Notification template for measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

Template for notifying the European Central Bank (ECB), the European Systemic Risk Board (ESRB) and the European Commission of stricter national measures pursuant to Article 458(2) CRR and for requesting the ESRB to issue a recommendation to other Member States to reciprocate the measures pursuant to Article 458(8) CRR

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- macropru.notifications@ecb.europa.eu when notifying the ECB (under Article 5 of the Single Supervisory Mechanism Regulation (SSMR)[1]);
- DARWIN/ASTRA when notifying the ESRB;
- FISMA-E-3-NOTIFICATIONS@ec.europa.eu when notifying the European Commission.

The ESRB will forward this notification to the European Parliament, the European Council and the European Banking Authority (EBA) without delay. This notification will be made public by the ESRB after the relevant authorities have adopted and published the notified macroprudential measure[2].

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1. Notifying national authority and scope of the notification	
1.1 Name of the notifying authority	Norwegian Ministry of Finance
1.2 Country of the notifying authority	Norway
1.3 Categorisation of the measure	The Ministry intends to implement a stricter national measure regarding risk weights for targeting asset bubbles in the residential property sector, pursuant to Article 458 (10) of the CRR. A similar measure targeting the commercial property sector is the subject of a separate notification.
1.4 Request to extend the period of application of an existing measure for up to two additional years **(Article 458(9) CRR)**	The measure would extend the existing risk weight floor targeting asset bubbles in the residential property sector, which was initially implemented with effect from 31 December 2020. The existing risk weight floor was implemented due to increased systemic risk resulting from high household debt and high housing prices. Since then, housing prices have continued to increase, and there is also increased concentration of debt in households with high debt-to-income (DTI) ratios. A risk weight floor of 20 pct. is still considered sufficient, but the Ministry is continuously assessing the need to amend the floor or introduce other measures in light of relevant

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

	developments. See further elaborations on the systemic risks related to the residential real estate market in section 4.1.
1.5 Notification of a measure to which Article 458(10) CRR applies ('notification only procedure')	The intended measure is subject to the procedure set out in Article 458 (10) of the CRR, as it extends the average risk weight floor at the same level as today.
2. Description of the measure	
2.1 Draft national measure **(Article 458(2)(d) CRR)**	The intended measure comprises a floor for (exposure-weighted) average risk weights of 20 % for Norwegian residential real estate exposures. Where the exposure-weighted average risk weight is lower than the floor, the total risk-weighted assets (RWA) should be increased correspondingly. Each institution's increase in risk-weighted assets would be the following: $\Delta RWA = \max(0, 20\% - RW_{RRE}) * EAD_{RRE}$ Where RW_{RRE} and EAD_{RRE} are the exposure-weighted average risk weight for non-default exposures for the residential real estate portfolio. Article 458(10) of the CRR is the legal basis for the measure as implemented in the CRR/CRD IV regulation § 2.
2.2 Scope of the measure **(Article 458(2)(d) CRR)**	The risk weight floor would be applicable for all Norwegian institutions with the relevant exposures and using the Internal Ratings Based Approach (IRB institutions). This includes one subsidiary whose parent is established in another Member State.[3] Moreover, the Ministry requests the ESRB to issue a recommendation to other Member States to reciprocate the measure, see section 6.3.
2.3 Calibration of the measure	The calibration of the risk weight floor for residential real estate exposures is aligned with existing requirements imposed by the Ministry of Finance and the Financial Supervisory Authority of Norway (Finanstilsynet) on models used by IRB institutions to estimate residential mortgage risk. IRB risk weights are sensitive to uncertainty in the banks' PD and LGD estimates, in particular for low-default segments such as RRE and CRE. As Norwegian banks' loss data are mainly from an exceptionally good period in the Norwegian real estate market, Finanstilsynet has published a circular clarifying its expectations regarding PD and LGD calibration.[4] In compliance with the expectations in the circular and the 20 per cent LGD floor set by the Ministry of Finance in 2014, Norwegian banks report IRB risk weights between 18 and 25 per cent. Finanstilsynet has communicated that it expects IRB banks to take account of higher potential price falls in the LGD estimates. Furthermore, a 2013 study applying data going back to the banking crisis in the early 1990s, suggested that such risk weights should be around 20 to 30 pct.[5]

[3] Nordea Eiendomskreditt AS
[4] Circular 3/2021, replacing circular 8/2014
[5] Andersen, Henrik (2013), How high should risk weights be on Norwegian residential mortgages? Norges Bank Staff Memo 10/2013.

