
EBA-Op-2021-01

Opinion of the European Banking Authority on measures in accordance with Article 458 Regulation (EU) No 575/2013

Introduction and legal basis

1. On 22 January 2021, the European Banking Authority (EBA) received notification from the National Bank of Belgium (NBB) of its intention to apply Article 458(9) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (Capital Requirements Regulation, CRR)¹ to extend for a second time a measure introduced by the NBB in 2018 making use of Article 458(2)(d)(vi) of the CRR concerning risk weights for targeting asset bubbles in the residential immovable property sector in order to account for changes in the intensity of macroprudential or systemic risk that could pose a threat to financial stability in Belgium.
2. The EBA's authority to deliver an opinion is based on the second subparagraph of Article 458(4) in conjunction with Article 458(9) of the CRR.
3. According to the second subparagraph of Article 458(4) of the CRR, within 1 month of receiving the notification from the designated or competent authority entrusted with the national application of Article 458 of the CRR, the EBA is required to provide its opinion on the points referred to in Article 458(2) of the CRR to the Council, the European Commission and the Member State concerned.
4. In accordance with Article 14(2) of the Rules of Procedure of the EBA², the Board of Supervisors has adopted this opinion.

Background of the measure to be extended

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 Decision of the EBA concerning the Rules of Procedure of the Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

5. The measure increases risk weights for Internal Ratings Based (IRB) banks' retail exposures secured by residential immovable property located in Belgium. It consists of two components. The first component imposes a 5-percentage-point risk weight add-on for IRB banks' exposures to Belgian mortgage loans. The second component further increases the risk weights as a function of the risk profile of the IRB bank's mortgage portfolio by applying a multiplier of 1.33 on the (microprudential) risk weight of the residential mortgage loan portfolio.
6. The original measure was notified to the EBA on 22 January 2018 and the EBA submitted its opinion³ to the Council, the Commission and the Member State on 23 February 2018. On 27 January 2020, a first request for extension of the measure was notified to the EBA and the EBA submitted its opinion⁴ to the Council, the Commission and the Member State on 26 February 2020. On 22 January 2021, the EBA received a request for a second extension of the measure, which will be applicable from 1 May 2021 until 30 April 2022.
7. In its opinion of the first extension, the EBA did not object to the original measure as set out in paragraph 5. The EBA acknowledged that the increases in house prices and household debt levels, in combination, could pose a threat to the financial stability of banks in Belgium in the event of a downturn.
8. However, the EBA raised some issues in its opinion, including the following:
 - The use of a multiplier on the risk weight of the residential mortgage loan portfolio would add further complexity to the determination of capital requirements and could reduce the transparency of risk weights for market participants.
 - The assumption behind the multiplier is that banks are correctly estimating risk weights and that risk weights are a good proxy for portfolio riskiness. While this might be true in general, there might be a risk of penalising banks with more conservative internal models and higher starting risk weights. If so, the multiplier may have a distorting effect, since it would reduce the incentive to estimate conservative risk parameters.
 - The use of stress tests to change risk weights can, in certain situations, lead to double-counting of risks, which might or might not be intended by the relevant authority. Moreover, it was not clear if the risks were already covered in capital requirements and Pillar 2 guidance for Belgian banks through stress tests such as the EU-wide stress test.

³ Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013 of 23 February 2018 (EBA/Op/2018/01), available at <https://eba.europa.eu/eba-issues-opinion-on-measures-to-address-macroprudential-ri-3>

⁴ Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013 of 26 February 2020 (EBA/Op/2020/04), available at https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2020/872842/EBA-2020-Op-04%20-%20EBA%20Opinion%20on%20measures%20taken%20by%20Belgium%20in%20accordance%20with%20Art%20458.pdf

- The EBA agreed with the NBB that cyclical risks should be addressed with countercyclical and temporary measures, as opposed to more structural measures such as the systemic risk buffer (SyRB).

