on financial stability. Moreover, a tightening of financial conditions may reduce the income of CRE companies and the value of their properties. This means that the scope they have to refinance existing debt and to take new loans may be severely limited. This, in turn, may force some investors to sell properties to meet maturing debt obligations and liquidity needs, even under stressed market conditions, thereby adding further downward pressure on prices.
- (5) Vulnerabilities related to structural changes include the impact of climate-related economic policies and the shift towards e-commerce in the CRE market. Moreover, the COVID-19 pandemic has accelerated the demand for flexibility in leasable office space as mobile and hybrid working models have expanded. These structural changes increase demand for energy-efficient properties and logistics facilities, such as large warehouses, while they reduce the demand for retail, offices and, more generally, non-prime CRE.
- (6) Credit institutions are particularly exposed to the CRE sector via credit risk on CRE loans. Available data suggest that bank lending in the CRE sector occurs at high loan-to-value (LTV) ratios in several EEA countries. If the value of the loan collateral decreases, the LTV ratio increases. This would increase credit institutions' loss-given-default ratios, potentially leading to higher provision and capital requirements, and could therefore limit the ability of credit institutions to maintain credit supply. Even where LTV ratios are low, aggregate information might mask other risky characteristics such as the prevalence of bullet repayment schemes, non-recourse structures, unhedged variable interest rates or very long maturities, which could be significant in some cases.

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<sup>(4)</sup> Recommendation ESRB/2016/14 of the European Systemic Risk Board of 31 October 2016 on closing real estate data gaps (OJ C 31, 31.1.2017, p. 1). Recommendation ESRB/2016/14 has been amended by Recommendation ESRB/2019/3 of the European Systemic Risk Board of 21 March 2019 amending Recommendation ESRB/2016/14 on closing real estate data gaps (OJ C 271, 13.8.2019, p. 1).

<sup>(5)</sup> See Report on commercial real estate and financial stability in the EU, ESRB, December 2015; see Report on vulnerabilities in the EU commercial real estate sector, ESRB, November 2018. Both reports are available on the ESRB website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

<sup>(6)</sup> See Methodologies for the assessment of real estate vulnerabilities and macroprudential policies: commercial real estate, ESRB, December 2019, available on the ESRB website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

<sup>(7)</sup> See Vulnerabilities in the EEA commercial real estate sector, ESRB, December 2022, available on the ESRB website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

<sup>(8)</sup> Warning ESRB/2022/7 of the European Systemic Risk Board of 22 September 2022 on vulnerabilities in the Union financial system (OJ C 423, 7.11.2022, p. 1).

- (7) With regard to the banking sector, the European Central Bank (ECB) has highlighted concerns about lending standards, collateral valuation and monitoring processes for the Single Supervisory Mechanism in an interim report on CRE exposures <sup>(9)</sup>.
- (8) One of the vulnerabilities for the non-banking sector is liquidity mismatches in open-ended real estate investment funds. This liquidity mismatch occurs when such funds offer redemption periods to their investors that are shorter than the period necessary to liquidate at current market prices the real estate assets that the fund has invested in. Real estate investment funds generally are also at risk of an asset price correction if the frequency of valuation is too low and there are incentives to overvalue property, particularly in a market where prices are already decreasing. This can, in turn, lead to cliff effects in asset redemptions.
- (9) Risks related to pension funds and insurance undertakings in CRE markets could differ significantly across jurisdictions, reflecting both different business models and practices as well as different market structures. Understanding the risks related to pension funds and insurance undertakings in CRE markets and the potential liquidity mismatches between their funding and investments in CRE markets, including where those are conducted through investments funds, is a prerequisite to addressing risks in the CRE sector for this segment of the market.
- (10) A materialisation of risks in the CRE sector would also negatively affect the credit rating of securitisations that pool CRE loans and are held by credit institutions or other market participants. Vulnerabilities arising from CRE securitisations relate to the underlying credit quality of securitised loans, as well as to the concentrations of investors and of borrowers and their interconnectedness.
- (11) Spillovers across financial markets and countries can amplify vulnerabilities, thus increasing risks of contagion across sectors or countries. In this regard, the exchange of information is considered necessary to improve the monitoring and analysis of potential sources of systemic risks. The ESRB could support the exchange of information that is deemed necessary for monitoring vulnerabilities related to CRE.
- (12) European Union and EEA countries' national supervisory authorities in the banking and non-banking financial sectors can contribute to the resilience of the EEA's financial sector by monitoring, identifying, and addressing CRE-related vulnerabilities of the institutions under their remit, in close collaboration with each other. Monitoring the vulnerabilities related to the CRE sector is key to identifying potential risks to financial stability and to assessing possible responses to address these risks. Such monitoring could also build on and further develop the assessments referred to in Article 124(2) and 164(6) of Regulation (EU) No 575/2013 of the European Parliament and of the Council <sup>(10)</sup>. National supervisory authorities need to stay vigilant to either materialising CRE-related risks or, on the contrary, to a further build-up of vulnerabilities in the EEA CRE sector. In monitoring vulnerabilities, authorities should differentiate across CRE sub-sectors and segments.
- (13) Recommendation ESRB/2016/14 on closing real estate data gaps <sup>(11)</sup> highlighted that there are severe data gaps and a lack of common data definitions affecting CRE markets across the EEA. Data availability and quality has significantly improved since Recommendation ESRB/2016/14 was issued. Although the implementation of final

