Assessment Team on national macroprudential measures

Assessment of the Dutch notification in accordance with Article 458 of Regulation (EU) No 575/2013 concerning an extension of a stricter national measure for residential mortgage lending

Background note

Introduction

On 22 July 2024 De Nederlandsche Bank (DNB) notified the European Systemic Risk Board (ESRB) of its intention to extend a stricter national measure concerning risk weights under Article 458(2)(d)(iv) of the Capital Requirements Regulation (CRR).[1] DNB is the designated authority responsible for the application of Article 458 of the CRR in the Netherlands.[2] Pursuant to Article 458(4) of the CRR, the ESRB must provide the EU Council, the European Commission and the Netherlands with an opinion within one month of receiving the notification. The opinion must be accompanied by an assessment of the national measure in terms of the points mentioned under Article 458(2) of the CRR. The procedural framework for providing opinions under Article 458 of the CRR is clarified in Decision ESRB/2015/4.[3]

The ESRB's assessment focuses on the net benefits of the national measure for maintaining financial stability. In particular, the ESRB has assessed the rationale and merit of the measure against the following criteria:

- Justification: has there been a change in the intensity of systemic risk and does it pose a threat to financial stability at the national level? Can alternative instruments provided for under the Capital Requirements Directive (CRD)[4] and the CRR adequately and appropriately address the risk, taking into account their relative effectiveness?

- Effectiveness: is the measure likely to achieve its intended objective?

[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] In accordance with Section 3:66 of the Dutch Financial Supervision Act, De Nederlandsche Bank has the power to take measures related to Article 458 of the CRR.

[3] Decision 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/2014/2.

[4] 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).

- Efficiency and suitability: will the measure achieve its objective in a cost-efficient way, i.e. have the appropriate instrument and calibration been used?
- Proportionality and impact on the Internal Market: is there an appropriate balance between the costs resulting from the measure and the problem it aims to address, taking into account any potential cross-border spillover effects?

The ESRB's assessment draws on the information provided by DNB in its notification, in addition to discussions with DNB and its staff. The ESRB has also relied on the compliance assessment[5] carried out with respect to Recommendation ESRB/2019/7 on medium-term vulnerabilities in the residential real estate sector in the Netherlands,[6] and on the analysis of vulnerabilities in the residential real estate sectors of European Economic Area (EEA) countries conducted by the ESRB in 2024.[7]

Section 1: Description of and background to the measure

The draft measure is an extension of the current measure under Article 458 of the CRR, which has been in place since 1 January 2022 and has been extended once already from 1 December 2022 to 30 November 2024. With this current extension the measure would run for two additional years, until 30 November 2026. The extension would not alter the design of the current measure, which imposes a minimum average risk weight to banks using the internal ratings-based approach (IRB banks) on portfolios of exposures to natural persons secured by mortgages on residential property in the Netherlands. The minimum average risk weight of these portfolios is the exposure-weighted average of the risk weights of the individual loans. The risk weight of each individual exposure item in scope of the measure is calculated as follows: (i) a 12% risk weight is assigned to the portion of the loan not exceeding 55% of the market value of the property that serves as a collateral, and (ii) a 45% risk weight is assigned to the remaining portion of the loan.

The measure provides a risk-sensitive floor to risk weights, as it differentiates the average minimum risk weight of the portfolio based on the loan-to-value (LTV) of the mortgage. The risk weights of individual loans increase with their LTV ratio, from 12% for loans with an LTV ratio of less than 55% up to, for example, 26.85% for loans with an LTV ratio of 100%. The average risk weight floor is updated by banks on a quarterly basis**.** The measure continues to be calculated based on the market value of the collateral, despite recent changes in the requirements for collateral valuation in CRR III. The new requirements stipulated in Article 229(1)(e) of the CRR imply more conservative revaluations, which might lead to banks needing to adjust collateral values downwards

[5] See **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 OJ C 366, 30.10.2019, p. 22-28**.

[6] See **ESRB (2022): Compliance report of Country-specific Recommendations of the European Systemic Risk Board of 27 June 2019 - part II February 2022**.

[7] See **ESRB (2024): Follow-up report on vulnerabilities in the residential real estate sectors of the EEA countries.**

given the surge in housing prices over the last couple of years.[8] According to DNB, continuing to calculate the risk weight floor based on market value fits the purpose of the measure to maintain the resilience of Dutch banks to a potential severe downturn in the housing market, which is based on current market values. Moreover, using market values ensures consistency in the measure and limits the risk of double-counting between the more conservative IRB risk weights and the risk weight floor measure, as the measure has originally been calibrated based on market value.

