EBA/Op/2024/02

24 May 2024

Opinion of the European Banking Authority on measures in accordance with Article 124 of Regulation (EU) No 575/2013

1. On 25 April 2024, the European Banking Authority (EBA) received a notification from the Ministry of Finance of Norway to amend an existing measure in accordance with Article 124(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council[1], as incorporated into the EEA Agreement[2] (Capital Requirements Regulation, CRR).
2. The notified measure amends a previous measure modifying the risk weight of exposures secured by commercial immovable property. The proposed measure sets a risk weight of 100% for exposures secured by commercial immovable property and 75% for exposures secured by commercial immovable property meeting the requirements for inclusion in the retail category. Exposures secured by agricultural immovable property, which are not considered residential immovable property, will be subject to the risk weight set out in article 126(1) CRR.
3. In accordance with the third subparagraph of Article 124(2) of the CRR, as incorporated into the EEA Agreement and adapted by Joint Decision No 079/2019[3] within one month of receiving notification from the designated or competent authority entrusted with the national application of Article 124 CRR, the EBA is required to provide its Opinion to the EFTA State concerned.
4. In accordance with Article 14(2) of the Rules of Procedure of the EBA,[4] the Board of Supervisors has adopted this Opinion.

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

[2] EEA Agreement: Annex IX Financial Services

[3] Decision No 79/2019 (OJ L 321, 12.12.2019, p. 170 and EEA Supplement No 99, 12.12.2019, p. 1), e.i.f. 1.1.2020.

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

Background of the measure

5. In 1989, the Norwegian authorities implemented a 100% risk weight on exposures secured by commercial immovable property as a part of the implementation of Basel I compliant regulation and then implemented in accordance with Directives 98/32/EC and 98/33/EC in 2001, and to Directives 2006/48/EC and 2006/49/EC in 2006.

6. In 2014, the named "Regulations on capital requirements and national adaptation of CRR/CRD regulation"[5] entered into force in Norway, although Regulation (EU) No 575/2013 and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013[6], as incorporated into the EEA Agreement, entered into force in the EEA on 1 January 2020. In 2019, the Norwegian' authority implemented a measure in accordance with article 124 CRR to set a higher risk weight for exposures secured by commercial immovable real estate. The measure laid out a 100% risk weight for exposures secured by commercial immovable property and a 75% risk-weight for exposures secured by commercial immovable property meeting the requirements for inclusion in the retail category.

7. The proposed measure extends the current risk weight adjustments for commercial immovable property but introduces a carve-out for agricultural immovable properties. Exposures secured by agricultural immovable property, which are not residential immovable property, will be subject to the risk weight set out in article 126(1) CRR as per below:

- exposures or any part of an exposure fully and completely secured by mortgages on agricultural immovable properties may be assigned a risk weight of 50%;
- exposures related to property leasing transactions concerning agricultural immovable properties under which the institution is the lessor and the tenant has an option to purchase may be assigned a risk weight of 50% provided that the exposure of the institution is fully and completely secured by its ownership of the property.

Economic rationale for the measure

8. According to the notification, the risk weight of 50% under the standardised method for exposures which are fully and completely secured by mortgages on commercial immovable property, does not reflect the actual risk. Historical data on losses affecting commercial immovable property lending in Norway indicates that the realisation risk is extremely volatile. During the Norwegian banking crisis (1988-1992) the increase in commercial real estate losses was on percentage significantly larger than for the loan portfolio as a whole. The Norwegian FSA estimates the accumulated losses on exposures secured by commercial

[5] Regulations on capital requirements and national adaptation of CRR/CRD IV (CRR/CRD IV regulations) - Lovdata

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

real estate amount to approximately 22% of the total losses experienced during the Norwegian banking crisis.

9. The Norwegian authority deems that there is currently, a significant uncertainty in the developments of the real economy, inflation and financial markets in Norway. Since September 2021, the Central Bank of Norway has tightened its monetary policy, reaching a policy rate of 4.5% in December 2023. The Norwegian FSA indicates that the policy rate is expected to remain high for some time. The effect of high inflation and higher interest rates has not yet been fully transmitted to the economy and it could lead to declining housing and commercial property prices. According to the Norwegian authority, introducing a lower risk weight for commercial real estate under the standardised method may increase lending to the segment significantly. In the current situation, this could be problematic considering banks' high exposure and the uncertainty in the economic outlook in general, and specifically in relation to the adaptation to higher interest rates.