	The measure increases Norwegian institutions' average risk weights by a maximum of (20 - 18)/18 = 11 pct. Considering the potential losses associated with such exposures, a risk weight floor of 20 pct. is considered appropriate.
2.4 Suitability, effectiveness and proportionality of the measure **(Article 458(2)(e) CRR)**	The calibration of the proposed measure is considered to be proportionate with the intensity of cyclical systemic risks associated with Norwegian property markets, and in particular with the risk of potential asset bubbles in the residential property sector (see section 4.1). The measure is suitable to ensure that domestic institutions meet a certain minimum standard as regards risk-weighting at the portfolio level. If reciprocated, it would also be the most effective measure to target Norwegian branches of foreign IRB institutions. Reciprocation by other EEA States will be crucial to ensure appropriate treatment of such exposures by foreign institutions, as well as to avoid leakages and regulatory arbitrage (see section 6).
2.5 Other relevant information	A draft measure proposed by Finanstilsynet to increase the floor was on a public consultation until 29 November. Norges Bank has recommended an extension of the floor at 20 pct.
3. Timing for the measure	
3.1 Timing for the decision on the measure	16/12/2022
3.2 Timing for publication	16/12/2022
3.3 Disclosure	The Ministry will publish this notification on the same day as it is submitted, as an attachment to a news item.
3.4 Timing for application (Article 458(4) CRR)	31/12/2022
3.5 Duration of the measure **(Article 458(4) CRR)**	The measure is intended to be in effect for a minimum of two years. The Ministry of Finance will assess the need to renew the measure well before the term would expire. After implementation of the measure, the Ministry will monitor and regularly assess risk developments and the need to amend the measure, including the need for deactivation before the term expires.
3.6 Review **(Article 458(9) CRR)**	The appropriateness of the measure will be assessed regularly, and the measure will be reviewed with a view to renew or deactivate it well in advance of the expiration of the 2 year-term.

4. Reason for the activation of the stricter national measure	
4.1 Description of the macroprudential or systemic risk in the financial system **(Article 458(2)(a) CRR)**	**Overview** The key vulnerabilities in the financial system in Norway are high household debt, high housing prices and high commercial property prices. Residential real estate and commercial real estate represent the two largest lending segments for Norwegian institutions, and combined they constitute more than ¾ of institutions' lending. The significant and prolonged increase in real estate prices and household debt have led to a build-up of financial imbalances, and an increase of systemic risk related to credit institutions' real estate exposures in Norway. Finanstilsynet and Norges Bank regularly carry out analyses of systemic risks in Norway. The evidence presented in this notification is based on these authorities' latest risk reports.[6] **Risk associated with high household debt** Household debt currently corresponds to approximately 120 pct. of GDP for Mainland Norway. Norwegian household debt is on a very high level, both historically and in an international context, although as a percentage of GDP it has remained stable over the last two years. Household debt has long risen faster than household income, increasing household leverage. Furthermore, the debt is very unevenly distributed, and many households have raised their debt level considerably during the protracted period of low interest rates. The share of households with high debt-to-disposable income (DTI) has increased significantly over the last years. Finanstilsynets residential mortgage lending survey reveal that a large share of new mortgages is taken up by households with high debt burden.[7] New mortgage borrowers had a total debt burden of 347 pct. of gross income, a 10 percentage point increase over the last two years. An interest rate increase of 5 percentage points from the 2020-level will increase the average interest burden for households from 6 percent to 15 percent of disposable income. For the most vulnerable households, an increase in interest rates will significantly impair their finances. The IMF noted in its Technical Note on systemic risk oversight and macroprudential policy framework, that household debt in Norway was at or close to an all-time high relative to disposable income, and high relative to other countries.[8] Owing to high household indebtedness and house price overvaluation, the ESRB issued a warning to Norway in June 2019, in which