<sup>(9)</sup> The report found that, generally, credit institutions did not perform sufficient sensitivity analyses on CRE exposures, especially to measure the potential impact of an increase in interest rates and other costs driven by higher inflation. As a result, the debt-servicing capacity of some borrowers may not be as robust as credit institutions had originally assumed. See ECB Supervision Newsletter, Commercial real estate: connecting the dots, 17 August 2022, available on the ECB's Banking Supervision website at [www.bankingsupervision.europa.eu](http://www.bankingsupervision.europa.eu).

<sup>(10)</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

<sup>(11)</sup> Recommendation ESRB/2016/14 of the European Systemic Risk Board of 31 October 2016 on closing real estate data gaps (OJ C 31, 31.1.2017, p. 1).

parts of Recommendation ESRB/2016/14 is due by 31 December 2025, the Recommendation should guide relevant authorities in their monitoring of CRE-related risks. It should not prevent relevant authorities from undertaking additional monitoring efforts regarding CRE markets using all available data <sup>(12)</sup>.

- (14) When determining the frequency of monitoring, relevant authorities should consider the principle of proportionality, the potential risks to financial stability arising from the CRE market and from the size of financial institutions' exposures to different CRE sub-sectors and market segments.
- (15) Policy actions taken by relevant authorities, with a view, inter alia, to implement this Recommendation, should take into account the results of the forward-looking monitoring carried out in order to prevent systemic risks from the CRE sub-sectors from materialising. In particular, when calibrating and deciding on phasing-in, relevant authorities should take into account the position of the respective EEA country in the economic and financial cycles. Furthermore, appropriate policy action should differentiate across CRE sub-sectors and segments where feasible.
- (16) Appropriate policy action to address risks in the CRE sector needs to balance several considerations, including the overall economic developments and potentially diverging dynamics across CRE sub-sectors and segments. The credit quality of CRE portfolios needs to be monitored and adequate provisioning is necessary for categories of loans that could be negatively impacted by changes in the CRE market, or by adverse economic and financial developments. Should vulnerabilities continue to build up, it is important to further ensure sound lending and investment practices with respect to the CRE sector, complemented by potential macroprudential policy actions. Capital-based measures and other macroprudential measures are already available to EEA countries either pursuant to national or Union law <sup>(13)</sup>, offering some macroprudential measures to address CRE-related risks in the bank, investment fund, pension fund and insurance sector. Reciprocating measures by national authorities in different EEA countries should be considered for any macroprudential policy action in order to ensure the effectiveness of national macroprudential measures and prevent the shifting of systemic risk from one jurisdiction to another.
- (17) To reflect the heterogeneous nature of CRE markets, risk weight measures, as well as sectoral systemic risk buffers could be considered to increase the resilience of the banking system in the presence of systemic risks.
- (18) Regarding policy measures with regard to the investment fund sector, macroprudential leverage limits and reducing the liquidity mismatch in the sector (as recommended in Recommendation ESRB/2020/4 of the European Systemic Risk Board on liquidity risks in investment funds <sup>(14)</sup>) could be considered to address the identified vulnerabilities, while reflecting country specificities. Recommendation ESRB/2017/6 of the European Systemic Risk Board on liquidity and leverage risks in investment funds <sup>(15)</sup> is designed to facilitate the implementation of Article 25 of Directive 2011/61/EU, which provides for a macroprudential tool to limit leverage in alternative investment funds.