10. The proposed measure excludes exposures secured by agricultural immovable property from the scope of the measure. These exposures will be subject to the risk weight set out in article 126(1) CRR. According to the notification, the sector "agriculture, forestries and fisheries (excl. fish farming)" is among the sectors with the lowest historical losses. Therefore, the higher risk weight of 100% set for exposures secured by commercial property would not be appropriate. According to a survey realised by Finanstilsynet (FSA Norway) this year, losses stemming from lending collateralised by agricultural immovable property up to 50% of the market value or 60% of the lending value (i.e., exposures meeting the condition under CRR 126 2(d)) have varied between 0 and 0.02% of outstanding loans over the last ten years. Meanwhile, overall losses stemming from lending collateralised by agricultural immovable property have varied between 0.04 and 0.16% of the outstanding loans in the same period.

11. In addition, the notification states that agriculture and forestry activities are eligible for state subsidies and support schemes. The earnings of many obligors whose exposures are secured by agricultural properties are positively affected by current subsidy and support schemes. This hereby might decrease the likelihood of loan losses for banks in case of a worsening economic outlook.

12. The Norwegian authority notes that the reduction of the risk weights for this sector is not expected to have a significant negative impact on banks' resilience given that the total exposure of the banking sector to the agricultural sector is relatively low, albeit the exposures are unevenly distributed across banks Indeed, the notification reports that 2.6% of the bank's loans to non-financial institutions are categorised as "agriculture, forestries and fisheries". In terms of CET1 impact of this exception, on average[7], banks CET1 will increase between 0.1 and 0.3 percentage points.

[7] Please note that the average and median do not include all banks, only the ones with agricultural exposures on their balance sheet.

13. No cross-border effects or impact on the internal market are expected, as the measure is mainly a continuation of the current framework.

14. The measure is not expected to contribute to leakages or regulatory arbitrage within the Norwegian financial system.

Assessment and conclusions

15. Based on the evidence provided by the Ministry of Finance of Norway, the EBA acknowledges the concerns regarding the financial stability risks stemming from commercial immovable property and the uncertainty in the macroeconomic environment in general.

16. Based on the information provided, the EBA does not object to the amended measure in accordance with Article 124(2) CRR.

17. The EBA understands that the measure may be appropriate to tackle the currently identified risks in the Norwegian banking sector, and particularly the risks associated with commercial immovable property. This might also result in a lower risk weight for exposures secured by agricultural immovable property given that the conditions set out in Article 126(2) CRR are met, according to the information provided in the notification. However, some uncertainty remains regarding the impact of the measure across the Norwegian banking sector based on the information provided in the notification.

18. The EBA welcomes the steps taken by Norwegian authorities to collect additional data and provide a better understanding of the agricultural immovable properties and related collateralised loans. The EBA encourages further analysis of the sector to fill the missing gaps and assess other sectors to ensure that the applied risk weights adequately reflect the actual risks related to the targeted exposures.

19. Therefore, the EBA invites the Ministry of Finance of Norway to closely monitor the measure amid the current and coming economic and regulatory landscape. The EBA would like to remind the Ministry of Finance that they shall assess the appropriateness of the risk weighs, in accordance with Article 124(2) CRR, as further specified by Commission Delegated Regulation (EU) 2023/206[8], as incorporated into the EEA Agreement[9], and adjust them if during its periodical assessment the risk weights do not adequately reflect the actual risks related to the targeted exposures and if it considers that the inadequacy of the

[8] Commission Delegated Regulation (EU) 2023/206 of 5 October 2022 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the types of factors to be considered for the assessment of the appropriateness of risk weights for exposures secured by immovable property and the conditions to be taken into account for the assessment of the appropriateness of minimum loss given default values for exposures secured by immovable property (OJ L 29, 1.2.2023, p. 1–5).

[9] By Joint Committee Decision No 282/2023 (OJ L [to be published and EEA supplement No [to be published]), e.i.f. 28.20.2023).

risk weights could adversely affect current or future financial stability in Norway.

20. Similarly, the EBA invites the Norwegian Ministry of Finance to carefully consider economic and regulatory developments that might also affect IRB banks.

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

Done at Paris, 24 May 2024

[signed]

[José Manuel Campa]

Chairperson
For the Board of Supervisors