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I

(Resolutions, recommendations and opinions)

RECOMMENDATIONS

EUROPEAN SYSTEMIC RISK BOARD

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 27 June 2019

on medium-term vulnerabilities in the residential real estate sector in Belgium

(ESRB/2019/4)

(2019/C 366/01)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

Having regard to 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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.
- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which Belgium was one ⁽⁶⁾.
- (8) In 2016 the main vulnerabilities identified in the residential real estate market in Belgium were the rapid growth in both house prices and mortgage loans, as well as the already high and increasing household indebtedness, with an increasing share of mortgagors being potentially vulnerable to adverse economic conditions or developments in the residential real estate market in Belgium.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards Belgium, this recent assessment has revealed that, since 2016, strong growth in housing credit has continued to fuel household indebtedness. Despite the fact that the growth in house prices has decelerated, the previous dynamics raise concerns about potential overvaluation. Moreover, a significant share of mortgage loans continue to be provided to households that are potentially vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market. Against this background, a 5 percentage point risk weight add-on, which was introduced in 2013 for the mortgage exposures of credit institutions that use the internal ratings-based (IRB) approach, has contributed to increasing the resilience of these institutions.
- (11) In 2018, the Nationale Bank van België/Banque Nationale de Belgique increased that 5 percentage point risk weight add-on by the application, pursuant to Article 458 of Regulation (EU) No 575/2013, of a proportionate risk weight add-on consisting of 33 % of the exposure-weighted average of the risk weights applied to the exposures at default in each credit institution's residential mortgage portfolio.
- (12) The risk weight add-on currently in place aims to increase the resilience of credit institutions that use the IRB approach, and to mitigate the build-up of risks related to new mortgage loans. However, there are currently no borrower-based measures (e.g. limits to the loan-to-value (LTV) ratio, the debt-to-income (DTI) ratio or the debt service-to-income (DSTI) ratio) in place in Belgium that would directly limit the share of mortgage loans provided to households which are potentially vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽⁶⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- (13) Therefore, the ESRB has concluded that the macroprudential measures that are in place or available in Belgium are partially appropriate and partially sufficient to address the vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards in the medium term. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk. The measures proposed in this Recommendation are intended to complement the existing macroprudential measures in Belgium, with the aim of strengthening resilience. They should not be considered as substitutes for the existing capital-based measures, which remain important in order to address existing vulnerabilities in the outstanding loan portfolio.
- (14) The purpose of this Recommendation is to recommend the activation of legally binding borrower-based measures to address the significant share of mortgage loans provided to households that are potentially vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market in Belgium.
- (15) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (16) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATION

Recommendation A — Activation of borrower-based measures

It is recommended that the Belgian national authorities entrusted with recommendation powers or with the application of borrower-based measures, recommend the activation of, and activate, legally binding borrower-based measures, respectively, in order to prevent:

- (a) a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market; or
- (b) a significant or an increasing share of new mortgage loans, secured by residential real estate, that could result in credit losses on these loans in the event of their default and a subsequent decrease in house prices.

SECTION 2

IMPLEMENTATION

1. Definitions

For the purposes of this Recommendation the following definitions apply:

- (a) 'borrower-based measures' means macroprudential measures that target borrowers;
- (b) 'direct control' means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) 'recommendation powers' means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;
- (d) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the value of the property at the moment of the loan origination;
- (e) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;

- (f) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (g) 'medium term' means within a three-year horizon;
- (h) 'legally binding borrower-based measures' means borrower-based measures that are introduced through legally binding acts;
- (i) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year);
- (j) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination;
- (k) 'macroprudential authority' means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ⁽⁸⁾.

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;
- (b) when activating borrower-based measures under Recommendation A, their calibration and phasing-in should take into account the position of Belgium in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
- (c) specific criteria for compliance with Recommendation A are set out in Annex I.

2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards for new mortgage loans, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, and maturities, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ⁽⁹⁾, together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
- (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

3. Timeline for the follow-up

The addressees are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation A are requested to submit to the ESRB and to the Council a report on any actions taken with regard to implementing borrower-based measures to address the vulnerabilities related to household indebtedness, house price overvaluation and lending standards for new mortgage loans in Belgium. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

⁽⁸⁾ 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).

⁽⁹⁾ 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).

4. Monitoring and assessment

1. The ESRB Secretariat will:
 - (a) assist the addressees, ensuring the coordination of reporting, 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 three follow-up reports regarding the implementation of Recommendation A to the General Board; the first report by 31 December 2020, the second report by 31 December 2021, and the third report by 31 December 2022.
2. The General Board will assess the actions and justifications reported by the addressees and, where appropriate, may decide that this Recommendation has not been followed and that an addressee has failed to provide adequate justification for its inaction.

Done at Frankfurt am Main, 27 June 2019.

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

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATION

Recommendation A — Activation of borrower-based measures

The following compliance criteria are applicable to Recommendation A.

1. In order to prevent:
 - (a) a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market; or
 - (b) a significant or an increasing share of new mortgage loans, secured by residential real estate, that could result in credit losses in the event of their default and a subsequent decrease in house prices;

the Belgian national authorities should use one or several borrower-based measures in combination (e.g. limits to the LTV ratio in combination with limits to the DTI ratio, or to the DSTI ratio, and maturity limits), to ensure the effectiveness of the measures in place and to minimise any potential for their circumvention or for unintended consequences that could reduce their effectiveness and possibly create risks in other areas.
 2. Prior to activating borrower-based measures, an assessment should be made of the position of Belgium in the economic and financial cycles, in order to determine the appropriate calibration and phasing-in of such measures.
 3. After the activation of borrower-based measures, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in Belgium; this will depend on the choice of the borrower-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.
-

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Denmark
(ESRB/2019/5)
(2019/C 366/02)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.
- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which Denmark was one ⁽⁶⁾.
- (8) In 2016 the main vulnerability identified in the residential real estate market in Denmark related to high household indebtedness. A significant share of mortgagors had variable interest rate debt or debt exceeding the value of their home, making them vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market. Even though there were no overall signs of overvaluation, house prices had been increasing robustly particularly in major cities, and were close to pre-crisis levels.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards Denmark, this recent assessment has revealed that, since 2016, even though household indebtedness has decreased, it nevertheless remains at one of the highest levels in the EEA. Moreover, the share of existing mortgage loans with deferred amortisation is significant, which makes households structurally more vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market. In addition, despite the fact that house price growth has slowed and apartment prices in Copenhagen have reached a plateau in recent years, the previous dynamics have led to pockets of overvaluation in the major cities, in particular in Copenhagen. Against this background, a legally binding minimum down payment requirement, which was set at 5 % in 2015, has provided some (albeit limited) additional collateral in the event of a decrease in house prices.
- (11) In 2018, consumer protection legislation introduced restrictions on the provision of residential mortgage products to mortgagors with a debt-to-income (DTI) ratio (before tax) above 4 and an LTV ratio above 60 %. These restrictions require that: (a) interest rates are fixed for at least 5 years; and (b) deferred amortisation is applicable only if the interest rate on a loan is fixed for at least 30 years. Furthermore, the Supervisory Diamond for mortgage banks was announced in 2014. It comprises a number of benchmarks and limit values set for special risk areas within banking activities, and is aimed at increasing the credit quality of the stock of mortgage loans by 2018 and 2020, thereby affecting the production of new loans. Moreover, in 2018 the countercyclical capital buffer rate was increased twice: from 0 % to 0,5 % from 1 March 2019; and from 0,5 % to 1 % from September 2019. In addition, the Danish Systemic Risk Council has recommended a further increase from 1 % to 1,5 % from June 2020 and has issued forward guidance that it should be increased to its potential maximum of 2,5 % unless there is a significant change in the build-up of risk in the Danish financial system. Finally, *Finanstilsynet* (the Danish Financial Supervisory Authority) has issued a guideline that requires credit institutions to display caution in their credit assessment of households when lending to real estate in geographical areas in which residential real estate prices have been growing.

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu

⁽⁶⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu

- (12) Despite the number of macroprudential measures in place, and given the high level of household indebtedness and the significant share of mortgagors vulnerable to adverse economic conditions or adverse developments in the residential real estate market, the current capital-based measures may not be sufficient to address the accumulated vulnerabilities. Furthermore, tightening of existing or activation of additional borrower-based measures may be necessary in the medium term if vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards increase.
- (13) While cyclical factors play an important role in fuelling the vulnerabilities identified in Denmark, there are also structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) complex rental market regulations with caps on rent in a significant share of apartment buildings in the major cities, which creates a lack of housing supply and exerts upward pressure on house prices and debt for households that buy their own property; and (ii) the tax deductibility of mortgages, which may act as an incentive for households to overborrow. Furthermore, since 2001 the system of housing property taxation has been decoupled from market prices, resulting in a decline in the effective tax rate, especially in the major cities. In 2017 the Danish parliament passed into law a bill on a new housing taxation system that re-establishes the link between taxes payable and current residential real estate market prices, which will take effect in 2021.
- (14) Therefore, the ESRB has concluded that while the macroprudential measures that are in place or available in Denmark are appropriate, they are partially sufficient to address the vulnerabilities related to household indebtedness in the medium term. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk. The measures proposed in this Recommendation are aimed at complementing the existing macroprudential measures in Denmark. Given that the vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in Denmark more efficiently and effectively, without producing excessive costs for the Danish real economy and financial system.
- (15) The purpose of this Recommendation is to recommend: a) the activation of further, or the tightening of existing, capital-based measures in order to ensure the resilience of the banking sector against the medium-term vulnerabilities identified in Denmark; b) the monitoring of vulnerabilities and the activation of further, or the tightening of existing, borrower-based measures if house price growth and credit growth accelerate in the medium term. This Recommendation also aims to emphasise the need for broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness.
- (16) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (17) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A – Activation or tightening of capital-based measures

It is recommended that the macroprudential authority, the designated authority or the competent authority in Denmark, as applicable, ensure, by activating additional or tightening existing capital-based measures, the resilience of credit institutions authorised in Denmark in the face of the potential materialisation of systemic risk related to residential real estate which could lead to direct and indirect credit losses stemming from mortgage loans or arising as a consequence of the decrease in consumption by households with housing loans.

Recommendation B — Monitoring of vulnerabilities and activation or tightening of borrower-based measures

1. It is recommended that the Danish national authorities entrusted with the monitoring of systemic risks closely monitor vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards for new mortgage loans over the medium term, including, inter alia, by:
 - a) assessing — using loan-level data for new mortgage loans — the ability of borrowers taking out new mortgage loans to withstand adverse economic or financial conditions or adverse developments in the residential real estate market; and
 - b) assessing the sustainability of house prices and the potential for their decrease in the event of adverse economic or financial conditions.
2. It is recommended that, in order to prevent the excessive accumulation of credit risk, the Danish authority entrusted with the activation of borrower-based measures activate additional, or tighten existing, borrower-based measures, if the results of the monitoring carried out pursuant to point (a) of sub-Recommendation B(1) provide evidence that a significant or an increasing share of borrowers taking out new mortgage loans might not be able to service their debt or maintain consumption under adverse economic or financial conditions or following adverse developments in the residential real estate market.
3. It is recommended that Denmark increase the legally binding minimum down payment requirement, if the results of the monitoring carried out pursuant to paragraph 1(b) provide evidence that the overvaluation of house prices has increased, in order to ensure that collateral for new mortgage loans is sufficient to cover credit losses corresponding to the potential decrease in house prices under adverse economic or financial conditions and to the estimated decrease in house prices in the event of a negative scenario.

Recommendation C — Structural changes related to mortgage loans and the residential real estate sector

It is recommended that Denmark review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Denmark as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt, or cause excessive growth in house prices and mortgage debt.

SECTION 2

IMPLEMENTATION**1. Definitions**

For the purposes of this Recommendation the following definitions apply:

- (a) 'borrower-based measures' means macroprudential measures that target borrowers;
- (b) 'direct control' means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) 'recommendation powers' means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;
- (d) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;
- (e) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immoveable property at the moment of loan origination relative to the value of the property at the moment of loan origination;
- (f) 'medium term' means within a three-year horizon;
- (g) 'macroprudential authority' means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ^(*);

^(*) 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).