<sup>(12)</sup> In this context, the Council of the European Union also encouraged the European Statistical System and the European System of Central Banks to improve commercial real estate indicators; see Council press release of 8 November 2022, 'Council adopted conclusions on statistics', available on the Council website at [www.consilium.europa.eu](http://www.consilium.europa.eu).

<sup>(13)</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1); Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1); Regulation (EU) No 575/2013; 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, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>(14)</sup> Recommendation ESRB/2020/4 of the European Systemic Risk Board of 6 May 2020 on liquidity risks in investment funds (OJ C 200, 15.6.2020, p. 1).

<sup>(15)</sup> Recommendation ESRB/2017/6 of the European Systemic Risk Board of 7 December 2017 on liquidity and leverage risks in investment funds (OJ C 151, 30.4.2018, p. 1).

- (19) While borrower-based measures are available in most EEA countries to mitigate systemic risks related to residential real estate markets, only a few EEA countries have borrower-based measures available to address systemic risks related to CRE markets. The concept and design of borrower-based measures for CRE-related risks are still under discussion in various fora, and a common view on the design of such borrower-based measures has not yet been established. In this context, the feasibility of borrower-based measures for CRE at EU level should be assessed further. Where and if such borrower-based measures are available at the national level, relevant authorities at national level, faced with a combination of strong real estate price growth and credit dynamics as well as eroding credit standards, should consider the appropriateness of such instruments. If deemed necessary and feasible national relevant authorities should also complement borrower-based measures with other measures to ensure resilience of financial institutions and to address CRE-related vulnerabilities.
- (20) In order to ensure consistent treatment of certain risks across the financial system, the ESRB considers after comprehensive analysis and discussion, the introduction of activity-based tools desirable. As such, macroprudential tools could cover both credit institutions and non-banking financial institutions if they are designed to be activity-based tools. These would complement existing entity-based regulation.
- (21) Any macroprudential policy action should aim to avoid procyclical effects on the real economy and other segments of the financial sector,

HAS ADOPTED THIS RECOMMENDATION:

## SECTION 1

### RECOMMENDATIONS

#### **Recommendation A – Improving the monitoring of systemic risks stemming from the CRE market**

It is recommended that relevant authorities that have a role in financial stability:

1. closely monitor current and potentially emerging vulnerabilities related to commercial real estate (CRE), inter alia by:
  - assessing the cyclical stage of CRE markets and their outlook, taking into account the impact of financing conditions and the general macroeconomic outlook;
  - assessing CRE-related vulnerabilities across different risk categories or stretches<sup>(16)</sup>, including, for example, monitoring of:
    - (a) risks related to CRE prices (collateral stretch);
    - (b) risks related to the income flows generated by CRE and investment activity on the CRE sector (income and activity stretch);
    - (c) risks stemming from financing conditions and sources of CRE financing, including implications of CRE securitisations, if relevant from a financial stability perspective, (financing stretch);
    - (d) risks stemming from interconnectedness between economic and financial sectors in relation to CRE, as well as from cross-border CRE investment and financing (spillover stretch);
  - complementing the monitoring of systemic risk with an assessment of country-specific indicators including structural features.
2. monitor risks in the CRE markets under Recommendation A(1) on a regular basis but at least annually. In accordance with the principle of proportionality, the frequency of monitoring risks should be based on the relative size and importance of exposures.

<sup>(16)</sup> See ESRB 'Methodologies for the assessment of real estate vulnerabilities and macroprudential policies: commercial real estate', December 2019, available on the ESRB website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

3. closely coordinate and cooperate with each other and the European Systemic Risk Board (ESRB) in monitoring vulnerabilities related to CRE when fulfilling the risk monitoring under Recommendation A(1). Such coordination and cooperation should include exchange of information deemed necessary for the monitoring of vulnerabilities related to CRE, in particular in the context of cross-country and cross-sectoral spillovers. Exchange of information should be done on a best effort basis supported by the ESRB within the legal frameworks of different jurisdictions.