Opinion on the extension

Economic rationale for the measure

9. Since the intensity of macroprudential risk in Belgium – with the potential to have serious negative consequences for the Belgian financial system and the real economy – is persistent, the NBB has decided to extend, for the second time, the period of application of its measure for one year until 30 April 2022. This follows the decision to apply the measure between 1 May 2018 and 30 April 2020 and to extend the measure for the first time between 1 May 2020 and 30 April 2021.
10. Most of the vulnerabilities affecting the intensity of macroprudential risk or systemic risk are still relevant. According to the NBB, the substantial level of systemic risk in banks' mortgage portfolios and the persistence of macrofinancial vulnerabilities in Belgium are mainly related to:
- 1) the protracted expansion of banks' exposures to mortgage lending to Belgian households;
 - 2) the persistent signs of some overvaluation in housing prices;
 - 3) the persistence of household indebtedness supported by excessively loose credit standards; and
 - 4) the intense competition between credit institutions on the mortgage loan market and the ensuing loose credit standards and loan pricing.
11. The importance of residential mortgage loan portfolios on the balance sheets of Belgian banks remains significant (around 20% of total assets and 415% of Common Equity Tier 1 (CET1) capital). The growth rate of mortgage lending to Belgian households continues to be persistently high, with an average year-on-year growth of 5.5% (5.2% in September 2020). Given the current uncertainties stemming from the COVID-19 pandemic, the NBB argues that a severe downturn in the Belgian residential real estate market cannot be excluded and may have a substantial impact on institutions' solvency positions, which may in turn entail unfavourable consequences for the Belgian real economy. It could also spill over to the commercial real estate market, amplifying the negative shock. Moreover, the NBB points out that safeguarding financial stability in Belgium will have positive effects on financial stability in Europe because of the importance of cross-border banking groups in Belgium and the degree of openness of the Belgium economy.
12. The NBB analysis shows that the COVID-19 pandemic has not (yet) impacted the Belgian residential real estate market, in terms of both transactions and prices, although recent developments in prices could be driven by some temporary factors. For instance, according to the NBB, the overvaluation of Residential Real Estate (RRE) prices⁵ has further increased and is

⁵ Defined as the gap between long-run equilibrium value and the current value of property prices.

now estimated at 14.6%, but the relevance of this high figure should be nuanced given the potentially temporary impact induced by the current COVID-19 pandemic context.

13. The calibration of the measure remains unchanged with respect to the original measure. The NBB assesses that the severe stress scenario used in the original notification remains meaningful and severe enough to be used to calibrate the measure. The NBB argues that the COVID crisis as such is no reason to change the parameters of the stress scenario. An updated sensitivity/scenario analysis indicates that microprudential capital requirements (implied by microprudential risk weights) still remain insufficient to cover all potential losses under severe (macroprudential) stress scenarios and that the macroprudential measure (with the original calibration) is still sufficient to cover – at the level of the sector – the simulated losses. According to the NBB, these scenario analyses have allowed the buffer need to be calibrated in such a way that sufficient resources are now available in the current crisis mode for a potential adverse scenario that could materialise in 2021/2022.
14. The NBB estimates that the total impact of the proposed measure on IRB banks' CET1 capital is EUR 2.06 billion (compared with EUR 1.5 billion at the time of the original notification in 2018), equivalent to approximately 3.7% of IRB banks' total CET1 capital. The increased impact of the measure on CET1 capital follows from the increased residential real estate exposures of Belgian IRB banks.
15. The NBB emphasises that the current macroprudential policy no longer focuses on building up buffers for future risks, but is now in a crisis mode where the focus lies in preserving previously accumulated buffers and being prepared for a materialisation of the risks targeted by the measure taken under Article 458 of the CRR and hence, for the release of accumulated buffers. The NBB assesses that the current measure continues to be necessary, suitable, effective and proportionate. First, the measure upholds the resilience of the Belgian banking sector against a potential severe downturn in the housing market. Second, the measure increases the risk weights (from 9.8 % to 18.1% on average) of portfolios where risk weights are deemed too low compared with the persistent systemic risk in the residential real estate market. Third, the measure complements a recent measure published by the NBB on the supervisory expectations regarding mortgage credit standards. Fourth, the measure provides an incentive-compatible mechanism for enhancing overall resilience with a multiplier affecting portfolios with riskier profiles more than portfolios with higher credit quality. Fifth, given the highly uncertain context, the timing of a potential materialisation of the systemic risk remains uncertain and may well take place after the current measure expires at the end of April 2021. According to the NBB, extending the current measure would continue to ensure banks' resilience without introducing any discontinuity that would inevitably result from the introduction of a different macroprudential instrument.
16. The NBB argues that the extension is complementary to NBB supervisory expectations, addressing the flow risks in new mortgage loans while the Article 458 measure targets the stock of RRE loans. However, despite some recent tightening of lending conditions since the introduction of supervisory expectations in January 2020, the NBB considers that the current

proportion of loans (already on the portfolio of banks) to riskier segments is still too high. The NBB is of the view that if credit standards remain in line with the supervisory expectations, the NBB supervisory expectations will contribute to a steady but gradual reduction of future risks in banks' RRE portfolios.

17. The NBB is closely monitoring the observed systemic risks in mortgage portfolios and RRE markets and signs of their potential materialisation. As expressed in the forward guidance issued in the NBB Financial Stability Report in July 2020, if the systemic risks were to materialise, the NBB would consider the immediate withdrawal of the measure should banks start taking substantial losses in the event of rising defaults or significant amounts of debt restructuring.

Rationale for not using alternative measures

18. The CRR and Directive 2013/36/EU (the Capital Requirements Directive – CRD)⁶ offer various options for addressing macroprudential risks. Article 458(2)(c) and (e) of the CRR require the designated authority to justify why other possible measures (i.e. under Articles 124 and 164 of the CRR and Articles 133 and 136 of the CRD) cannot adequately address the macroprudential or systemic risk identified, taking into account the relative effectiveness of those measures, and why the stricter national measure is suitable, effective and proportionate.