[6] Finanstilsynet's Financial Outlook June 2022 and Financial Outlook December 2022, and Norges Bank's Financial Stability 2022.
[7] Finanstilsynet's residential mortgage lending survey 2022
[8] See the IMF's report Norway: Financial Sector Assessment Program-Technical Note-Systemic Risk Oversight and Macroprudential Policy Framework, IMF Country Report No. 2020/265

	it points out that the vulnerabilities are a source of systemic risk to the financial system.[9] Credit institutions' loans to households are mainly residential mortgage loans. The institutions' losses on loans to households have been low, but the high level of debt makes the households vulnerable to increases in interest rates or loss of income. Households' debt service ratio is on a historically high level despite the low interest rates, and only a small proportion of household debt carries fixed interest rates. Increasing interest rates will therefore quickly be reflected in households' debt service ratio. This may reduce earnings in the corporate sector and impair their debt-servicing capacity. This may in turn lead to a fall in the economic activity and increase unemployment, and higher losses on banks' corporate exposures. **Risks stemming from the housing market** Developments in household debt are strongly linked to price developments in the housing market. Higher house prices give a rise in housing wealth, and increase the collateral value of the real estate, which in turn provides scope for increased borrowing secured by real estate property. Over time, this interdependence has contributed to strong growth in both house prices and debt. Since the banking crisis at the start of the 1990s, house prices have grown considerably more than disposable income per capita. Analyses from the IMF, OECD and others indicate that the residential real estate prices in Norway are overvalued. A 2019 IMF study found that house prices as of year-end 2018 were overvalued in the range of 0-10 pct. at the national level, and between 5 and 20 pct. in Oslo, one of the highest valuation gaps among the countries in the sample.[10] In its 2020 Financial Sector Assessment Programme (FSSA) of Norway, the IMF points out that real estate prices have risen strongly over past decades. This is, as the IMF highlights, a continuation of an uptrend that started in the 1990s. As of June 2020, residential real estate prices increased by more than 70 pct. over the last decade, while rising more in large cities (particularly in Oslo, where they doubled).[11] As of September 2022, Norwegian housing prices increased by 12,6 pct. over the last two years, although housing prices have decreased somewhat in the last months. In November 2022, housing prices increased by 1,1 percent compared to November 2021.

[9] See Warning of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector of Norway

[10] See Norway: 2019 Article IV Consultation-Press Release; and Staff Report, IMF Country Report No. 19/159.

[11] See Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director of Norway, IMF Country Report No. 2020/259

	High house prices remain a key vulnerability in the financial system in Norway. Sharp and sudden declines in house prices may trigger tightening of household consumption and result in increased losses on banks' loan portfolios. The covered bond market may also be weakened, which may cause funding shocks. Furthermore, the economic outlook has deteriorated. Supply chain disturbances, due to lasting effects of the covid-19 pandemic and the war in Ukraine, has reduced growth expectations and contributed to increasing interest rates to reduce inflation globally and in Norway. Statistics Norway and Norges Bank predict a gradual decline in economic activity in mainland Norway in the years to come, and a moderate decline in housing prices. However, the development is highly uncertain. Statistics Norway and Norges Bank underline that the Norwegian and the international economy is at risk of facing stagflation, where inflation remains high while the real economy stagnates. These factors increase the probability that systemic risks materialise in the years to come, which may lead to substantially increased losses on the banks' residential real estate portfolios.
4.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b) CRR)**	Norwegian and foreign IRB institutions are crucial for the credit supply to households and corporates in Norway. The IRB institutions have a combined market share of approximately ¾ in the Norwegian credit market. A disruption of the credit supply could have severe consequences for the real economy. For example, a negative shock in domestic property markets or tightened consumption may cause a significant increase in credit losses, and in turn constrain institutions’ capacity to provide new credit. The negative dynamic that could develop between the institutions and the real economy, may destabilise the financial system and amplify a downturn in the Norwegian economy. As institutions established in other Nordic countries have significant operations in Norway, turbulence in the Norwegian financial system may easily spread to neighbouring systems.
4.3 Indicators prompting the use of the measure	The main indicators are: • Institutions’ residential real estate lending relative to all lending • Household debt-to-income ratio • Household debt service ratio • Share of floating-rate residential mortgage loans • Housing prices relative to disposable income • Institutions’ losses on retail market loans in percent of gross retail market lending • Average risk weights for real estate exposures in IRB institutions Data files are available upon request.
4.4 Justification for the stricter national measure **(Article 458(2)(c) CRR)**	**Objective** The measure will ensure that all Norwegian IRB institutions employ appropriate risk weights at the portfolio level for their residential real estate exposures in Norway, given the prevailing systemic risks associated with