- (h) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year);
- (i) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (j) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination.

2. Criteria for implementation

1. The following criteria apply to the implementation of this Recommendation:
 - (a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A, of Recommendation B and of Recommendation C;
 - (b) when activating additional, or tightening existing, capital-based measures under Recommendation A, their calibration and phasing-in should take into account the position of Denmark in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
 - (c) when activating additional, or tightening existing, borrower-based measures under Recommendation B, their calibration and phasing-in should take into account the position of Denmark in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
 - (d) when increasing the minimum down payment requirement under Recommendation B, the calibration and phasing-in of such measure should take into account the position of Denmark in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
 - (e) as regards Recommendation C, when making policy changes, the phasing-in of such measures should take into account the position of Denmark in the economic and financial cycles, so that these measures do not serve to amplify or trigger the materialisation of accumulated vulnerabilities in the residential real estate sector in Denmark;
 - (f) specific criteria for compliance with Recommendation A, with Recommendation B and with Recommendation C are set out in Annex I.
2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards for new mortgage loans, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, maturities, and amortisation profiles, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ^(*), together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
 - (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

3. Timeline for the follow-up

The addressees of this Recommendation are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

(a) Recommendation A

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressee of Recommendation A is requested to submit to the ESRB and to the Council a report on any actions taken with regard to implementing capital-based measures. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

^(*) 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).

(b) *Recommendation B*

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation B are requested to submit to the ESRB and to the Council a report on monitoring vulnerabilities related to household indebtedness and actions taken to address such vulnerabilities. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

(c) *Recommendation C*

By 31 October 2022, the addressee of Recommendation C is requested to deliver to the ESRB and to the Council a report on the implementation of Recommendation C. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

4. **Monitoring and assessment**

1. The ESRB Secretariat will:

- (a) assist the addressees, ensuring the coordination of reporting, 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. Three assessments will be initiated as follows:
 - (i) by 31 December 2020, regarding the implementation of Recommendations A and B;
 - (ii) by 31 December 2021, regarding the implementation of Recommendations A and B; and
 - (iii) by 31 December 2022, regarding the implementation of Recommendations A, B and C.

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

Done at Frankfurt am Main, 27 June 2019.

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

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATIONS

Recommendation A — Activation or tightening of capital-based measures

The following compliance criteria are applicable to Recommendation A.

1. Prior to activating additional, or tightening existing, capital-based measures, an assessment should be made of the position of Denmark in the economic and financial cycles in order to determine whether activating such measures would be appropriate.
2. 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 Denmark; 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.

Recommendation B — Monitoring of vulnerabilities and activation or tightening of borrower-based measures

The following compliance criteria are applicable to Recommendation B.

1. Prior to activating additional, or tightening existing, borrower-based measures, an assessment should be made of the position of Denmark in the economic and financial cycles in order to determine whether such activation or tightening would be appropriate.
2. Prior to increasing the existing minimum down payment requirement, an assessment should be made of the position of Denmark in the economic and financial cycles in order to determine an appropriate calibration and phasing-in of the measure.

Recommendation C — Structural changes related to mortgage loans and the residential real estate sector

The following compliance criterion is applicable to Recommendation C.

When formulating policy options, and before implementing any policy changes, an assessment should be made of the impact of the proposed measures considering the position of Denmark in the economic and financial cycles, to ensure that such measures do not amplify or trigger the materialisation of the accumulated vulnerabilities in the residential real estate sector in Denmark.

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Luxembourg
(ESRB/2019/6)
(2019/C 366/03)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.
- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which Luxembourg was one ⁽⁶⁾.
- (8) In 2016 the main vulnerabilities identified in the residential real estate market in Luxembourg related to the rapid growth in both house prices and mortgage loans, as well as the high and increasing household indebtedness. Moreover, a significant share of mortgagors had high debt and debt-servicing costs relative to income, thus making them vulnerable to a potential increase in interest rates.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards Luxembourg, this recent assessment has revealed that, since 2016, strong growth in mortgage loans has continued to fuel household indebtedness. Despite the fact that the growth in house prices has decelerated, the previous dynamics raise concerns about potential overvaluation. Moreover, the most recent evidence on lending standards confirms that a significant share of households are potentially vulnerable to adverse economic or financial conditions or adverse developments in the residential real estate market.
- (11) Since 2016, and following the recommendations issued by *Comité du Risque Systémique* (the Luxembourg macroprudential authority) several capital-based measures have been activated in Luxembourg: (i) in 2016, the *Commission de Surveillance du Secteur Financier* (CSSF, the Luxembourg Financial Sector Supervisory Commission) introduced for retail exposures secured by residential property located in Luxembourg, an average risk weight floor of 15 % for credit institutions that use the internal ratings-based approach, under Article 92 of Regulation (EU) No 575/2013; and (ii) in 2018, the CSSF increased the countercyclical capital buffer rate from 0 % to 0,25 %, from 1 January 2020.
- (12) Even though the national authorities in Luxembourg have proposed the establishment of a legal framework for legally binding borrower-based measures, these measures are not yet available in Luxembourg. However, the vulnerabilities identified, which are related to the growth in both house prices and mortgage loans as well as increasing household indebtedness, would require the activation of such measures.
- (13) While cyclical factors play an important role in fuelling the vulnerabilities identified in Luxembourg, there are also structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) a lack of housing supply, which has been exerting upward pressure on house prices and debt for households that buy their own property; and (ii) the tax deductibility of interest paid on mortgage loans, which may act as an incentive for households to overborrow.

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽⁶⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- (14) Therefore, the ESRB has concluded that the macroprudential measures that are in place or available in Luxembourg are partially appropriate and partially sufficient to address the medium-term vulnerabilities that have been identified in Luxembourg. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk. The measures proposed in this Recommendation are intended to complement the existing macroprudential measures in Luxembourg, with the aim of strengthening resilience. They should not be considered as substitutes for the existing capital-based measures, which remain important in order to address existing vulnerabilities in the outstanding loan portfolio. Given that the vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in Luxembourg more efficiently and effectively, without producing excessive costs for the Luxembourg real economy and financial system.
- (15) The purpose of this Recommendation is to recommend the establishment in Luxembourg law of a framework for legally binding borrower-based measures, as well as the activation of such measures as soon as they are available under national law. This Recommendation also aims to emphasise the need for broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness.
- (16) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (17) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A — Legal framework for borrower-based measures

It is recommended that Luxembourg establish a legal framework for borrower-based measures which includes at least the following legally-binding borrower-based measures:

- a. limits that apply to the DTI ratio;
- b. limits that apply to the DSTI ratio;
- c. limits that apply to the LTV ratio; and
- d. maturity limits.

Recommendation B — Activation of borrower-based measures

1. It is recommended that, pending the establishment of the legal framework referred to in Recommendation A, the Luxembourg national authorities entrusted with the application of borrower-based measures apply non-legally-binding borrower-based measures in order to prevent:
 - (a) a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market; or
 - (b) a significant or an increasing share of new mortgage loans, secured by residential real estate, that could result in credit losses on these loans in the event of their default and a subsequent decrease in house prices.

2. It is recommended that, once the legal framework referred to in Recommendation A is established, the Luxembourg national authorities entrusted with the application of borrower-based measures activate legally-binding borrower-based measures to further address the objectives set out in sub-recommendation B(1).

Recommendation C — Structural changes related to mortgage loans and the residential real estate sector

It is recommended that Luxembourg review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Luxembourg as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt, or cause excessive growth in house prices and mortgage debt.

SECTION 2

IMPLEMENTATION

1. Definitions

For the purposes of this Recommendation the following definitions apply:

- (a) 'borrower-based measures' means macroprudential measures that target borrowers;
- (b) 'direct control' means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) 'recommendation powers' means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;
- (d) 'medium term' means within a three-year horizon;
- (e) 'macroprudential authority' means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ^(*);
- (f) 'legally binding borrower-based measures' means borrower-based measures that are introduced through legally binding acts;
- (g) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;
- (h) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (i) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the value of the property at the moment of loan origination;
- (j) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination;
- (k) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year).

2. Criteria for implementation

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

- (a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A and Recommendation B;
- (b) Recommendation A must be implemented before sub-recommendation B(2) to ensure compliance with sub-recommendation B(2);

^(*) 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).

- (c) when activating borrower-based measures under Recommendation B, their calibration and phasing-in should take into account the position of Luxembourg in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
 - (d) as regards Recommendation C, when making policy changes, the phasing-in of such measures should take into account the position of Luxembourg in the economic and financial cycles, so that these measures do not serve to amplify or trigger the materialisation of accumulated vulnerabilities in the residential real estate sector in Luxembourg;
 - (e) specific criteria for compliance with Recommendation A, with Recommendation B and with Recommendation C are set out in Annex I.
2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to household indebtedness, house price overvaluation and lending standards for new mortgage loans, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, and maturities, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ⁽⁹⁾, together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
 - (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

3. Timeline for the follow-up

The addressees of this Recommendation are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

(a) Recommendation A

- (i) By 31 October 2020, the addressee of Recommendation A is requested to submit to the ESRB and to the Council an interim report on the implementation of Recommendation A including at least a statement clarifying whether it is planned that Recommendation A be implemented and which body or bodies will be responsible for the decision to activate and implement the borrower-based measures set out in that Recommendation. The ESRB may inform the addressee of Recommendation A of its views on the interim report.
- (ii) By 31 March 2021, the addressee of Recommendation A is requested to submit to the ESRB and to the Council a final report on the implementation of Recommendation A.

(b) Recommendation B

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation B are requested to submit to the ESRB and to the Council a report on any actions taken with regard to implementing borrower-based measures or any other available measures to address the vulnerabilities related to household indebtedness, house price overvaluation and lending standards for new mortgage loans in Luxembourg. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

(c) Recommendation C

By 31 October 2022, the addressee of Recommendation C is requested to submit to the ESRB and to the Council a report on the implementation of Recommendation C. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

⁽⁹⁾ 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).

4. Monitoring and assessment

1. The ESRB Secretariat will:
 - (a) assist the addressees, ensuring the coordination of reporting, 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. Three assessments will be initiated as follows:
 - (i) by 31 December 2020, regarding the implementation of Recommendation B;
 - (ii) by 31 December 2021, regarding the implementation of Recommendations A and B; and
 - (iii) by 31 December 2022, regarding the implementation of Recommendations B and C.
2. The General Board will assess the actions and justifications reported by the addressees and, where appropriate, may decide that this Recommendation has not been followed and that an addressee has failed to provide adequate justification for its inaction.

Done at Frankfurt am Main, 27 June 2019.

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

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATIONS

Recommendation A — Legal framework for borrower-based measures

The following compliance criteria are applicable to Recommendation A.

1. The Luxembourg legal framework for borrower-based measures should ensure that:
 - (a) the limits that apply to the debt-to-income (DTI) ratio and to the debt-service-to income (DSTI) ratio, as well as the maturity limits, are applicable to loans granted to all types of borrowers and by all types of lenders, in order to avoid circumvention of the limits;
 - (b) when calculating the loan-to-value (LTV) ratio, only immoveable property can be considered as collateral;
 - (c) the Luxembourg national authorities entrusted with the activation of borrower-based measures are able to activate legally-binding borrower-based measures in an effective and pre-emptive way and are provided with the necessary flexibility in order to design those measures based on the vulnerabilities identified.
2. The Luxembourg legal framework for borrower-based measures should be in force by no later than 1 July 2021.

Recommendation B – Activation of borrower-based measures

The following compliance criteria are applicable to Recommendation B.