### **Recommendation B – Ensuring sound CRE financing practices**

It is recommended that, taking into account the results of the forward-looking monitoring carried out pursuant to Recommendation A, supervisory authorities should, within their respective mandates and by having recourse to the instruments at hand, ensure that financial institutions providing financing for CRE have prudent risk management practices in place through measures that could potentially include:

- regular assessments of the quality of the existing CRE loans and investments, in particular with respect to the debt-servicing capacity of the borrowers and the collateral values;
- prudent lending standards for new loans to be provided;
- adequate provisioning practices;
- proactive and regular adjustment of capital projections under baseline and adverse scenarios;
- adequate reflection of the risks identified;
- heeding supervisors' guidance and expectations.

### **Recommendation C – Increasing resilience of financial institutions**

Relevant authorities, within their respective mandates, while taking into account the results of the forward-looking monitoring carried out pursuant to Recommendation A and the tools at their disposal that are designed to address the risks identified, should continue to ensure that risks and vulnerabilities related to the CRE sector are adequately addressed. Subject to the identified risks being material and the identified exposures being considered as potential sources of risk to financial stability, relevant authorities should take further macroprudential action as deemed feasible, appropriate and efficient, while avoiding overlaps between different macroprudential and microprudential tools for targeting similar CRE-related risks.

For this purpose, it is recommended that:

1. where CRE-related exposures held by credit institutions are material, designated authorities entrusted with the activation of capital-based measures or other macroprudential measures ensure the resilience of credit institutions authorised in the respective EEA countries by activating appropriate capital-based measures deemed necessary to mitigate risks to financial stability stemming from the CRE sector;
2. where CRE-related exposures held by investment funds are material, supervisory authorities, within their respective mandates, promote the resilience of investment funds authorised in the respective EEA countries and mitigate vulnerabilities in the CRE sector as a source of risk to financial stability by considering measures that could potentially include:
  - an assessment of the risks arising from liquidity mismatch in the investment fund sector with respect to CRE market investment and lending; requiring, where appropriate and available, the use of appropriate liquidity management tools to ensure sound liquidity management for safeguarding financial stability and ensuring structural alignment between fund redemption terms and liquidity of underlying assets;
  - an assessment of the risks arising from leverage in the investment fund sector with respect to CRE investment and lending, in particular, by using, where appropriate, leverage limits for investment funds investing in CRE markets in accordance with Article 25 of Directive 2011/61/EU;

3. where CRE-related held by insurance undertakings are material, supervisory authorities, within their respective mandates, ensure the resilience of insurance undertakings authorised in the respective EEA countries and mitigate vulnerabilities in the CRE sector as a source of risk to financial stability by considering measures that could potentially include:
  - an assessment of how CRE risks are accounted for, in terms of capital requirements, investment rules and risk management, by insurance undertakings when investing in CRE through investment funds;
  - an assessment of the method how collateral for CRE investments is considered, in particular when computing solvency capital requirements;
  - an assessment of the extent to which CRE exposures in the form of equity or debt, including through opaque financing structures, reflect the true CRE exposures of insurance undertakings;
4. where CRE-related exposures held by pensions funds are material, supervisory authorities, within their respective mandates, ensure the resilience of pension funds authorised in the respective EEA countries and mitigate vulnerabilities in the CRE sector as a source of risk to financial stability;
5. relevant authorities at the respective national level consider the appropriateness of borrower-based measures, provided that such instruments are available at the respective national level, if deemed necessary and feasible to complement other measures to ensure resilience of financial institutions and to ensure sound lending practises.

#### **Recommendation D – Development of activity-based tools for CRE in the Union**

It is recommended that the European Commission assesses the current macroprudential framework in the European Union and ensures that consistent rules for addressing risks related to CRE exposures are applied across all financial institutions when they perform the same activities, taking into account their specificities and specific risk profiles. In this regard, the Commission should, inter alia propose, if deemed necessary based on its assessment, Union legislation that complements the existing entity-specific macroprudential tools with activity-based macroprudential tools to help address CRE vulnerabilities effectively and to avoid regulatory arbitrage and the shifting of risks between banking and non-banking sectors.