	these exposures. The measure may also function as a backstop accounting for uncertainty in IRB models, stemming i.a. from data largely being collected over periods of positive economic development. **Other measures considered** *Article 124 of the CRR* concerns risk weights under the Standardised Approach, which in Norway remains at 35 pct. This level is considered adequate for institutions using the Standardised Approach. *Article 164 of the CRR* enables authorities to increase the LGD floor for IRB institutions' residential real estate exposures. In Norway this provision has been employed to increase the LGD floor to 20 pct., see section 2.3 above. *Article 133 of the CRD* allows for requiring a systemic risk buffer to target long-term systemic risks. The Ministry of Finance has set a buffer requirement at a level which is commensurate with the level and intensity of such risks in the Norwegian financial system. While structural and cyclical systemic risks may not always be easily distinguishable, the risk-weight floor for residential real estate exposures is primarily intended to mitigate risks associated with potential asset bubbles and financial imbalances, which have been increasing in recent years. Although systemic risk buffers may apply specifically to real estate exposures, they would not ensure that the increased risks in the real estate markets are reflected in the risk weighted exposure amounts underlying the capital and buffer requirements. As cyclical systemic risks are particularly present and elevated in regards to real estate exposures, IRB risk weight floors would be the more efficient tools to apply in the current environment. *Article 136 of the CRD* requires the setting of a countercyclical capital buffer to address time-varying systemic risks. The buffer rate in Norway has been increased to 2.0 pct. and will be further increased to 2.5 pct. effective from 31 March 2023, justified to a certain extent by the same developments that necessitates IRB risk weight floors for residential real estate exposures, namely a build-up of financial imbalances in the household sector and high house prices. Moreover, the countercyclical capital buffer does not target residential real estate exposures in particular, and it does not promote an adequate level of average risk weights across all IRB institutions in Norway.
5. Sufficiency, consistency and non-overlap of the policy response	
5.1 Sufficiency of the policy response	The measure will contribute to resilience in the Norwegian financial system, by maintaining mortgage risk weights to sufficiently prudential levels.
	The proposed measure is consistent with Finanstilsynet's general practices for IRB-supervision.

5.2 Consistency of application of the policy response	Moreover, to ensure consistency across member states and across institutions operating in the Norwegian market, it is important that the risk weight floor also applies to foreign institutions operating in Norway.
5.3 Non-overlap of the policy response	The risk-weight floor is non-overlapping but complementary to the level of the systemic risk buffer requirement. The Ministry of Finance has set a systemic risk buffer requirement at a level which is commensurate with the level and intensity of structural long-term risks in the Norwegian financial system. While the structural and cyclical dimensions of systemic risk are not easily distinguishable, especially when it comes to debt and real estate prices, the risk-weight floor is primarily intended to mitigate the cyclical systemic risks associated with potential asset bubbles and financial imbalances related to the residential real estate market, which have been increasing in recent years (see section 4.1). The risk weight floor is also considered complementary insofar as the systemic risk buffer increases the pillar 1 capital requirement for all exposures in Norway, whereas the risk-weight floor is intended to help prevent underestimation of the risk-weighted exposures.
6. Cross-border and cross-sector impact of the measure	
6.1 Assessment of cross-border effects and the likely impact on the Internal Market **(Article 458(2)(f) CRR and Recommendation ESRB/2015/2[12])**	The measure will promote domestic financial stability in Norway by contributing to an average risk-weight of residential real estate exposures that is considered appropriate in the current risk environment. If authorities of other EEA states reciprocate the measure, it may have a positive impact on other EEA markets where the relevant institutions have activities, since it could increase institutions' loss-absorbing capacity related to Norwegian credit exposures. A misalignment of risks and loss-absorbing capital associated with the Nordic institutions' Norwegian operations may have repercussions for the institutions' ability to serve other markets. For several institutions domiciled in other Nordic countries, lending in the Norwegian market constitutes a significant portion of their total lending. Reference is made to the MoU signed by the relevant Nordic ministries in 2016, which acknowledges ESRB recommendations as a "minimum standard for reciprocity in macro-prudential matters".[13]
6.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	The measure is not expected to contribute to leakages or regulatory arbitrage within the Norwegian financial system. Experiences with current capital levels in Norwegian institutions do not suggest that there is significant potential for migration to "shadow banking" or other sectors of the financial system. The scope for regulatory arbitrage is generally very limited within the Norwegian financial system, owed to a consistent adherence to the principle of "same risk, same regulation".