1. In order to prevent:
 - (a) a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market; or
 - (b) a significant or an increasing share of new mortgage loans, secured by residential real estate, that could result in credit losses in the event of their default and a subsequent decrease in house prices;

the Luxembourg national authorities should use one or several borrower-based measures in combination (e.g. limits to the LTV ratio in combination with limits to the DTI ratio, or to the DSTI ratio, and maturity limits), to ensure the effectiveness of the measures in place and to minimise any potential for their circumvention or for unintended consequences that could reduce their effectiveness and possibly create risks in other areas.
2. Prior to activating borrower-based measures, an assessment should be made of the position of Luxembourg in the economic and financial cycles, in order to determine the appropriate calibration and phasing-in of such measures.
3. After the activation of the borrower-based measures, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in Luxembourg; this will depend on the choice of the borrower-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.
4. Once the legal framework referred to in Recommendation A is in force, the Luxembourg national authorities entrusted with the application of borrower-based measures may decide to retain non-legally-binding borrower-based measures that are already in place, provided that there is evidence that the vulnerabilities identified have been adequately mitigated by such measures.

Recommendation C — Structural changes related to mortgage loans and the residential real estate sector

The following compliance criterion is applicable to Recommendation C.

When formulating policy options, and before implementing any policy changes, an assessment should be made of the impact of the proposed measures considering the position of Luxembourg in the economic and financial cycles, to ensure that such measures do not amplify or trigger the materialisation of the accumulated vulnerabilities in the residential real estate sector in Luxembourg.

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in the Netherlands
(ESRB/2019/7)
(2019/C 366/04)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.
- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which the Netherlands was one ⁽⁶⁾.
- (8) In 2016 the main vulnerability identified in the residential real estate market in the Netherlands related to high household indebtedness, with a significant share of mortgagors having total debt exceeding the value of their home. This vulnerability reflected, among other things, that although the share of new amortising mortgage loans was increasing, a significant share of the existing mortgage loans was non-amortising – despite the fact that in 2016 there were no signs of overvaluation and house prices in major cities were returning to pre-crisis levels.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards the Netherlands, this recent assessment has revealed that, since 2016, household indebtedness has decreased slightly and the share of new non-amortising mortgage loans has also continued to decrease. On the other hand, since 2016, house prices have continued to increase, leading to pockets of overvaluation in the major cities. Against this background, the loan-to-value (LTV) ratios of new mortgage loans have remained high, in particular because the regulatory limit of 100 % that applies to the LTV ratio does not require additional collateral for an event of a decrease in house prices. The vulnerabilities posed by these developments with regard to financial stability have not been reflected in the application of risk weights for mortgage loans in the Netherlands, which are among the lowest in the EEA.
- (11) Since 2016, the gradual tightening of the legally-binding limit that applies to the LTV ratio continued, and it was lowered to 100 % in 2018 (from 106 % in 2012). In 2018, the Dutch Government also announced that it would gradually reduce the maximum rate at which interest paid on mortgage loans can be deducted, from 49,5 % in 2018 to around 37 % in 2023.

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu

- (12) Even though the macroprudential authority in the Netherlands (Financieel Stabieliteitscomité) has recommended a further tightening of the legally binding limit that applies to the LTV ratio to 90 %, the Dutch Government, which is responsible for implementing such measures, has chosen not to follow this recommendation. Furthermore, since the current legal framework does not provide for an ‘act or explain’ mechanism for recommendations made by the macroprudential authority, the Dutch Government has not been formally required to explain its inaction to the macroprudential authority, but has only explained its position to the Dutch Parliament. However, in order to address the vulnerabilities identified in the Netherlands as regards pockets of overvaluation of house prices and the collateralisation of new mortgage loans, the limit that applies to the LTV ratio would need to be reduced. Moreover, there are no macroprudential capital-based measures — for example higher risk weights for mortgage loans — currently in place to address the accumulated vulnerabilities related to the collateralisation of existing mortgage loans and the potential second-round effects related to household indebtedness.
- (13) Although the debt-service-to-income (DSTI) ratio for mortgage loans has important risk mitigating characteristics, such as assumptions about potential increases in interest rates, certain elements of the current methodology for calibrating the limit that applies to the DSTI ratio in the Netherlands reduce the effectiveness of the measure and may increase its procyclical effects on the financial and economic cycles. While some adjustments (such as the use of four-year averages of the calculated ratios as inputs for the calibration) have been made to address the procyclical elements of the methodology, certain of these elements remain.
- (14) While cyclical factors play an important role in fuelling the vulnerabilities identified in the Netherlands, there are also structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) a lack of housing supply, which has been exerting upward pressure on house prices and debt for households that buy their own property; and (ii) the tax deductibility of interest paid on mortgage loans, which may act as an incentive for households to overborrow.
- (15) Therefore, the ESRB has concluded that the macroprudential measures that are in place in the Netherlands are partially appropriate and partially sufficient to address the vulnerabilities related to household indebtedness in the medium term. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk. The measures proposed in this Recommendation are aimed at complementing the existing macroprudential measures in the Netherlands.
- (16) Given that the vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in the Netherlands more efficiently and effectively, without producing excessive costs for the Dutch real economy and financial system.
- (17) The purpose of this Recommendation is to recommend: a) the establishment in Dutch law of an ‘act or explain’ mechanism in relation to recommendations issued by the macroprudential authority on the activation of legally binding borrower-based measures; (b) the tightening of the existing legally binding limit that applies to the LTV ratio; (c) an amendment to the methodology for determining the maximum limit that applies to the DSTI ratio; and (d) the activation of capital-based measures in order to ensure the resilience of the banking sector in relation to the medium-term vulnerabilities identified in the Netherlands. This Recommendation also aims to emphasise the need for broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness.
- (18) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (19) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A — Legal framework for borrower-based measures

It is recommended that the Netherlands ensure that the recommendation powers of the macroprudential authority over all applicable legally binding borrower-based measures are complemented by an ‘act or explain’ mechanism, or alternatively, where this is not possible under Dutch law, that an accountability mechanism is established in order to make public the views of the authority responsible for the application of borrower-based measures following a recommendation issued by the macroprudential authority in the Netherlands.

Recommendation B — Tightening of borrower-based measures and approach to calibration

1. It is recommended that the Netherlands lower the current legally binding limit that applies to the LTV ratio, thus ensuring that collateral for new mortgage loans is sufficient to cover credit losses corresponding to the potential decrease in house prices under adverse economic or financial conditions.
2. It is recommended that the Netherlands change the methodology for determining the maximum limit that applies to the DSTI ratio so that the measure does not lead to increasing procyclicality of the economic and financial cycles.

Recommendation C — Activation of capital-based measures

It is recommended that the macroprudential authority, the designated authority or the competent authority in the Netherlands, as applicable, ensure, by activating capital-based measures, the resilience of credit institutions authorised in the Netherlands in the face of the potential materialisation of systemic risk related to residential real estate which could lead to direct and indirect credit losses stemming from mortgage loans or arising as a consequence of the decrease in consumption by households with housing loans.

Recommendation D — Structural changes related to mortgage loans and the residential real estate sector

It is recommended that the Netherlands review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in the Netherlands as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt, or cause excessive growth in house prices and mortgage debt.

SECTION 2

IMPLEMENTATION

1. Definitions

For the purposes of this Recommendation the following definitions apply:

- (a) ‘borrower-based measures’ means macroprudential measures that target borrowers;
- (b) ‘direct control’ means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) ‘recommendation powers’ means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;
- (d) ‘loan-to-value ratio’ (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the value of the property at the moment of the loan origination;
- (e) ‘macroprudential authority’ means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ^(*);

^(*) 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).

- (f) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year);
- (g) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (h) 'medium term' means within a three-year horizon;
- (i) 'legally binding borrower-based measures' means borrower-based measures that are introduced through legally binding acts.

2. Criteria for implementation

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

- (a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A, Recommendation B, Recommendation C and Recommendation D;
- (b) when lowering the existing limit that applies to the LTV ratio under Recommendation B, the calibration and phasing-in of the measure should take into account the position of the Netherlands in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
- (c) when activating capital-based measures under Recommendation C, their calibration and phasing-in should take into account the position of the Netherlands in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
- (d) as regards Recommendation D, when making policy changes, the phasing-in of such measures should take into account the position of the Netherlands in the economic and financial cycles, so that these measures do not serve to amplify or trigger the materialisation of accumulated vulnerabilities in the residential real estate sector in the Netherlands;
- (e) specific criteria for compliance with Recommendation B, with Recommendation C and with Recommendation D are set out in Annex I.

2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to pockets of overvaluation of house prices and the collateralisation of new and existing mortgage loans, including the distribution of new mortgage loans according to their LTV ratios, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ^(*), together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
- (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

3. Timeline for the follow-up

The addressees of this Recommendation are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

(a) Recommendation A

By 31 March 2021, the addressee of Recommendation A is requested to submit a final report to the ESRB and to the Council on the implementation of Recommendation A.

^(*) 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).

(b) *Recommendation B*

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressee of sub-Recommendation B(1) is requested to submit to the ESRB and to the Council a report on any actions taken with regard to tightening borrower-based measures. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

By 31 March 2021, the addressee of sub-Recommendation B(2) is requested to submit to the ESRB and to the Council a report on the implementation of sub-Recommendation B(2). Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

(c) *Recommendation C*

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation C are requested to submit to the ESRB and to the Council a report on any actions taken with regard to implementing capital-based measures. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

(d) *Recommendation D*

By 31 October 2022, the addressee of Recommendation D is requested to submit to the ESRB and to the Council a report on the implementation of Recommendation D. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

4. **Monitoring and assessment**

1. The ESRB Secretariat will:

- (a) assist the addressees, ensuring the coordination of reporting, 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. Three assessments will be initiated as follows:
 - (i) by 31 December 2020, regarding the implementation of sub-recommendation B(1) and Recommendation C;
 - (ii) by 31 December 2021, regarding the implementation of Recommendations A, sub-recommendations B(1) and B(2) and Recommendation C;
 - (iii) by 31 December 2022 regarding the implementation of subrecommendation B(1) and Recommendations C and D.

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

Done at Frankfurt am Main, 27 June 2019.

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

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATIONS

Recommendation B — Tightening of borrower-based measures and approach to calibration

The following compliance criterion is applicable to sub-recommendation B(1).

Prior to further lowering the existing limits that apply to the loan-to-value (LTV) ratio, an assessment should be made of the position of the Netherlands in the economic and financial cycles in order to determine an appropriate calibration and phasing-in of such measures.

The following compliance criterion is applicable to sub-recommendation B(2).

When calibrating the limit that applies to the DSTI ratio, the Netherlands should assess the potential procyclical effects of different elements of the methodology used for the calibration.

Recommendation C — Activation of capital-based measures

The following compliance criteria are applicable to Recommendation C.

1. Prior to activating capital-based measures, an assessment should be made of the position of the Netherlands in the economic and financial cycles in order to determine whether activating such measures would be appropriate.
2. 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 Netherlands; this will depend on the choice of the capital-based measures activated, on the initial calibration of those measures and on the results of the assessment of vulnerabilities.

Recommendation D — Structural changes related to mortgage loans and the residential real estate sector

The following compliance criterion is applicable to Recommendation D.

When formulating policy options, and before implementing any policy changes, an assessment should be made of the impact of the proposed measures considering the position of the Netherlands in the economic and financial cycles, to ensure that such measures do not amplify or trigger the materialisation of the accumulated vulnerabilities in the residential real estate sector in the Netherlands.