19. The present notification reiterates the previous justification for not using alternative measures. Moreover, it includes the following justifications:

- The low level of risk weights applied by Belgian IRB banks to RRE exposures does not reflect developments in loss given default (LGD) estimates, which have increased over the last few years, but results from a fall in probability of default (PD) estimates. Therefore, raising the average LGD floor would miss the point and would be a biased way to increase risk weights.
- While the sectoral Systemic Risk Buffer (SyRB) comes before Article 458 in the pecking order, the NBB judges that its introduction in the current context of the COVID-19 pandemic would generate undesirable discontinuities in the levels of the macroprudential capital “buffer” held by individual institutions (even if the aggregate capital buffer were to remain broadly the same at sector level). Such discontinuities are considered to be unfortunate and potentially disruptive – much more than in normal times – in the current highly uncertain, crisis-mode circumstances. In order to avoid these discontinuities, the NBB therefore deems the extension by one year (and, exceptionally, for the last time) of the current Article 458 macroprudential measure justified and, by providing the required continuity, clearly preferable to the introduction of a sectoral SyRB. At the end of 2021, and assuming that no release of the extended Article 458 measure has taken place by then, the NBB will assess the need for introducing a sectoral SyRB in replacement of the then prevailing Article 458

⁶ 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).

measure expiring at the end of April 2022. In any case, the NBB makes the commitment that the Article 458 measure will not be extended again, beyond April 2022.

- With regard to Article 136 of the CRD, the countercyclical buffer rate similarly applies to all credit exposures to the non-financial private sector. Applying a buffer rate to all exposures in Belgium would equally penalise credit and other exposures to SMEs and corporates in Belgium, which is not the purpose of the current measure. In March 2020, the NBB released the Countercyclical Capital Buffer (CCyB) to 0% to free up buffers and help banks maintain their critical financial intermediation function and deal with possible loan losses resulting from the COVID-19 pandemic.

Assessment and conclusions

20. Based on the evidence provided by the NBB and on a recent analysis conducted by the European Systemic Risk Board,⁷ the EBA acknowledges the persistent high level of systemic risk in Belgian banks' mortgage portfolios and hence the persistence of macroprudential vulnerabilities in the Belgian financial system. The EBA does not object to the one-year extension of the current measure.

21. The COVID-19 pandemic may have material implications for the systemic risk related to the housing market in Belgium. However, it is too early to assess the full impact of the COVID-19 pandemic and the EBA acknowledges the high level of uncertainty with regard to the materialisation of systemic risk related to the residential real estate market. Therefore, the EBA welcomes the NBB's forward guidance as regards the potential release of the measure before the end of April 2022.

22. The EBA takes note that this extension is, according to the NBB, the last extension of the current Article 458 macroprudential measure. The EBA welcomes the intention of the NBB to assess the need for introducing a sectoral SyRB in replacement of the Article 458 measure at the end of April 2022. The EBA agrees that the macroprudential policy in the European Union is not currently in the process of building buffers for future risks and should be prepared for the release of accumulated buffers in case systemic risks materialise. However, the argument of discontinuity in capital requirements for some banks that is used by the NBB to express a preference for a one-year extension of the current Article 458, against introducing a sectoral SyRB, is also likely to hold to a certain degree next year when the NBB plans to consider the introduction of a sectoral SyRB.

23. The calibration of the current measure was based on severe macroprudential stress scenarios described in the original notification of 2018. Although the economic situation has changed dramatically since 2018, the NBB deems these stress scenarios to remain meaningful and severe enough and the COVID pandemic as such is no reason to change the parameters of the scenarios. The EBA acknowledges that an updated scenario analysis carried out by the NBB indicates that

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https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation190923_be_recommandation~2cb5134896.en.pdf

the current macroprudential measure with the original calibration is sufficient to cover the simulated losses at sector level. However, the EBA invites the NBB to reassess the stress scenarios when introducing sectoral SyRB in replacement of the Article 458 measure.

24. Some of the concerns raised in the EBA opinion of 26 February 2020 to the Commission remain valid. In particular, according to the NBB, Belgian IRB banks are applying risk weights for residential mortgage exposures in Belgium that are still too low from a macroprudential point of view. The NBB underlines that the low microprudential risk weights remain insufficient to cover all potential losses under severe stress scenarios. The EBA invites the competent authority to continue to remind Belgian IRB banks to review their internal models and address any potential deficiencies affecting their resilience in the event of a severe downturn in the Belgian residential real estate market.

This opinion will be published on the EBA's website.

Done at Paris, XX February 2021

Jose Manuel Campa

Chairperson

For the Board of Supervisors