

OPINION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 14 December 2023

**regarding the Latvian notification of an adjustment of the risk weight set for commercial immovable property pursuant to Articles 124(2) and 126(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012
(ESRB/2023/14)**

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 Board¹, and in particular Article 3(2)(j) thereof,

Having regard to 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 648/2012², and in particular Article 124(2) thereof,

Having regard to Decision ESRB/2015/4 of the European Systemic Risk Board of 16 December 2015 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2³.

Whereas:

- (1) Latvijas Banka, acting as the designated authority for the purpose of Article 124 of Regulation (EU) No 575/2013 in Latvia, notified the European Systemic Risk Board (ESRB) on 17 November 2023 of its decision to reduce the previously set higher risk weight applicable to exposures fully and completely secured by mortgages on commercial immovable property, in accordance with Article 124(2) of that Regulation.
- (2) Under Articles 124 to 126 of Regulation (EU) No 575/2013, standard risk weights are assigned to exposures fully secured by mortgages on residential property and commercial immovable property. Under Article 126(1) of Regulation (EU) No 575/2013 standard risk weights may be assigned to exposures fully and completely secured by mortgages on commercial immovable

¹ OJ L 331, 15.12.2010, p. 1.

² OJ L 176, 27.6.2013, p. 1.

³ OJ C 97, 12.3.2016, p. 28.

property.

- (3) According to Article 124(2) of Regulation (EU) No 575/2013, the authority designated in accordance with Article 124(1a) of Regulation (EU) No 575/2013 must periodically and at least annually assess whether the standard risk weights assigned under Regulation (EU) No 575/2013 are appropriately based on the loss experience of exposures secured by immovable property and on forward-looking immovable property markets developments. Where, on the basis of that assessment, the authority designated in accordance with Article 124(1a) of Regulation (EU) No 575/2013 concludes that the risk weights do not adequately reflect the actual risks related to exposures secured by mortgages on commercial immovable property, and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in its Member State, it may increase the risk weights applicable to those exposures within the ranges determined in Article 124(2), or impose stricter criteria than those set out in Article 126(2) of that Regulation. The designated authority must notify EBA and the ESRB of any adjustments to risk weights and criteria applied pursuant to Article 124(2) of Regulation (EU) No 575/2013.
- (4) Since 2007, the risk weight applicable to exposures fully and completely secured by mortgages on commercial immovable property in Latvia was set at 100 %. The 100 % risk weight was maintained when Regulation (EU) No 575/2013 entered into force even though Article 126(1) of that Regulation indicates 50 % as the level of standard risk weight for these exposures.
- (5) In 2022, the ESRB issued a Recommendation on vulnerabilities in the commercial real estate sector in the European Economic Area⁴, after having issued a general warning pointing, inter alia, to potential vulnerabilities in commercial real estate markets⁵. The ESRB also noted that measures adjusting the risk weight for commercial real estate exposures can constitute appropriate macroprudential measures, increasing the resilience of financial institutions.
- (6) Latvijas Banka intends to lower the risk weight for exposures fully and completely secured by mortgages on commercial immovable property from 100 % to 80 %, to be applied from 30 June 2024 as a result of Latvijas Banka observing that the market liquidity has improved and loss rates decreased compared to the period when the 100 % risk weight was introduced, including the period of the global financial crisis and its aftermath. The new risk weight remains above the level indicated in Article 126(1) of the Regulation (EU) No 575/2013 for these exposures, which is 50 %.
- (7) The measure may incentivise credit institutions in Latvia to evaluate whether exposures in their commercial property loan portfolios conform to the applicable criteria for the classification of 'fully and completely secured by mortgages on commercial immovable property'.

⁴ Recommendation [ESRB/2022/9](#) of the European Systemic Risk Board of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area (OJ C 39, 1.2.2023, p. 1).

⁵ Warning [ESRB/2022/7](#) of the European Systemic Risk Board of 22 September 2022 on vulnerabilities in the Union financial system (OJ C 423, 7.11.2022, p. 1).

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- (8) Pursuant to Article 124(2), subparagraph 3, of Regulation (EU) No 575/2013 the ESRB is to provide the Member State concerned with an opinion on the proposed measure within one month of receipt of notification from the competent authority.
- (9) The ESRB acknowledges Latvijas Banka's assessment of the financial stability that the risk of exposures secured by mortgages on commercial immovable property is heightened but decreasing, and these exposures have seen limited growth in recent years. Commercial real estate constitutes a significant share of the lending of Latvian credit institutions, hence the inadequacy of the risk weight could adversely affect current or future financial stability in Latvia. However, lowering the applicable risk weight to 80 % reflects the assessment of decreased vulnerabilities affecting commercial real estate exposures compared to the situation in 2007 when a 100 % risk weight requirement was implemented and is also supported by a comparison with the implied risk weights of banks that use the internal ratings-based approach, which are on average higher than the 50 % risk weight pursuant to Article 126(1) of Regulation (EU) No 575/2013 and only slightly lower than the new 80 % risk weight.
- (10) Since the measure which is a downward adjustment of previously set risk weight to reflect the actual risks related to exposures secured by mortgages on commercial immovable property, Latvian authorities are encouraged to assess over time and at least annually the appropriateness of the measure.

HAS ADOPTED THIS OPINION:

1. The measure adjusting the risk weight applicable to exposures fully and completely secured by mortgages on commercial immovable property in Latvia by Latvijas Banka, is considered as appropriate. The reduced risk weight remains above the level indicated in Article 126(1) of Regulation (EU) No 575/2013. The adjustment lowers the loss absorbency requirements for exposures secured by mortgages on commercial immovable property in Latvia. However, the cumulative effect of the risk weight measure and the implementation of the positive neutral countercyclical capital buffer when fully phased in, by mid-2025, will ultimately represent a tightening, as the decrease in capital requirements associated with the reduction of the risk weight will be more than offset.
2. The measure adjusting the risk weight applicable to exposures fully and completely secured by mortgages on commercial immovable property in Latvia by Latvijas Banka is assessed as effective and proportionate. Under the current circumstances, the measure does not entail disproportionate adverse effects on financial stability in Latvia or in the Union, nor is it expected to form or create an obstacle to the proper functioning of the internal market. In addition, the



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measure is expected to provide an incentive for credit institutions in Latvia to classify exposures as secured by mortgages on commercial real estate. This would improve the availability of data on these exposures and close data gaps in the area of commercial real estate financing, which would also align with the ESRB's view on closing data gaps in the real estate area, as expressed in Recommendation ESRB/2016/14.

3. The ESRB notes that Latvijas Banka, acting as the designated authority for the purpose of Article 124 of Regulation (EU) No 575/2013, must periodically, and at least annually assess, whether the risk weights provided for in Regulation (EU) No 575/2013, or set by the designated authority in accordance with Article 124(1a) of Regulation (EU) No 575/2013, adequately reflect the actual risks related to exposures secured by mortgages on commercial immovable property and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in Latvia, and adjust the risk weights if deemed necessary in accordance with Article 124(2) of Regulation (EU) 575/2013, as further specified by Commission Delegated Regulation (EU) 2023/206.
4. The attached assessment note entitled 'Assessment of a risk weight adjustment for exposures secured by mortgages on commercial immovable property in accordance with Article 124 of the Capital Requirements Regulation in Latvia' is an integral part of this Opinion.

Done at Frankfurt am Main, 14 December 2023.

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

Francesco MAZZAFERRO