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Finland
(ESRB/2019/8)
(2019/C 366/05)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.
- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which Finland was one ⁽⁶⁾.
- (8) In 2016 the main vulnerability identified in the residential real estate market in Finland was high and increasing household indebtedness, with a significant share of households being potentially vulnerable to adverse economic or financial conditions or adverse developments in that market.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards Finland, this recent assessment has revealed that household indebtedness is higher than it was in 2016. Recently, this increase has partly been accounted for by loans taken out by housing companies ⁽⁸⁾ and then repaid from the income of households and other investors holding shares in these companies. In addition, newly available evidence regarding lending standards for new mortgage loans supports previous evidence of the potential vulnerability of a significant share of households taking out new mortgage loans to adverse economic or financial conditions or adverse developments in the residential real estate market.
- (11) Since 2016, the Finnish national authorities have tightened or introduced several borrower- and capital-based measures: (i) in 2017 the Board of *Finanssivalvonta* (the Finnish Financial Supervisory Authority) introduced, pursuant to Article 458 of Regulation (EU) No 575/2013, an average risk weight floor of 15 % for housing loans for credit institutions that use the internal ratings-based approach; (ii) in 2018 a systemic risk buffer of between 1 % and 3 % was imposed on all credit institutions; (iii) in 2018 the limit that applies to the loan-to-value (LTV) ratio was tightened from 90 % to 85 %; and (iv) also in 2018, *Finanssivalvonta* issued recommendations concerning lending standards for new loans, which also applied to loans to housing companies. In addition, the tax deductibility of mortgage interest expenses was reduced, from 100 % in 2011 to 25 % in 2019.
- (12) Despite these recently introduced measures, and except for the limit that applies to the LTV ratio, other legally binding borrower-based measures, namely limits that apply to the debt-to-income (DTI) ratio, the debt-service-to-income (DSTI) ratio and, maturity limits, are still not available in Finland, even though such measures may be necessary in the medium term if vulnerabilities related to household indebtedness continue to increase. Activating the limits that apply to either the DTI ratio or the DSTI ratio, in combination with maturity limits, would increase the effectiveness of the existing macroprudential measures that are already in place. Furthermore, the LTV ratio is currently defined in a manner that allows assets other than real estate assets to be considered as collateral.

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽⁶⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

⁽⁸⁾ In Finnish: *asunto-osakeyhtiö*.

- (13) Therefore, the ESRB has concluded that the macroprudential measures that are in place or available in Finland are partially appropriate and partially sufficient to address the vulnerabilities related to household indebtedness in the medium term. Consequently, further policy action is required to address these vulnerabilities, which can be a source of systemic risk. The measures proposed in this Recommendation are aimed at complementing the existing macroprudential measures in Finland.
- (14) The purpose of this Recommendation is to recommend the inclusion in Finnish law of additional legally binding borrower-based measures, as well as the adoption of such measures to prevent the vulnerabilities related to household indebtedness from increasing.
- (15) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (16) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A — Legal framework for borrower-based measures

1. It is recommended that Finland ensure that the existing legal framework for borrower-based measures includes at least the following legally-binding borrower-based measures:
 - a. either limits that apply to the DTI ratio or limits that apply to the DSTI ratio;
 - b. limits that apply to the LTV ratio; and
 - c. maturity limits.
2. It is recommended that Finland amend the definition of the LTV ratio in the existing legal framework for borrower-based measures.

Recommendation B — Activation of income-related borrower-based measures

1. It is recommended that, pending the amendment of the existing legal framework as referred to in Recommendation A, the Finnish national authorities entrusted with the activation of income-related borrower-based measures apply non-legally-binding borrower-based measures in order to prevent a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market.
2. It is recommended that, once the existing legal framework has been amended as referred to in Recommendation A, the Finnish national authorities entrusted with the activation or calibration of income-related borrower-based measures activate or calibrate, respectively, legally binding income-related borrower-based measures to further address the objectives set out in sub-recommendation B(1).

SECTION 2

IMPLEMENTATION

1. Definitions

For the purposes of this Recommendation the following definitions apply:

- (a) 'borrower-based measures' means macroprudential measures that target borrowers;
- (b) 'direct control' means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) 'recommendation powers' means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;

- (d) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the value of the property at the moment of loan origination;
- (e) 'legally binding borrower-based measures' means borrower-based measures that are introduced through legally binding acts;
- (f) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;
- (g) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year);
- (h) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (i) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination;
- (j) 'medium term' means within a three-year horizon;
- (k) 'income-related borrower-based measures' means limits that apply to the DTI ratio and limits that apply to the DSTI ratio;
- (l) 'macroprudential authority' means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ⁽⁹⁾.

2. Criteria for implementation

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

- (a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A and of Recommendation B;
- (b) Recommendation A must be implemented before sub-recommendation B(2) to ensure compliance with sub-recommendation B(2);
- (c) when activating income-related borrower-based measures under Recommendation B, their calibration and phasing-in should take into account the position of Finland in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
- (d) specific criteria for compliance with Recommendation A and with Recommendation B are set out in Annex I.

2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to household indebtedness and lending standards for new mortgage loans, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios, and maturities, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ⁽¹⁰⁾, together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
- (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

⁽⁹⁾ 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).

⁽¹⁰⁾ 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).

3. Timeline for the follow-up

The addressees of this Recommendation are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

(a) *Recommendation A*

- (i) By 31 October 2020, the addressee of Recommendation A is requested to submit to the ESRB and to the Council an interim report on the implementation of Recommendation A including at least a statement clarifying whether it is planned that Recommendation A be implemented and which body or bodies will be responsible for the decision to activate and implement the borrower-based measures set out in that Recommendation. The ESRB may inform the addressee of Recommendation A of its views on the interim report.
- (ii) By 31 March 2021, the addressee of Recommendation A is requested to submit to the ESRB and to the Council a final report on the implementation of Recommendation A.

(b) *Recommendation B*

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation B are requested to deliver to the ESRB and to the Council a report on any actions taken with regard to implementing income-related borrower-based measures or any other available measures to address the vulnerabilities related to household indebtedness and lending standards for new mortgage loans in Finland. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

4. Monitoring and assessment

1. The ESRB Secretariat will:

- (a) assist the addressees, ensuring the coordination of reporting, 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. Three assessments will be initiated as follows:
 - (i) by 31 December 2020, regarding the implementation of Recommendation B;
 - (ii) by 31 December 2021, regarding the implementation of Recommendations A and B; and
 - (iii) by 31 December 2022, regarding the implementation of Recommendation B.

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

Done at Frankfurt am Main, 27 June 2019.

Head of the ESRB Secretariat
on behalf of the General Board of the ESRB
Francesco MAZZAFERRO

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATIONS

Recommendation A — Legal framework for borrower-based measures

The following compliance criteria are applicable to Recommendation A.

1. The Finnish legal framework for borrower-based measures should ensure that:
 - (a) the limits that apply to the debt-to-income (DTI) ratio and to the debt-service-to income (DSTI) ratio, as well as the maturity limits, are applicable to loans granted to all types of borrowers and by all types of lenders, in order to avoid circumvention of the limits by the use of loans to housing companies or other methods;
 - (b) when calculating the loan-to value (LTV) ratio, only immovable property can be considered as collateral;
 - (c) the Finnish national authorities entrusted with the activation of borrower-based measures are able to activate legally-binding borrower-based measures in an effective and pre-emptive way and are provided with the necessary flexibility in order to design those measures based on the vulnerabilities identified.
2. The amendments to the Finnish legal framework for borrower-based measures should be in force by no later than 1 July 2021.

Recommendation B — Activation of income-related borrower-based measures

The following compliance criterion is applicable to Recommendation B:

1. In order to prevent a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the residential real estate market, the Finnish national authorities should use one or several income-related borrower-based measures in combination (e.g. limits to the LTV ratio in combination with limits to the DTI ratio, or to the DSTI ratio, and maturity limits), to ensure the effectiveness of the measures in place and to minimise any potential for their circumvention or for unintended consequences that could reduce their effectiveness and possibly create risks in other areas.
 2. Prior to activating income-related borrower-based measures, an assessment should be made of the position of Finland in the economic and financial cycles, in order to determine the appropriate calibration and phasing-in of such measures.
 3. After the activation of the income-related borrower-based measures, their further tightening or the activation of additional macroprudential measures may be needed to address the vulnerabilities identified in Finland; this will depend on the choice of the income-related borrower-based measures activated, on the initial calibration of those activated measures and on the results of the assessment of vulnerabilities.
 4. When activating or calibrating the income-related borrower-based measures the Finnish national authorities entrusted with the activation or calibration of income-related borrower-based measures should take into account all loans which are to be serviced by households from their income, regardless of the form of the loans (i.e. treating loans to housing companies as household debt).
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RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Sweden
(ESRB/2019/9)
(2019/C 366/06)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16, 17 and 18 thereof,

Whereas:

- (1) The real estate sector plays an important role in the economy and its developments may have a material influence on the financial system. Past financial crises have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole, which may also lead to negative cross-border spillovers. Adverse real estate market developments in some Member States have, in the past, resulted in large credit losses and/or had a negative impact on the real economy. Such effects reflect the close interplay between the real estate sector, funding providers and other economic sectors. Furthermore, the strong feedback loops between the financial system and the real economy reinforce any negative developments.
- (2) These links are important because they mean that risks originating in the real estate sector may have a systemic impact that is procyclical in nature. Financial system vulnerabilities tend to accumulate during the upswing phase of the real estate cycle. The perceived lower risks of, and easier access to, funding may contribute to a rapid expansion of credit and investment, together with an increased demand for real estate, which puts upward pressure on property prices. Since the resulting higher collateral values further favour the demand for, and supply of, credit, these self-reinforcing dynamics may result in potential systemic consequences. Conversely, during the downturn phase of the real estate cycle, tighter credit conditions, higher risk aversion and downward pressure on real estate prices may adversely affect the resilience of borrowers and lenders, thereby weakening economic conditions.
- (3) Vulnerabilities relating to residential real estate can be a source of systemic risk and they may affect financial stability both directly and indirectly. Direct effects are credit losses on mortgage portfolios due to adverse economic or financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects could be related to adjustments in household consumption, leading to further consequences for the real economy and financial stability.
- (4) As stated in recital 4 of Recommendation ESRB/2013/1 ⁽²⁾, the ultimate objective of macroprudential policy is to contribute to the safeguard of the stability of the financial system as a whole, including by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

⁽²⁾ Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (OJ C 170, 15.6.2013, p. 1).

- (5) To this end, macroprudential authorities may use one or more of the capital-based macroprudential measures set out in Directive 2013/36/EU of the European Parliament and of the Council ⁽³⁾ and Regulation (EU) No 575/2013 of the European Parliament and of the Council ⁽⁴⁾, and/or borrower-based macroprudential measures, which are exclusively based on national law, depending on the assessment of risks. While the capital-based measures are primarily aimed at increasing the resilience of the financial system, the borrower-based measures may be particularly suitable for preventing the further build-up of systemic risks.
- (6) In addition, Recommendation ESRB/2013/1 recommends that Member States establish a legal framework that permits the macroprudential authorities to have direct control or recommendation powers over the macroprudential instruments identified in that Recommendation.
- (7) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of the vulnerabilities relating to residential real estate ⁽⁵⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries, of which Sweden was one ⁽⁶⁾.
- (8) In 2016 the main vulnerability identified in the residential real estate market in Sweden related to the substantial and prolonged growth in both house prices and mortgage loans, which led to an overvaluation of house prices as well as to high and increasing household indebtedness.
- (9) The ESRB has recently concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities relating to residential real estate ⁽⁷⁾.
- (10) As regards Sweden, this recent assessment has revealed that, since 2016, the growth in house prices has decelerated, and they are currently at the same level as in 2016. However, house prices remain overvalued and household indebtedness has increased significantly.
- (11) Since 2016, the Swedish national authorities have tightened or introduced several borrower- and capital-based measures. In 2016, requirements for amortisation of new mortgage loans were introduced. These requirements were linked to the loan-to-value (LTV) ratio of the new loans, requiring amortisation by a minimum of 2 % annually for loans with an LTV ratio above 70 %, and by 1 % annually for loans with an LTV ratio of 50 % to 70 %. In 2017, these requirements were tightened in relation to the loan-to-income (LTI) ratio of the new loans, increasing these requirements by 1 percentage point per year for new mortgage loans with an LTI ratio above 4,5. In 2018, *Finansinspektionen* (the Swedish Financial Supervisory Authority) imposed on all domestic credit institutions that use the internal ratings-based approach, pursuant to Article 458 of Regulation (EU) No 575/2013, a credit institution-specific minimum level (floor) of 25 % for the exposure-weighted average of the risk weights applied to the portfolio of retail exposures to obligors residing in Sweden secured by mortgages on immovable property. Finally, *Finansinspektionen* increased the countercyclical capital buffer rate in 2018 from 2 % to 2,5 %, applicable from September 2019.
- (12) While cyclical factors play an important role in fuelling the vulnerabilities that have been identified in Sweden, there are also important structural factors that have driven these vulnerabilities, resulting in a higher level of systemic risk. These factors include: (i) a lack of housing supply, which has been exerting upward pressure on house prices and debt for households that buy their own property; and (ii) the favourable tax treatment of housing, such as the tax deductibility of interest paid on mortgage loans, which may facilitate house price increases and act as an incentive for households to overborrow.