### SECTION 2

#### IMPLEMENTATION

##### 1. Definitions

For the purposes of this Recommendation the following definitions apply:

- (a) 'commercial real estate (CRE)' means commercial real estate as defined in Section 2(1)(1), point (4) of Recommendation ESRB/2016/14;
- (b) 'relevant authorities' means:
  - (i) supervisory authorities;
  - (ii) national macroprudential authorities;
  - (iii) designated authorities;
- (c) "relevant authorities that have a role in financial stability" means relevant authorities mandated to contribute to the prevention or mitigation of systemic risks to financial stability in the Union or in an EEA country;
- (d) 'supervisory authority' means:
  - (i) the ECB for the tasks conferred on it in accordance with Articles 4(1), 4(2) and 5(2) of Council Regulation (EU) No 1024/2013 <sup>(17)</sup>;
  - (ii) the European Supervisory Authorities;

<sup>(17)</sup> 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).

- (iii) the national supervisory authorities for credit institutions;
- (iv) the national supervisory authority for alternative investment fund managers and undertakings for collective investment in transferable securities;
- (v) the national supervisory authorities for insurance undertakings;
- (vi) the national supervisory authorities for pension funds;
- (e) 'European Supervisory Authorities' means the European Supervisory Authority (European Banking Authority) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council <sup>(18)</sup>, together with the European Supervisory Authority (European Insurance and Occupational Pensions Authority) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council <sup>(19)</sup> and the European Supervisory Authority (European Securities and Markets Authority) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council <sup>(20)</sup>;
- (f) 'national supervisory authority for credit institutions' means a competent or supervisory authority in an EEA country as defined in Article 4(1), point (40) of Regulation (EU) No 575/2013 and in Article 3(1), point (36) of Directive 2013/36/EU;
- (g) 'national supervisory authority for alternative investment fund managers and undertakings for collective investment in transferable securities' means a competent authority in an EEA country as defined in Article 4(1), point (f) of Directive 2011/61/EU and Article 2(1), point (h) of Directive 2009/65/EC of the European Parliament and of the Council <sup>(21)</sup>;
- (h) 'national supervisory authorities for insurance undertakings' means a supervisory authority in an EEA country as defined in Article 13, point (10) of Directive 2009/138/EC;
- (i) 'national supervisory authorities for pension funds' means a competent authority in an EEA country as defined in Article 6, point (8) of Directive (EU) 2016/2341 of the European Parliament and of the Council <sup>(22)</sup>;
- (j) 'national macroprudential authority' means a national authority with the objectives, arrangements, tasks, powers, instruments, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 of the European Systemic Risk Board <sup>(23)</sup>;
- (k) 'designated authority' means a designated authority in accordance with Chapter 4 of Title VII of Directive 2013/36/EU, and in accordance with Article 124(1a), Article 164(5) and Article 458(1) of Regulation (EU) No 575/2013;
- (l) 'market intelligence' means a source of information for assessing systemic risks and includes information gained from meetings with market contacts and from regular analysis of market analyst reports;
- (m) 'credit institution' means a credit institution as defined in Article 4(1), point (1) of Regulation (EU) No 575/2013;

<sup>(18)</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

<sup>(19)</sup> Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Investment and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

<sup>(20)</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

<sup>(21)</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

<sup>(22)</sup> Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (OJ L 354, 23.12.2016, p. 37).

<sup>(23)</sup> Recommendation ESRB/2011/3 of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (OJ C 41, 14.2.2012, p. 1).



- (n) 'investment fund' means an investment fund as defined in Article 4(1), point (a) of Directive 2011/61/EU and undertakings for collective investment in transferable securities as defined in Article 1(2) of Directive 2009/65/EC;
- (o) 'insurance undertaking' means an insurance undertaking as defined in Article 13, point (1) and reinsurance undertakings as defined in Article 13, point (4) of Directive 2009/138/EC;
- (p) 'pension fund' means a pension scheme arrangement as defined in Article 2, point (10) of Regulation (EU) No 648/2012 of the European Parliament and of the Council <sup>(24)</sup> and an institution for occupational retirement provision as defined in Article 6, point (1) of Directive (EU) 2016/2341;
- (q) 'financial institution' means credit institutions, investment funds, insurance undertakings and pension funds;
- (r) 'leverage' means any method by which an investor increases its exposure over and above the assets of the fund whether through the borrowing of cash or securities or leverage embedded in derivative positions or by any other means;
- (s) 'capital-based measures' means any own funds requirements imposed on a credit institution to prevent and/or mitigate systemic risk as defined in Article 2, point (c) of Regulation (EU) No 1092/2010, including, under Articles 124, 164 or 458 of Regulation (EU) No 575/2013 or Chapter 4 of Title VII of Directive 2013/36/EU, such as the countercyclical capital buffer or the sectoral systemic risk buffer;
- (t) 'other macroprudential measures' means any macroprudential measure other than capital-based measures and that is available to European Economic Area (EEA) countries either through national or Union law and may include also non-legally binding measures such as warnings and recommendations;
- (u) 'activity-based tools' means a dedicated macroprudential framework that includes consistent rules across all financial institutions when they perform the same activities, while taking account of their specific risk profiles;
- (v) 'borrower-based measures' means macroprudential measures that target borrowers;
- (w) 'securitised loans' means a securitisation as defined in Article 2, point (1) of Regulation (EU) 2017/2402 of the European Parliament and of the Council <sup>(25)</sup> with CRE loans as underlying assets;
- (x) 'bullet loans' means non-amortising loans where the principal, in some cases including the interest, is due at maturity.