[12] Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/3) (OJ C 97, 12.3.2016, p. 9).

[13] Memorandum of understanding between the Finnish, Norwegian and Swedish Ministries of Finance and the Danish Ministry of Business on cooperation regarding significant branches of cross-border banking groups, published on the Ministry of Finance website on 19 December 2016.

	If domestic macroprudential policy measures are not reciprocated, however, there may be risks associated with leakage from the domestic financial system to other EEA systems. The effectiveness of the measures would then be undermined.
6.3 Request for reciprocation by other Member States **(Article 458(8) CRR and Recommendation ESRB/2015/2)**	Do you intend to ask the ESRB to issue a recommendation to other Member States to reciprocate the measure in accordance with Article 458(8) CRR? Yes - If yes, please provide in Section 6.4 the justification for that reciprocity. - If no, what are the reasons for not requesting reciprocation?
6.4 Justification for the request for reciprocation by other Member States **(Article 458(8) CRR and Recommendation ESRB/2015/2)**	The measure comprises an extension of the current floor for average risk weights of 20 pct. for Norwegian residential real estate exposures from 31 December 2022. Institutions established in other Member States have significant exposures and activities in the Norwegian lending market, and should be subject to the same requirements as Norwegian institutions. Lending from branches of banks from other Nordic countries constitutes around 1/3 of the Norwegian bank lending market. In an integrated financial system like the Nordic banking market, strong policy coordination is needed to ensure the effectiveness of national macroprudential policies. Coordination based on the competence of national authorities to assess which macroprudential measures are necessary to facilitate financial stability given national vulnerabilities, is a matter of common interest. Reciprocity will be crucial in order to avoid leakages and regulatory arbitrage, in addition to ensuring that the foreign institutions' loss-absorbing capacity is aligned with their risk exposure in the Norwegian market. ESRB recommended reciprocation of the current Norwegian risk-weight floor at 20 pct. for all exposures in Norway, which will be extended for a two-year period. The materiality threshold for reciprocation of the current risk-weight floor was set to 1 per cent of institutions' gross RRE lending to Norwegian customers (a gross lending of NOK 32.3 billion), adjusted to account for branches' share of total lending in Norway, confer the Ministry of Finance's letter to the ESRB of 2 February 2021. The Ministry of Finance proposes to maintain the materiality threshold at NOK 32.3 billion gross RRE lending to Norwegian customers.
7. Miscellaneous	
7.1 Contact person(s)/mailbox at notifying authority	Tormod Fauske Tho, Advisor Phone: +47 22 24 45 11 / +47 22 24 45 21 E-mail: tho@fin.dep.no

7.2 Any other relevant information	The Ministry of Finance has submitted another notification together with this notification, which notifies the intended use of measures in accordance with Article 458 (10) of the CRR (a floor for average risk weights for commercial real estate exposures).
7.3 Date of the notification	Please provide the date on which this notification was uploaded/sent. 16/12/2022