⁽³⁾ 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).

⁽⁴⁾ 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).

⁽⁵⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽⁶⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽⁷⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- (13) Therefore, despite the fact that the ESRB acknowledges the wide range of macroprudential measures that are in place in Sweden, it has concluded that even though these macroprudential measures are appropriate, they are partially sufficient to address the identified vulnerabilities related to residential real estate, in particular the household indebtedness and overvaluation of house prices, in the medium term. Given that these vulnerabilities are, to some extent, driven by structural factors which go beyond macroprudential policy, other policies are needed to complement and support the current macroprudential measures, with the aim of addressing factors contributing to the build-up of systemic risks in the residential real estate market in Sweden more efficiently and effectively, without producing excessive costs for the Swedish real economy and financial system. The measures proposed in this Recommendation are aimed at complementing the existing macroprudential measures in Sweden.
- (14) The purpose of this Recommendation is to recommend: a) broader policy action aiming to curb factors which facilitate or promote increasing household indebtedness; and b) the tightening of the existing, or the activation of other, macroprudential measures if the vulnerabilities related to household indebtedness and overvaluation of house prices continue to increase due to cyclical economic and financial reasons.
- (15) This Recommendation is without prejudice to the monetary policy mandates of the central banks in the Union.
- (16) ESRB recommendations are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS RECOMMENDATION:

SECTION 1

RECOMMENDATIONS

Recommendation A – Structural changes related to mortgage loans and the residential real estate sector

It is recommended that Sweden review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Sweden as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt, or cause excessive growth in house prices and mortgage debt.

Recommendation B – Monitoring of vulnerabilities and activation or tightening of macroprudential measures

1. It is recommended that the Swedish national authorities entrusted with the monitoring of systemic risks closely monitor vulnerabilities related to household indebtedness and overvaluation of house prices over the medium term, including, inter alia, by:
 - a) assessing – using loan-level data for new mortgage loans – the ability of borrowers taking out new housing loans to withstand adverse economic or financial conditions or adverse developments in the residential real estate market; and
 - b) assessing potential credit losses on existing mortgage portfolios, as well as potential second-round effects on financial stability in the event of adverse economic or financial developments.
2. It is recommended that, in order to prevent the accumulation of credit risk, the Swedish macroprudential authority entrusted with the activation of borrower-based measures tighten existing, or activate other, borrower-based measures, if the results of the monitoring carried out pursuant to point (a) of sub-Recommendation B(1) provide evidence that a significant or an increasing share of borrowers taking out new housing loans might not be able to service their debt following an adverse economic or financial development.
3. It is recommended that the macroprudential authority, the designated authority or the competent authority in Sweden, as applicable, tighten existing, or introduce other, capital-based measures in order to ensure sufficient capital for mortgage loans granted by credit institutions authorised in Sweden, if the results of the monitoring carried out pursuant to point (b) of sub-Recommendation B(1) provide evidence that potential credit losses on existing mortgage loans in the event of adverse economic or financial conditions or adverse developments in the residential real estate market, as well as credit losses on other loans as a consequence of the decrease in consumption by households with housing loans, have increased due to cyclical, economic and financial factors.

SECTION 2

IMPLEMENTATION**1. Definitions**

For the purposes of this Recommendation the following definitions apply:

- (a) 'borrower-based measures' means macroprudential measures that target borrowers;
- (b) 'direct control' means a real and effective capacity to impose and modify, where necessary to achieve an ultimate or intermediate objective, macroprudential measures applicable to the financial institutions that are under the scope of action of the corresponding macroprudential authority;
- (c) 'recommendation powers' means the capacity to guide, by means of recommendations, the application of macroprudential instruments, where necessary to achieve an ultimate or intermediate objective;
- (d) 'loan-to-value ratio' (LTV ratio) means the sum of all loans or loan tranches secured by the borrower on the immoveable property at the moment of loan origination relative to the value of the property at the moment of loan origination;
- (e) 'loan-to-income ratio' (LTI ratio) means the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;
- (f) 'medium term' means within a three-year horizon;
- (g) 'debt-service' means the combined interest and principal repayment on a borrower's total debt over a given period (generally one year);
- (h) 'macroprudential authority' means a national macroprudential authority with the objectives, arrangements, powers, accountability requirements and other characteristics set out in Recommendation ESRB/2011/3 ⁽⁸⁾;
- (i) 'debt-to-income ratio' (DTI ratio) means the total debt of the borrower at the moment of loan origination relative to the borrower's total annual disposable income at the moment of loan origination;
- (j) 'debt-service-to-income ratio' (DSTI ratio) means the annual total debt service relative to the borrower's total annual disposable income at the moment of loan origination;
- (k) 'maturity' means the duration of the residential real estate loan contract expressed in years at the moment of loan origination.

2. Criteria for implementation

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

- (a) due regard should be given to the principle of proportionality, taking into account the objective and content of Recommendation A and of Recommendation B;
- (b) as regards Recommendation A, when making policy changes, the phasing-in of such measures should take into account the position of Sweden in the economic and financial cycles, so that these measures do not serve to amplify or trigger the materialisation of accumulated vulnerabilities in the residential real estate sector in Sweden;
- (c) when activating or tightening borrower-based or capital-based measures under Recommendation B, their calibration and phasing-in should take into account the position of Sweden in the economic and financial cycles, and any potential implications as regards the associated costs and benefits;
- (d) specific criteria for compliance with Recommendation A and with Recommendation B are set out in Annex I.

⁽⁸⁾ 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).

2. The addressees of this Recommendation are requested to report to the ESRB and to the Council 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) an assessment of the vulnerabilities related to household indebtedness and overvaluation of house prices, including the distribution of new mortgage loans according to their LTV, DTI and DSTI ratios and maturities, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board ⁽⁹⁾, together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation;
 - (c) a detailed justification of any inaction or departure from this Recommendation, including any delays.

3. Timeline for the follow-up

The addressees of this Recommendation are requested to report to the ESRB and to the Council on the actions taken in response to this Recommendation, or adequately justify any inaction, in compliance with the following timelines:

(a) *Recommendation A*

By 31 October 2022, the addressee of Recommendation A is requested to deliver to the ESRB and to the Council a report on the implementation of Recommendation A.

(b) *Recommendation B*

By 31 October 2020, and yearly thereafter until 31 October 2022, the addressees of Recommendation B are requested to submit to the ESRB and to the Council a report on monitoring vulnerabilities related to household indebtedness and actions taken to address such vulnerabilities. Where there is more than one body responsible for taking actions to address the vulnerabilities identified, one joint report should be submitted.

4. Monitoring and assessment

1. The ESRB Secretariat will:

- (a) assist the addressees, ensuring the coordination of reporting, 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. Three assessments will be initiated as follows:
 - (i) by 31 December 2020, regarding the implementation of Recommendation B;
 - (ii) by 31 December 2021, regarding the implementation of Recommendation B; and
 - (iii) by 31 December 2022, regarding the implementation of Recommendations A and B.

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

Done at Frankfurt am Main, 27 June 2019.

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

⁽⁹⁾ 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).

ANNEX I

SPECIFICATION OF COMPLIANCE CRITERIA APPLICABLE TO THE RECOMMENDATIONS

Recommendation A – Structural changes related to mortgage loans and the residential real estate sector

The following compliance criterion is applicable to Recommendation A.

When formulating policy options, and before implementing any policy changes, an assessment should be made of the impact of the proposed measures considering the position of Sweden in the economic and financial cycles, to ensure that such measures do not amplify or trigger the materialisation of the accumulated vulnerabilities in the residential real estate sector in Sweden.

Recommendation B – Monitoring of vulnerabilities and activation or tightening of macroprudential measures

The following compliance criterion is applicable to Recommendation B.

Prior to activating other, or tightening existing, macroprudential measures, an assessment should be made of the position of Sweden in the economic and financial cycles in order to determine whether such activation or tightening would be appropriate.

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in the Czech Republic
(ESRB/2019/10)
(2019/C 366/07)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include a lack of housing supply – which has been exerting upward pressure on house prices and debt for households that buy their own property – or other public policies which may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate ⁽²⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium ⁽³⁾, Denmark ⁽⁴⁾, Luxembourg ⁽⁵⁾, the Netherlands ⁽⁶⁾, Austria ⁽⁷⁾, Finland ⁽⁸⁾, Sweden ⁽⁹⁾ and the United Kingdom ⁽¹⁰⁾.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate ⁽¹¹⁾.
- (7) In this context, the ESRB has identified in eleven countries, of which the Czech Republic is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB takes note of the macroprudential action taken by the Czech Republic in order to mitigate the systemic risk from the residential real estate sector and it suggests that the relevant Czech authorities should stand ready to take further action in the event that the current macroprudential policy stance should prove to be insufficient.
- (9) The ESRB's assessment of vulnerabilities highlights the following in relation to the Czech Republic:
- a. The growth in house prices has outpaced the growth in household income over the medium term, and cannot be fully justified by developments in the debt-servicing capacity of households. Česká národní banka (CNB) estimates that as of the second half of 2018, house prices in the Czech Republic were overvalued by between 10 % and 15 %. In addition to the contribution from cyclical factors, there are important structural factors that may have contributed to this overvaluation. In particular, the slow pace of work on the future Metropolitan Plan in Prague and delays in issuing building permits may also have contributed to the shortage in housing supply, especially in the capital.
 - b. The overvaluation of house prices, which continues to increase, coupled with high growth in housing loans and the loosening of lending standards in recent years have increased the possibility of credit losses from mortgage loans in the event of adverse economic and financial conditions or adverse developments in the residential real estate market, with direct effects on financial stability. Similarly, the increasing indebtedness of households, coupled with the growing share of households that are potentially vulnerable to adverse economic and financial conditions or adverse developments in residential real estate market may lead to households reducing their consumption in the event of an economic or financial shock, which could lead to second-round effects that would affect financial stability indirectly.
 - c. The annual growth in housing loans has been high over the medium term. Prior to the introduction of recommended limits to the loan-to-value (LTV) ratio, debt-to-income (DTI) ratio and debt-service-to-income (DSTI) ratio, the growth of housing credit was coupled with the loosening of lending standards as evidenced by the increasing percentage of loans with a high LTV ratio (of over 80 % and 90 %) and the increasing percentage of loans with high DTI and DSTI ratios (of over 8 % and 40 %, respectively). These loans were provided to households that may be vulnerable to adverse economic and financial conditions. Moreover, an increasing percentage of loans were provided that combined high LTV ratios with a high DTI ratio or DSTI ratio, thus further increasing the potential for credit losses related to these new mortgage loans. While the average risk weights for the mortgage portfolios held by credit institutions in the Czech Republic using the internal ratings-based approach can be regarded as being relatively high in comparison to other EEA countries, these risk weights have been declining.