## 2. Criteria for implementation

1. The following criteria apply to the implementation of this Recommendation:

- (a) due regard should be paid to the principle of proportionality, taking into account the objective and content of Recommendation A, Recommendation B, Recommendation C and Recommendation D, in particular, with regard to implementing any recommended actions in response to the risks monitored under Recommendation A;
- (b) regulatory arbitrage should be avoided;
- (c) when monitoring financing of CRE under Recommendation A relevant authorities should distinguish between flows and stocks of CRE loans and financing;
- (d) when ensuring sound financing practices under Recommendation B relevant authorities should distinguish between flows and stocks of CRE loans and financing;

<sup>(24)</sup> Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

<sup>(25)</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).

- (e) when activating capital-based measures or other macroprudential instruments under Recommendation C, their calibration and phasing-in should take into account the position of the respective EEA country in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
  - (f) specific criteria for compliance with this Recommendation are set out in the Annex.
2. Addressees are requested to report to the Council and to the ESRB on the assessments and conclusions drawn from the monitoring under Recommendation A as well as on the actions undertaken in response to this Recommendation, or adequately justify any inaction. The reports should as a minimum contain:
- (a) information on the substance and timeline of the actions undertaken;
  - (b) a detailed justification of any inaction or departure from this Recommendation, including any delays.

### 3. Timeline for the follow-up

In accordance with article 17(1) of Regulation (EU) No 1092/2010, the addressees must communicate to the European Parliament, the Council, the Commission and to the ESRB the actions undertaken in response to this Recommendation or substantiate any inaction. The addressees are requested to submit such communication in compliance with the following timelines:

#### 1. Recommendation A – Improving the monitoring of systemic risks stemming from the CRE market

By 31 March 2024 and by 31 March 2026, the addressees of Recommendation A are requested to submit to the European Parliament, the Council, the Commission and to the ESRB a report on any actions taken, assessments carried out and conclusions reached with regard to Recommendation A. Where there is more than one relevant authority per EEA country responsible for taking actions to comply with Recommendation A, one joint report per EEA country should be submitted.

#### 2. Recommendation B – Ensuring sound CRE financing practices

By 31 March 2026, the addressees of Recommendation B are requested to submit to the European Parliament, the Council, the Commission and to the ESRB a report on any actions taken with regard to Recommendation B. Where there is more than one body per EEA country responsible for taking actions to comply with Recommendation B, one joint report per EEA country should be submitted.

#### 3. Recommendation C – Increasing resilience of financial institutions

By 31 March 2026, the addressees of Recommendation C are requested to submit to the European Parliament, the Council, the Commission and to the ESRB a report on any actions taken with regard to Recommendation C. Where there is more than one body per EEA country responsible for taking actions to comply with Recommendation C, one joint report per EEA country should be submitted.

#### 4. Recommendation D – Development of activity-based tools for CRE in the Union

By 31 December 2026, the Commission is requested to submit to the European Parliament, the Council and to the ESRB a report on any actions taken with regard to Recommendation D.

### 4. Monitoring and assessment

1. The ESRB Secretariat will:
- (a) assist the addressees, ensuring the coordination of reporting and the provision of relevant templates, and detailing where necessary the procedure and the timeline for the follow-up;
  - (b) verify the follow-up by the addressees, provide assistance at their request, and submit follow-up reports to the General Board.

2. The General Board will assess the actions and justifications communicated by the addressees and, where appropriate, may decide that this Recommendation has not been followed and that the addressee has failed to provide adequate justification for its inaction.

Done at Frankfurt am Main, 1 December 2022.