⁽²⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽³⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁴⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁵⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁽⁸⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁹⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽¹⁰⁾ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

⁽¹¹⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- d. Although household indebtedness in the Czech Republic can be regarded as being moderate compared to other EEA countries, it has been increasing in line with the growth in housing loans. Despite the fact that recently there have been longer periods during which interest rates were fixed, a significant share of new mortgage loans were previously provided with initial rate fixation periods of less than five years. Consequently, a significant percentage of households taking out new mortgage loans may find it difficult to service their debt in the event of an interest rate increase.
- e. Adverse economic and financial conditions or adverse developments in the residential real estate market may lead to risks materialising as a result of some of the vulnerabilities mentioned above. For example, if the growth in household income decreases or interest rates increase, then highly indebted households may find it more difficult to service their loans. If these households default on their loans and house prices decrease at the same time, this may lead to credit losses from mortgage loans. Taking into account a previous Recommendation of CNB ⁽¹²⁾ related to lending standards for new mortgage loans, the risk of defaults and direct credit losses for credit institutions is currently expected to be limited. Moreover, given the relatively high average risk weights for the mortgage portfolios of credit institutions using the internal ratings-based approach and the relatively high capitalisation of the banking sector in the Czech Republic, credit institutions may be well-placed to absorb direct credit risk shocks related to the residential real estate sector. However, households may still need to adjust their consumption, as possible reductions in income or net wealth could lead to indirect effects on financial stability.
- f. The ESRB takes note of the wide range of borrower-based macroprudential measures to mitigate risks related to the residential real estate sector in the Czech Republic. The limits to the LTV ratio aim to address the build-up of vulnerabilities related to the provision of new mortgage loans in a market in which house prices are overvalued, with potential direct effects on financial stability. Furthermore, limits to the DTI ratio and the DSTI ratio aim to increase the effectiveness of the limits to the LTV ratio by limiting the provision of new loans to households that are potentially vulnerable to adverse economic and financial conditions and adverse developments in the residential real estate market in the Czech Republic. Credit providers are also recommended to stress-test the ability of debtors to withstand shocks related to increased interest rates or decreased incomes. To increase the resilience of institutions in relation to cyclical vulnerabilities, in 2018 CNB further increased the counter-cyclical capital buffer rate to 2 % (from 1,5 %), with effect from 1 July 2020.
- g. However, the current borrower-based measures have been introduced on the basis of a Recommendation from CNB which is not legally binding, and there is no legal framework in place to activate these measures through legally binding acts. As such, the effectiveness of the current measures cannot be guaranteed over the medium term, and during this period both the overvaluation of house prices and the growth in mortgage credit may increase further.
- h. The current macroprudential policy is assessed to be partially appropriate and partially sufficient as regards the potential development of vulnerabilities in the residential real estate sector in the Czech Republic over the medium term. It is important that national authorities have legally binding borrower-based measures at their disposal to provide them with the necessary powers to address potential financial stability vulnerabilities, including, in particular, powers to set legally binding limits to loan-to value ratios – and to either debt-to-income ratios or debt-service-to-income ratios, in combination with maturity limits – where necessary in relation to new housing loans. Only legally binding borrower-based measures would ensure that all credit providers, irrespective of their type or whether they are domestic or foreign, comply fully with the measures in place.

⁽¹²⁾ Recommendation of 12 June of 2018 on the management of risks associated with the provision of retail loans secured by residential property, available at <https://www.cnb.cz> (ÚS ČNB ze dne 12. června 2018 – Doporučení k řízení rizik spojených s poskytováním retailových úvěrů zajištěných rezidenční nemovitostí).

- (10) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of the Czech Republic in the economic and financial cycles, and any potential implications as regards the associated costs and benefits.
- (11) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector in the Czech Republic as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerabilities to be the high overvaluation of house prices coupled with the high growth in housing credit and loose lending standards, against the backdrop of the non-legally-binding nature of the borrower-based measures currently available and in place.

Done at Frankfurt am Main, 27 June 2019.

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

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Germany
(ESRB/2019/11)
(2019/C 366/08)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include a lack of housing supply – which has been exerting upward pressure on house prices and debt for households that buy their own property – or other public policies which may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate ⁽²⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium ⁽³⁾, Denmark ⁽⁴⁾, Luxembourg ⁽⁵⁾, the Netherlands ⁽⁶⁾, Austria ⁽⁷⁾, Finland ⁽⁸⁾, Sweden ⁽⁹⁾ and the United Kingdom ⁽¹⁰⁾.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate ⁽¹¹⁾.
- (7) In this context, the ESRB has identified in eleven countries, of which Germany is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB's assessment of vulnerabilities highlights the following in relation to Germany:
- a. Most of the residential real estate price indicators available indicate that house prices are overvalued in Germany. Similar to previous estimates made for 2016 and 2017, existing estimates for 2018 point to a significant overvaluation of house prices in urban areas. Following a period of gradual increases since 2010, nominal house price growth has accelerated in recent years, slightly outpacing the growth in household income. Furthermore, this growth has become more widespread in both urban and rural areas. House price increases in the large cities and urban areas reflect a shortage of housing supply relative to demand, and the German Federal Government has introduced a number of measures aimed at alleviating this shortage. Future movements in house prices are, therefore, likely to depend on the effects of these measures.
 - b. Despite a recent pick-up in new lending, the annual growth in housing credit has been moderate over the past three years. A comprehensive analysis of lending standards is currently hindered by the lack of detailed data on loan-to-value (LTV) ratios and on other credit ratios for newly granted loans. However, there is some evidence indicating that the demand for loans with high sustainable ⁽¹²⁾ LTV ratios has increased. Moreover, the ECB's euro area bank lending survey further suggests that in 2018 the surveyed banks have decreased their margins on loans for house purchases.
 - c. Household indebtedness can be considered moderate when compared with that in other Member States. However, even though the home ownership rate in Germany is the lowest in the European Union, the share of home owners with a mortgage represents around a quarter of the total population, which is close to the EU average. Although the growth in housing loans has been relatively moderate in the past, the increase in house prices is notable and could at some point be accompanied by a strong increase in newly granted housing loans. This could lead to further growth in overall household indebtedness over the medium-term.

⁽²⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽³⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁴⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁵⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁽⁸⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁹⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽¹⁰⁾ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

⁽¹¹⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

⁽¹²⁾ The sustainable LTV ratio is the ratio between the amount of a real estate loan and the mortgage lending value attributed to the property in question. The latter is the value of the property as produced by a prudent assessment, taking into account the fundamental determinants of the value of the property. See section 16(2) of the Law on covered bonds (*Pfandbriefgesetz*).

- d. Adverse economic and financial developments may trigger or be triggered by sharp adjustments in the residential real estate market that could, in the context of cyclical vulnerabilities, lead to the materialisation of direct and indirect risks to financial stability, given the vulnerabilities mentioned above. Potential direct risks to the banking system in Germany relate both to possible defaults of loans granted in an environment of a long-lasting economic upswing and overvalued and strongly increasing house prices, and to competitive pressures that might lead to a loosening of credit standards and reductions in margins for new loans. Moreover, some households may experience a negative wealth effect or fall into negative equity if the decrease in house prices is significant. If, for example, unemployment increases and/or household income growth decreases, some households may find it more difficult to service their debts. The associated negative household income and wealth effects may reinforce the initial shock if households are required to reduce consumption in order to service their debt. This could lead to second-round effects and an increase in risks to credit institutions and the financial system.
- e. However, it is noted that the long periods over which mortgage interest rates are fixed serve to mitigate the risk posed by increasing interest rates for borrowers. Given the positive income prospects for private households and the persistent favourable labour market conditions, potential risks from households having to stretch themselves financially appear to be rather low. It should be noted, however, that the interest rate risk from the long rate fixation periods lies with the credit institutions and this is one of the cyclical vulnerabilities of the banking system.
- f. The ESRB takes note of the fact that the *Bundesanstalt für Finanzdienstleistungsaufsicht* (the Federal Financial Supervisory Authority – BaFin) has announced that the *Ausschuss für Finanzstabilität* (the Financial Stability Committee) recommended the activation of a countercyclical capital buffer rate of 0,25 % in order to build up the resilience of institutions in a preventive manner. BaFin intends to activate the countercyclical capital buffer in the recommended manner. The recommended calibration has taken into account the credit dynamics in Germany, which are accompanied by strong residential property price dynamics. However, it is not expected to curb housing credit growth or halt a potential deterioration in lending standards. The national authorities have been monitoring credit conditions, but there has been no formal guidance from them on what prudent standards should include.
- g. The current policy measures are assessed to be partially appropriate and partially sufficient to mitigate the identified systemic risks related to vulnerabilities in the residential real estate sector. Germany could activate further capital-based measures requiring credit institutions to create additional capital buffers to increase the resilience of the banking system to cyclical risks and vulnerabilities (i.e. credit risk and interest rate risk) that might have accumulated, given the long-lasting economic upswing and also the rapidly evolving housing price dynamics. In view of the significant house price overvaluation in the urban areas of Germany that has already existed for several years, as well as uncertainty regarding lending standards, Germany could contribute to ensuring sound lending standards in relation to new loans in an appropriate manner (e.g. through a recommendation or activation of legally binding limits to LTV ratios, if the legal conditions for activation are met), in order to prevent a build-up of vulnerabilities, thereby fostering financial stability.
- h. As already proposed by the *Ausschuss für Finanzstabilität* in 2015 ⁽¹³⁾, it is also important that national authorities have all necessary macroprudential instruments at their disposal to provide them with the necessary powers to address potential financial stability vulnerabilities, including, in particular, powers to set legally binding limits to loan-to-value ratios – and to either debt-to-income ratios, or debt-service-to-income ratios, in combination with maturity limits – where necessary in relation to new housing loans. Currently, the income-based instruments are, however, not available in Germany. Although the national authorities do have the power to set legally binding loan-to-value limits if deemed necessary to guarantee financial stability, this is conditional on the identification of risks to financial stability stemming from a strong increase in house prices and mortgage lending accompanied by a substantial loosening of lending standards. The current data gaps with regard to lending standards for new mortgage loans should therefore also be closed, so as to improve the ability to identify those risks and to address them when needed – such an initiative is a necessary addition to the German macroprudential monitoring framework.

⁽¹³⁾ Recommendation AFS/2015/1 on new instruments for regulating loans for the construction or purchase of residential real estate (*Empfehlung AFS/2015/1 vom 30. Juni 2015 zu neuen Instrumenten für die Regulierung der Darlehensvergabe zum Bau oder Erwerb von Wohnimmobilien*).

- (9) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of Germany in the economic and financial cycles, and any potential implications as regards the associated costs and benefits.
- (10) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector in Germany as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerabilities to be the significant overvaluation of house prices in urban areas, associated with widespread and rapid house price dynamics and some indication of a loosening of lending standards, in the context of the overall uncertainty regarding lending standards for housing loans due to the significant data gaps.

Done at Frankfurt am Main, 27 June 2019.

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

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in France
(ESRB/2019/12)
(2019/C 366/09)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include a lack of housing supply – which has been exerting upward pressure on house prices and debt for households that buy their own property – or other public policies which may act as an incentive for households to take on additional debt. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate ⁽²⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium ⁽³⁾, Denmark ⁽⁴⁾, Luxembourg ⁽⁵⁾, the Netherlands ⁽⁶⁾, Austria ⁽⁷⁾, Finland ⁽⁸⁾, Sweden ⁽⁹⁾ and the United Kingdom ⁽¹⁰⁾.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate ⁽¹¹⁾.
- (7) In this context, the ESRB has identified in eleven countries, of which France is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB's assessment of vulnerabilities highlights the following in relation to France:
- a. Household indebtedness in France is relatively high in relation to disposable income. It has grown significantly over the past 10 years and the recent medium-term dynamics indicate that this trend could continue. The main risks associated with such a level of household indebtedness are the possibility of a contraction of consumption and second-round effects to financial stability in the event of a macroeconomic shock. However, some mitigating factors are present in the French economy. First, households have a high savings rate by international comparison. Second, important social safety nets exist which aim at mitigating the impact of a sudden decrease in borrowers' income in the event of unemployment, thus reducing the potential second-round effects of a macroeconomic shock. Third, a high percentage of borrowers are not exposed to interest rate risk due to the high proportion of fixed-rate housing loans.
 - b. The growth in housing loans has been relatively strong, both over the short and medium term. The increase in new housing loans is notable and this could lead to further growth in overall household indebtedness. Moreover, some indicators suggest that certain households with housing loans in France may be vulnerable to economic and financial shocks, in particular young and lower-income households with higher debt-service-to-income (DSTI) ratios. In addition, around a third of the new housing loans have a loan-to-value (LTV) ratio of over 95 % and the average loan-to-income ratio for new loans reached a historical peak in 2017. The average maturity of housing loans has also increased, while the distribution of DSTI ratios has deteriorated. Preliminary microdata used by the French authorities to monitor these developments suggest that a large share of high-LTV or high-DSTI borrowers are wealthy households whose loans are backed by collateral and guarantees.