*The Head of the ESRB Secretariat,  
on behalf of the General Board of the ESRB*  
Francesco MAZZAFERRO

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## ANNEX

**SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATION****Recommendation A – Improving the monitoring of systemic risks stemming from the CRE market**

The following compliance criteria are applicable to Recommendation A.

1. The risk monitoring should be done on best-effort basis. Whenever possible and indicated from a risk perspective, relevant authorities should assess the vulnerabilities separately for the different sub-sectors or segments (especially office, industrial and logistic, retail and residential) and segments (prime and non-prime). Relevant authorities may exempt one or more sub-sectors or segments if there is no evidence that financial institutions are taking significant risks when investing in those sectors or segments.
2. For monitoring systemic risk the relevant authorities should use indicators defined by Recommendation ESRB/2016/14 as guidance or apply definitions and metrics established by the relevant authorities, including information from market intelligence, where these definitions, metrics and information are deemed to better accommodate monitoring systemic risks arising from commercial real estate (CRE), taking into account the specificities related to national requirements. Market intelligence and other sources of soft information might be used as an alternative to indicators and hard data in cases where these are not available. The risk indicators and the approach to the risk assessment, which is proposed in the European Systemic Risk Board (ESRB) report on the assessment of vulnerabilities in the CRE sector <sup>(1)</sup>, can serve as a guidance to the relevant authorities.
3. In relation to the collateral and income and activity stretches, relevant authorities should assess developments in CRE prices and income flows generated by the properties in the context of cyclical as well as structural developments and changes.
4. In relation to the financing and activity stretch, relevant authorities should assess the liquidity and resilience of financial institutions with exposures to CRE in view of potential materialisation of CRE risks (also taking into account the results of monitoring the collateral and income and activity stretches). In relation to CRE credit providers, relevant authorities should assess the characteristics of existing CRE loan portfolios, as well as lending standards of newly provided CRE loans. In relation to investment into CRE, relevant authorities should analyse the investor base, the leverage of the investment and the depth of the market to the extent data are available.
5. In relation to the spillover stretch, relevant authorities should assess the importance of CRE for the real economy and financial system, including effects of a potential CRE market downturn on the real economy (with second-round effects on the financial system), interconnectedness between financial institutions and interlinkages between countries.
6. With a view to monitoring systemic risks stemming from the CRE market in the investment fund sector relevant authorities should specifically:
  - (a) identify investment funds in their respective jurisdiction that have particularly large exposures to CRE markets;
  - (b) monitor and assess their current state of preparedness for an unexpected increase in redemptions and/or an increase in valuation uncertainty;
  - (c) forming a view as to how these investment funds might respond to potential future adverse shocks in the short term, including which liquidity management tools have been activated and how they have been used as well as the size of redemption requests and how the investment funds identified have responded to these requests.

<sup>(1)</sup> See Methodologies for the assessment of real estate vulnerabilities and macroprudential policies: commercial real estate, ESRB, December 2019, available on the ESRB website at [www.esrb.europa.eu](http://www.esrb.europa.eu).

7. Specifically, and with a view to monitoring systemic risks stemming from the CRE market in the insurance sector relevant authorities should identify the insurance undertakings in their respective jurisdiction that have particularly large exposures to CRE markets.
8. Specifically, and with a view to monitoring the financial stability implications of securitisation relevant authorities should carefully assess if securitisation plays an important part in the CRE lending, including the quality of the securitised loans (reflecting both the borrower and the assets collateralising the loan) and the concentrations of investors and borrowers, paying particular attention to their interconnectedness.
9. Relevant authorities should facilitate the exchange of information by means of arrangements within the scope of the applicable legal confidentiality regime.
10. The relevant authorities should ensure that any voluntary arrangements, such as memoranda of understanding, establish, inter alia, a general principle of mutual exchange of information in line with the principles of cooperation between relevant authorities.

### **Recommendation B – Ensuring sound CRE financing practices**

The following compliance criteria are applicable to Recommendation B.