⁽²⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽³⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁴⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁵⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁽⁸⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁹⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽¹⁰⁾ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

⁽¹¹⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- c. While there is no strong evidence of widespread house price overvaluation in France, residential real estate prices have increased significantly in some large cities ⁽¹²⁾ – the Paris area in particular – and this may have eroded housing affordability in some locations. At the local level, there is some indication that residential real estate prices are elevated, relative to income and rents. Given that a third of all loans granted have a high LTV ratio and that in the future house prices could adjust, some households may experience a negative wealth effect. However, direct credit losses from a potential decrease in the collateral values of mortgage loans, are expected to be low due to several country-specific factors. First, the use of the guarantee scheme to collateralise housing loans ⁽¹³⁾ mitigates the direct credit risk to credit institutions in the event of a decrease in house prices. Second, the potential wealth effects for households are estimated to be weaker than in other advanced economies as there is no possibility to withdraw cash or equity from house revaluations.
- d. Adverse economic and financial conditions or adverse developments in the residential real estate market could lead to the materialisation of direct and indirect risks to financial stability given the vulnerabilities mentioned above. Potential direct risks to the banking system in France relate both to the potential defaults of loans granted in an environment of strongly increasing house prices and low interest rates, and to indebted households and competitive pressures leading to some loosening of lending standards and narrowing of margins. In France a number of factors, such as the collateral channel which is expected to be relatively weak, important social safety nets and the prevalence of fixed-rate loans, are expected to mitigate direct credit risks related to housing market shocks. However, if, for example, unemployment increases and/or household income growth decreases, some households may find it more difficult to service their debts. The associated negative household income and wealth effects may reinforce the initial shock if households are required to reduce consumption in order to service their housing loans. This could lead to second-round effects and an increase in the risks to credit institutions and the financial system.
- e. The ESRB takes note of the fact that France has announced a 0,5 % countercyclical capital buffer rate to build up the resilience of institutions in a preventive manner. The calibration of this macroprudential measure took into account the indebtedness of the non-financial sector in France more broadly and that of the household sector more specifically, as household lending is also supported by the recovery of residential property prices. Therefore, the capital measure is expected to enhance the banking sector's resilience to the accumulated vulnerabilities. However, it is not expected to curb either the dynamics of household indebtedness or the deterioration in lending standards. Although the national authorities in France have been monitoring credit conditions, there has been no formal guidance on what should be considered as prudent credit conditions.
- f. The current policy measures are assessed to be partially appropriate and partially sufficient to mitigate the identified systemic risks related to vulnerabilities in the residential real estate sector in France. In particular, the current capital-based macroprudential measures in place could be complemented by other measures to tackle the vulnerabilities related to increasing household indebtedness and to the signs of deteriorating lending standards. The ESRB acknowledges the efforts made by the French authorities to monitor risks in the residential real estate sector as well as their aim to further improve the monitoring framework in accordance with Recommendation ESRB/2016/14 of the European Systemic Risk Board ⁽¹⁴⁾. Notwithstanding this, further actions may be needed to address the vulnerabilities identified in France. In particular, given the rising household indebtedness and signs of deteriorating lending standards, the national authorities in France could consider the need for additional pre-emptive actions such as explicit guidelines for lending standards, in the form of either a recommendation or formal borrower-based measures.

⁽¹²⁾ INSEE, (last data Q4 2018) available at <https://www.insee.fr/fr/statistiques/3733241>, with data for Paris, Lyon and Marseilles in particular.

⁽¹³⁾ The guarantors are financial institutions or insurance companies owned by one or more credit institutions; in all cases, they are regulated bodies supervised by the *Autorité de contrôle prudentiel et de résolution* (the French Prudential Supervision and Resolution Authority).

⁽¹⁴⁾ 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).

- (9) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of France in the economic and financial cycles, and potential implications as regards the associated costs and benefits.
- (10) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector in France as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerabilities to be high and increasing household indebtedness associated with a recent deterioration in lending standards.

Done at Frankfurt am Main, 27 June 2019.

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

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Iceland
(ESRB/2019/13)
(2019/C 366/10)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include lack of housing supply — which has been exerting upward pressure on house prices and debt for households that buy their own property — or other public policies which may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate ⁽²⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium ⁽³⁾, Denmark ⁽⁴⁾, Luxembourg ⁽⁵⁾, the Netherlands ⁽⁶⁾, Austria ⁽⁷⁾, Finland ⁽⁸⁾, Sweden ⁽⁹⁾ and the United Kingdom ⁽¹⁰⁾.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate ⁽¹¹⁾.
- (7) In this context, the ESRB has identified in eleven countries, of which Iceland is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB's assessment of vulnerabilities highlights the following in relation to Iceland:
 - a. Household indebtedness relative to household disposable income is high when compared with other countries, in spite of the substantial decline in this ratio from levels in previous years. Highly leveraged households are typically more sensitive to adverse economic and financial conditions or adverse developments in the residential real estate market, which can affect their debt-servicing capacity and lead to reductions by them in consumption. Indebted households are, however, less vulnerable to increases in interest rates, given the prevalence of fixed interest rate loans.
 - b. In terms of the structure of household debt, loans indexed to the consumer price index (hereinafter 'CPI-indexed loans') ⁽¹²⁾ have historically been common in Iceland, and may pose some risks for highly leveraged households. Even though the share of CPI-indexed loans as a proportion of new loans is decreasing, the share of these loans as a proportion of the existing stock of loans is, nevertheless high. Moreover, CPI-indexed loans typically have negative amortisation schedules early in the repayment period, depending on the level of inflation, which could further increase the accumulation of debt. Loans of this type can have both mitigating and amplifying effects on households' vulnerability to risk. In the event of high inflation, households would experience less impact on their ability to service mortgage debt in the short term — as the CPI-indexed loans would smooth out the debt service — whereas the monthly repayments on non-CPI-indexed loans would increase more steeply over the short term. However, over the long term, households with CPI-indexed loans may need to further constrain consumption, since in the event of economic distress coupled with increasing inflation they would not see their debt eroded by inflation. High indebtedness is partially explained by the indexation of annuity mortgage loans with maturities of up to 40 years, which allow low-income borrowers to borrow higher amounts at affordable debt service levels. However, during the last decade inflation has been close to the Central Bank of Iceland's target and consequently the share of non-indexed loans has been growing.
 - c. Housing credit has been growing moderately over recent years, and on average lending standards appear to be prudent. However, as regards the distribution of the debt-to-income (DTI) ratios of households which have taken out loans of this type, a significant share of households may be vulnerable to adverse economic and financial conditions or adverse developments in the residential real estate market. In spite of growing vulnerabilities in Iceland's RRE sector, the Icelandic credit institutions appear to be resilient. National authorities have conducted a number of stress tests on Iceland's three largest credit institutions; those stress tests included scenarios incorporating sharp price decreases in the housing market in conjunction with large negative shocks to the overall economy and the results indicated that those banks should be able to withstand such shocks.

⁽²⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽³⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁴⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁵⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁽⁸⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁹⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽¹⁰⁾ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

⁽¹¹⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

⁽¹²⁾ The CPI-indexed loan is a contract where the loan amount is linked to the consumer price index and the interest rate is kept fixed (for more details see Eliasson, L., 'Indexation 101', *Economic Affairs*, Vol. 6, The Central Bank of Iceland, Reykjavik, Iceland, 2014).

- d. Furthermore, there is some concern related to house price overvaluation. House price appreciation has decelerated in recent quarters, following steady growth over the past eight years. House price growth over the medium-term has been high by international comparison. Given the high rate of home ownership in Iceland, a decrease in house prices could lead to households in negative equity. Nevertheless, potential direct credit losses from mortgage loans are expected to be contained, as the loan-to-value ratios of mortgages held by households are relatively low.
- e. Adverse economic and financial conditions or adverse developments in the residential real estate market may lead to the materialisation of direct and indirect risks to financial stability, given the vulnerabilities mentioned above. Potential direct risks to the banking system in Iceland relate both to the potential losses generated by default of loans granted in an environment of possibly overvalued house prices, and to competitive pressures that may lead to the loosening of lending standards. Moreover, households may experience a negative wealth effect or fall into negative equity if the decrease in house prices is significant. Given the low potential direct credit losses anticipated from mortgage loans and the prevalence of fixed interest rate loans with indexation to CPI, households are not expected to experience constraints on their debt servicing capacity that are large enough to lead to defaults. However, if, for example, unemployment increases and/or household income growth decreases, some households may find it more difficult to service their debts over the long-term. The associated negative household income and wealth effects may reinforce the initial shock if households are required to reduce spending in order to service their housing loans. This could lead to second-round effects and an increase in risks to credit institutions and the financial system.
- f. The ESRB takes note of the fact that Iceland has in place various mechanisms — limits to loan-to-value (LTV) ratios; creditworthiness assessments related to borrowers' incomes; and capital buffers — all of which are aimed at ensuring the resilience of both credit institutions and borrowers. The countercyclical capital buffer and the systemic risk buffer are expected to strengthen the resilience of credit institutions against the materialisation of vulnerabilities stemming from private sector indebtedness. Nevertheless, special attention should be also paid to the non-bank lenders (i.e. the pension funds and the government-owned Housing Financing Fund), which are more present in the housing sector in Iceland than in most other countries. The LTV ratios were applied in the expansionary phase of the financial cycle in order to strengthen the resilience of borrowers, prevent deterioration of lending standards and mitigate excessive credit and house price growth. As the LTV ratios are applied to all lenders, potential leakages across sectors are avoided. Moreover, microprudential requirements currently in place require the assessment of the credit-worthiness of borrowers taking out new loans. Therefore, any potential future borrower-based measures should also apply to all lenders, in order to avoid leakages.
- g. The current policy measures are assessed to be partially appropriate and partially sufficient to mitigate the identified systemic risks related to vulnerabilities in the residential real estate sector in Iceland. In particular, the high level of household indebtedness may not be sufficiently addressed by the current macroprudential measures. Though at the aggregate level, debt may have decreased, at the individual level, pockets of risk associated with highly leveraged households persist. While the ESRB acknowledges the initiatives taken as regards monitoring of residential real estate, further measures may be needed concerning lending to households with high DTI ratios. Iceland may consider a pre-emptive implementation of explicit guidelines on income-based measures, either in the form of a recommendation or of legally-binding borrower-based measures. Income-based measures may help to better prevent households from becoming overly indebted, should the strong growth in house prices persist. Such measures could be particularly relevant, as the growth in house prices may have reduced the effectiveness of the cap on LTV ratios.
- (9) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of Iceland in the economic and financial cycles, and potential implications as regards the associated costs and benefits.

- (10) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of Iceland as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerability to be a high household indebtedness associated with the strong medium-term increase of house prices and potential overvaluation of house prices.

Done at Frankfurt am Main, 27 June 2019.

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

WARNING OF THE EUROPEAN SYSTEMIC RISK BOARD
of 27 June 2019
on medium-term vulnerabilities in the residential real estate sector in Norway
(ESRB/2019/14)
(2019/C 366/11)

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

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

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 ⁽¹⁾, and in particular Articles 3, 16 and 18 thereof,

Whereas:

- (1) Housing is a key sector of the real economy and represents a major part of household wealth and bank lending. Residential real estate properties make up a large component of households' asset holdings and loans for housing are often a large part of the balance sheets of credit institutions. Furthermore, housing construction is typically an important element of the real economy, being a source of employment, investment and growth.
- (2) Past financial crises and experience in many countries have demonstrated that unsustainable developments in real estate markets may have severe repercussions on the stability of the financial system and of the economy as a whole in a given country, which may also lead to negative cross-border spillovers. The effects on financial stability may be both direct and indirect. Direct effects consist of credit losses from mortgage portfolios due to adverse economic and financial conditions and simultaneous negative developments in the residential real estate market. Indirect effects relate to adjustments in household consumption, with further consequences for the real economy and financial stability.
- (3) Real estate markets are prone to cyclical developments. Excessive risk-taking, excessive leverage and misaligned incentives during the upturn of the real estate cycle may lead to severe negative implications for both financial stability and the real economy. Given the relevance of residential real estate (RRE) for financial and macroeconomic stability, seeking to prevent the build-up of vulnerabilities in residential real estate markets by the use of macroprudential policy is especially important, in addition to its use as a means of mitigating systemic risk.
- (4) While cyclical factors play an important role in fuelling the vulnerabilities identified in residential real estate markets in the European Economic Area (EEA) countries, there are also structural factors that have driven these vulnerabilities. These factors can include a lack of housing supply – which has been exerting upward pressure on house prices and debt for households that buy their own property – or other public policies which may act as an incentive for households to overborrow. Given that these factors go beyond macroprudential policy, measures originating from other policy areas can complement and support the current macroprudential measures in addressing the vulnerabilities present in the residential real estate markets in the individual countries efficiently and effectively, without generating excessive costs for the real economy and the financial system.