1. Close monitoring of the credit quality of CRE portfolios and adequate provisioning are needed for categories of loans that could become non-performing in case of adverse economic and financial developments.
2. When ensuring sound financing practices, supervisory authorities should take into account the results of the forward-looking risk assessment pursuant to Recommendation A, distinguishing, where relevant, between individual CRE sub-sectors and segments:
  - (a) in relation to the existing loans, supervisory authorities should ensure that credit providers:
    - reassess the expected income generated by the CRE property (if it is the source of income for servicing the loan) or the expected income generated by the business activity of the borrower; such reassessment should consider the expected developments in rents and vacancy rates, construction costs and profit from a sale of property, or performance of business sectors as relevant;
    - reassess the debt servicing capacity of the borrowers taking into account the results of 1., as well as the estimated costs of financing and the amortisation profile of the loans;
    - revalue the CRE properties which serve as collateral to the existing loans, taking into account the expected development of the market prices.
  - (b) in relation to the new loans, supervisory authorities should ensure that credit providers grant new loans with sound lending standards.
3. The provisioning should take into account the results of the reassessment of the expected debt servicing capacity of the borrowers and collateral values.

### **Recommendation C – Increasing resilience of financial institutions**

The following compliance criteria are applicable to Recommendation C(1).

1. Where risks related to the CRE market identified in the respective European Economic Area (EEA) country warrant activating capital-based measures, the designated authorities should seek to ensure the resilience of credit institutions in the face of the potential materialisation of systemic risk related to CRE which could lead to direct and indirect credit losses stemming from CRE loans and CRE investments or arising as a consequence of an economic downturn.
2. Appropriate policy action should consider potentially different dynamics across CRE sub-sectors and segments. Risk weight measures defined for CRE exposures, or higher sectoral systemic risk buffer rate (SyRB) should be considered as targeted macroprudential measures in a situation of vulnerabilities in the CRE sector in particular. A higher countercyclical buffer rate (CCyB) or general SyRB rate would be suitable if not only CRE-related but also broad cyclical or structural risks materialise.

3. Prior to activating capital-based measures, an assessment should be made of the respective EEA country's position in the economic and financial cycles in order to determine whether activating such measures would be necessary, appropriate and effective.
4. After the activation of the capital-based measures, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in the respective EEA country. This will depend on the choice of the capital-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.

The following compliance criteria are applicable to Recommendation C(2).

1. The supervisory authorities should ensure that the redemption terms of investment funds exposed to the CRE sector are designed in consideration of the inherently illiquid nature of CRE assets and, where appropriate, provide additional guidance.
2. The supervisory authorities should address constraints, including those related to data availability and quality, that might hamper the assessment of risk arising from liquidity mismatch and leverage in the investment fund sector with respect to CRE market investments and lending.
3. The supervisory authorities should, where appropriate:
  - (a) facilitate the timely use of appropriate liquidity management tools by investment fund managers;
  - (b) timely exercise their power to suspend repurchase or redemption of investment fund units or use other appropriate liquidity management tools.

The following compliance criteria are applicable to Recommendation C(3).

1. The supervisory authorities should ensure the resilience of insurance undertakings in the face of the potential materialisation of systemic risks related to CRE which could lead to direct and indirect losses stemming from CRE loans and CRE investment or arising as a consequence of an economic downturn.
2. Appropriate policy action should consider potentially different dynamics across CRE sub-sectors and segments.
3. Prior to implementing any action under Recommendation C(3), an assessment should be made of the respective EEA country's position in the economic and financial cycles in order to determine whether activating such measures would be necessary, appropriate and effective.

The following compliance criteria are applicable to Recommendation C(5).

1. Supervisory authorities should consider borrower-based measures (BBMs) to avoid further built-up of vulnerabilities in the CRE sector through the provision of new loans.
2. Prior to activating BBMs, an assessment should be made of the position of the respective EEA country in the economic and financial cycles in order to determine the appropriate calibration and phasing-in of such measures.
3. After the activation of BBMs, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in the respective EEA country. This will depend on the choice of BBMs activated, on their initial calibration and on the results of the assessment of vulnerabilities.

#### **Recommendation D – Development of activity-based tools for CRE in the EU**

The following compliance criteria are applicable to Recommendation D.

1. When assessing the current macroprudential framework the European Commission should discuss with the relevant stakeholders the level playing field across financial institutions with regard to CRE financing, with the aim to narrow down potential regulatory arbitrage, which can create risks to financial stability.
  2. The European Commission should consider existing (or future) analyses of the appropriateness of BBMs for CRE loans and, provided that the results of the analyses conclude general appropriateness of the BBMs for these CRE loans, propose BBMs for CRE loans as activity-based tools.
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