⁽¹⁾ OJ L 331, 15.12.2010, p. 1.

- (5) In 2016, the European Systemic Risk Board (ESRB) conducted a Union-wide assessment of medium-term vulnerabilities relating to residential real estate ⁽²⁾. This assessment enabled the ESRB to identify a number of medium-term vulnerabilities in several countries as sources of systemic risk to financial stability, which led to the issuance of warnings to eight countries: Belgium ⁽³⁾, Denmark ⁽⁴⁾, Luxembourg ⁽⁵⁾, the Netherlands ⁽⁶⁾, Austria ⁽⁷⁾, Finland ⁽⁸⁾, Sweden ⁽⁹⁾ and the United Kingdom ⁽¹⁰⁾.
- (6) The ESRB has recently concluded a systematic and forward-looking EEA-wide assessment of vulnerabilities relating to residential real estate ⁽¹¹⁾.
- (7) In this context, the ESRB has identified in eleven countries, of which Norway is one, certain medium-term vulnerabilities as sources of systemic risk to financial stability that have not been sufficiently addressed.
- (8) The ESRB's assessment of vulnerabilities highlights the following in relation to Norway:
- a. Household indebtedness is very high when compared with other countries and with previous years, and has been increasing steadily over the past 10 years. Moreover, a large share of loans are at variable interest rates, which also makes households vulnerable to interest rate increases. However, stress testing for interest rate increases has shown that mortgage applicants would generally be able to meet normal living expenses in case of a shock to interest rates. Therefore, the risk of potential defaults due to interest rate increases could be contained.
 - b. Mortgage lending has been growing over the medium term, and constitutes the main contributor to the growth in lending to households. Moreover, mortgage credit is systemically important for the banking sector, as it represents a high share of total loans by credit institutions. The banking sector may also be exposed to risks stemming from the international environment, owing to the large share of foreign investors participating in the covered bond market and the interconnectedness of Norway's financial system with the other Nordic countries.
 - c. There are signs of house price overvaluation, following a long period of elevated and persistent growth in house prices. Moreover, in recent quarters house prices have moderated, but transaction volumes have not decreased. The rate of home ownership through mortgages is high, which could potentially make households vulnerable to adverse economic and financial conditions or adverse developments in the residential real estate market.
 - d. An economic or financial shock could lead to the materialisation of direct and indirect risks to financial stability, given the vulnerabilities mentioned above. Potential direct risks to the banking system in Norway relate to potential credit losses from new mortgage loans, since these loans were granted in an environment of possibly overvalued house prices. Moreover, households may experience a negative wealth effect or fall into negative equity if a decrease in house prices is significant. Furthermore, if, for example, unemployment increases and/or growth of household income decreases, some households may find it more difficult to service their debts. The associated negative household income and wealth effects may reinforce the initial shock if households are required to reduce consumption in order to service their housing loans. This could lead to second-round effects and an increase in risks to the credit institutions and the financial system.

⁽²⁾ See 'Vulnerabilities in the EU Residential Real Estate Sector', ESRB, November 2016, available on the ESRB's website at www.esrb.europa.eu.

⁽³⁾ Warning ESRB/2016/06 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Belgium (OJ C 31, 31.1.2017, p. 45).

⁽⁴⁾ Warning ESRB/2016/07 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Denmark (OJ C 31, 31.1.2017, p. 47).

⁽⁵⁾ Warning ESRB/2016/05 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Luxembourg (OJ C 31, 31.1.2017, p. 51).

⁽⁶⁾ Warning ESRB/2016/10 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (OJ C 31, 31.1.2017, p. 53).

⁽⁷⁾ Warning ESRB/2016/09 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Austria (OJ C 31, 31.1.2017, p. 43).

⁽⁸⁾ Warning ESRB/2016/08 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Finland (OJ C 31, 31.1.2017, p. 49).

⁽⁹⁾ Warning ESRB/2016/11 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (OJ C 31, 31.1.2017, p. 55).

⁽¹⁰⁾ Warning ESRB/2016/12 of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the United Kingdom (OJ C 31, 31.1.2017, p. 57).

⁽¹¹⁾ See 'Vulnerabilities in the residential real estate sectors of EEA countries', ESRB, 2019, available on the ESRB's website at www.esrb.europa.eu.

- e. The ESRB takes note of the fact that Norway has implemented a comprehensive set of borrower-based and capital measures, which aim at ensuring the resilience of both credit institutions and borrowers. The loss-given-default (LGD) floor and the requirements for probability of default (PD) models ⁽¹²⁾, alongside the countercyclical capital buffer are all important capital-based measures that are expected to ensure that credit institutions are able to absorb losses following a potential economic or financial shock. Moreover, the Norwegian authorities have activated a wide range of borrower-based measures: a combination of limits to loan-to-value (LTV) ratios and debt-to-income (DTI) ratios, and affordability tests. The effects of the borrower-based measures have been documented and there has been a decrease in the share of mortgages with high values in relation to the ratios to which limits apply. Notwithstanding the substantial efforts made in the area of macroprudential policy, systemic risks related to the residential real estate market remain elevated in Norway.
- f. The current macroprudential policy measures are assessed to be appropriate to mitigate the identified systemic risks related to vulnerabilities in the residential real estate sector in Norway. However, there is still considerable systemic risk related to the Norwegian residential real estate market, and on these grounds the macroprudential policy is assessed to be partially sufficient. Within the area of macroprudential policy, the mitigation of identified vulnerabilities has been a primary concern, resulting in a comprehensive set of policy measures. Nevertheless, macroprudential policies could be complemented by broader policy action aimed at the mitigation or elimination of the factors which facilitate or promote increasing household indebtedness. These policies should support the current macroprudential measures to address the remaining vulnerabilities identified in the residential real estate market in Norway efficiently and effectively, without producing excessive costs for the Norwegian real economy and financial system. Further policies could include removing incentives for higher household indebtedness, by increasing efficiency in the rental housing market and the development of owner-occupied housing, and by ensuring adequate housing supply. If no other policy action is taken and if the vulnerabilities do not recede, or if they increase due to economic and financial developments, existing macroprudential measures could be tightened or new macroprudential measures could be activated.
- (9) When activating any measures to address the identified vulnerabilities, their calibration and phasing-in should take into account the position of Norway in the economic and financial cycles, and any potential implications as regards the associated costs and benefits.
- (10) ESRB warnings are published after the General Board has informed the Council of the European Union of its intention to do so and provided the Council with an opportunity to react, and after the addressees have been informed of the intention to publish,

HAS ADOPTED THIS WARNING:

The ESRB has identified medium-term vulnerabilities in the residential real estate sector of Norway as a source of systemic risk to financial stability, which may have the potential for serious negative consequences for the real economy. From a macroprudential perspective, the ESRB considers the main vulnerability to be high household indebtedness associated with the long-term increase of house prices and their potential overvaluation.

Done at Frankfurt am Main, 27 June 2019.

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

⁽¹²⁾ Norway has tighter requirements for the residential mortgage internal ratings-based approach in place, including an LGD floor of 20 % and specific requirements for calculating the PD for mortgage loans. National authorities report that the LGD floor and PD requirements work to increase the average risk weight on residential mortgages for Norwegian banks using internal ratings-based models.

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES

EUROPEAN COMMISSION

Euro exchange rates ⁽¹⁾

29 October 2019

(2019/C 366/12)

1 euro =

Currency			Exchange rate		
Currency			Exchange rate		
USD	US dollar	1,1095	CAD	Canadian dollar	1,4486
JPY	Japanese yen	120,88	HKD	Hong Kong dollar	8,6994
DKK	Danish krone	7,4706	NZD	New Zealand dollar	1,7481
GBP	Pound sterling	0,86328	SGD	Singapore dollar	1,5121
SEK	Swedish krona	10,7923	KRW	South Korean won	1 295,86
CHF	Swiss franc	1,1041	ZAR	South African rand	16,2241
ISK	Iceland króna	138,10	CNY	Chinese yuan renminbi	7,8392
NOK	Norwegian krone	10,2748	HRK	Croatian kuna	7,4568
BGN	Bulgarian lev	1,9558	IDR	Indonesian rupiah	15 590,95
CZK	Czech koruna	25,543	MYR	Malaysian ringgit	4,6410
HUF	Hungarian forint	328,78	PHP	Philippine peso	56,623
PLN	Polish zloty	4,2693	RUB	Russian rouble	70,9154
RON	Romanian leu	4,7559	THB	Thai baht	33,524
TRY	Turkish lira	6,3596	BRL	Brazilian real	4,4300
AUD	Australian dollar	1,6186	MXN	Mexican peso	21,1812
			INR	Indian rupee	78,6150

⁽¹⁾ Source: reference exchange rate published by the ECB.

Notice on the application of Commission Implementing Regulation (EU) 2019/1131 establishing a customs tool in order to implement Article 14a of Regulation (EU) 2016/1036 of the European Parliament and of the Council and Article 24a of Regulation (EU) 2016/1037 of the European Parliament and of the Council

(2019/C 366/13)

In accordance with Article 14a of Regulation (EU) 2016/1036 ⁽¹⁾ and Article 24a of Regulation (EU) 2016/1037 ⁽²⁾, the European Commission adopted Commission Implementing Regulation (EU) 2019/1131 ⁽³⁾ ('Customs Tool') on 3 July 2019.

Article 14a of Regulation (EU) 2016/1036 and Article 24a of Regulation (EU) 2016/1037 permit the extension of anti-dumping and/or countervailing duties on goods brought in significant quantities to an artificial island, a fixed or floating installation or any other structure in the continental shelf of a Member State or the exclusive economic zone declared by a Member State pursuant to UNCLOS, where this would cause injury to the Union industry. In cases where the regulation imposing anti-dumping and/or countervailing measures explicitly provides for such an extension into those areas, the Customs Tool lays down the conditions for the levying of anti-dumping and/or countervailing duties as well as procedures relating to the notification and declaration of such products and the payment of such duty.

In order to give customs authorities sufficient time to prepare for the processing of receipt declarations, Article 9 of the Customs Tool deferred the application of the provisions of the Customs Tool by four months from the date of its publication in the Official Journal.

Article 14a of Regulation (EU) 2016/1036 and Article 24a of Regulation (EU) 2016/1037 stipulate that the Commission shall inform all economic operators that the Customs Tool is operational by a separate publication.

The Commission hereby informs all economic operators that the Customs Tool will become operational and fully applicable as of 4 November 2019.

⁽¹⁾ Regulation (EU) 2016/1036 of the European Parliament and of the Council of 8 June 2016 on protection against dumped imports from countries not members of the European Union (OJ L 176, 30.6.2016, p. 21).

⁽²⁾ Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union (OJ L 176 30.6.2016, p. 55).

⁽³⁾ Commission Implementing Regulation (EU) 2019/1131 of 2 July 2019 establishing a customs tool in order to implement Article 14a of Regulation (EU) 2016/1036 of the European Parliament and of the Council and Article 24a of Regulation (EU) 2016/1037 of the European Parliament and of the Council (OJ L 179, 3.7.2019, p. 12).

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