The measure applies to exposures of IRB banks to natural persons secured by mortgages on residential property located in the Netherlands, excluding loans wholly or partly covered by the Dutch National Mortgage Guarantee (NHG) scheme.[9] The measure targets only IRB banks' portfolios, because (i) IRB banks account for 96% of all mortgage lending by banks in the Netherlands, and (ii) risk weights under the standardised approach are higher than the average risk weight resulting from the intended risk weight floor and are considered adequate by DNB. NHG mortgages benefit from a guarantee by a government-backed foundation, so DNB considers them to be safer than non-NHG mortgages. They have therefore been excluded from the scope of the proposed measure, even though they account for 20-25% of banks' mortgage portfolios and therefore are sufficiently material to contribute significantly to systemic risk (owing to both indirect effects on consumer spending and a potential sovereign-bank nexus[10]). To indirectly take these factors into account DNB considered all average risk weights, including for mortgages covered by the NHG, when calibrating the measure.

The current measure was originally notified on 8 January 2020, with the intention it would enter into force by September 2020. On 17 March 2020 DNB announced the postponement of the measure owing to the pandemic. On 23 September 2021 DNB notified the ESRB the measure would be activated as of 1 January 2022. On 8 August 2022 DNB notified the ESRB of its intention to extend the measure for an additional two years, from 1 December 2022 to 30 November 2024. In September 2022 the ESRB issued an opinion on extending the measure which assessed it as being justified, suitable, proportionate, effective and efficient.[11] The financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified were deemed to outweigh any negative impacts on the Internal Market. The ESRB assessment also clarified that the measure did not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole, thus forming or creating an obstacle to the functioning of the Internal Market.

The current extension does not alter the calibration of the measure currently in place and is therefore already fully phased in. The extension is intended to enter into force on 1 December 2024 (after the application

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[8] CRR , as amended by CRR III, states in Art 229(1)(e) states that "where the property is revalued, the value of the property does not exceed the average value measured for that property, or for a comparable property over the last six years for residential property or eight years for commercial immovable property or the value at origination, whichever is higher."

[9] The NHG scheme is a guarantee provided by a government-backed foundation, the Homeownership Guarantee Fund (Waarborgfonds Eigen Woningen, WEW), which covers 90% of the residual debt if a forced sale of the house is inevitable owing to circumstances beyond the control of the borrower (job loss, becoming disabled, divorce). The amount guaranteed under the NHG decreases over time on the basis of an annuity scheme.

[10] In general, the risks related to the nexus between banks and sovereigns are increased sovereign contingent liabilities and higher funding costs (**see IMF (2013): Global Financial Stability Report - Transition Challenges to Stability, October 2013**.).

[11] See **Opinion of the European Systemic Risk Board** of 6 September 2022

period of the current measure expires). The final decision by DNB to extend the current measure will be communicated in the Financial Stability Report scheduled for publication on 21 October 2024. DNB has already published its intention to extend the measure on 14 May 2024 for public consultation.

DNB requested reciprocation of the existing measure by other Member States under Article 458(8) of the CRR and the General Board of the ESRB decided to recommend this.[12] The ESRB's recommendation for reciprocation will continue to apply to the measure in its extended form. DNB has noted that reciprocity remains relevant in order to avoid leakages and regulatory arbitrage.[13]

Article 458(10) of the CRR does not apply to the measure, as the increase in average risk weights is expected to be higher than 25%. According to DNB's calculations, the proposed measure is expected to increase targeted banks' average risk weights from 12% without the current measure to 16% on aggregate (compared with raising them from 11% to between 14% and 15% when the measure was originally notified in 2020).

Section 2: Analysis of the underlying systemic risks

In recent years the ESRB has been monitoring risks related to the residential real estate (RRE) sector in the Netherlands and all other EEA countries. In 2016 the ESRB issued a warning to the Netherlands,[14] mainly over high mortgage loan indebtedness, very high LTV ratios and the significant share of borrowers who would have total debt exceeding the value of their home if house prices declined (commonly referred to as "underwater mortgages"). In September 2019 the ESRB issued a recommendation[15] to the Dutch authorities to take further measures aimed at mitigating risks in the housing market. The ESRB recommended that the Netherlands (i) establish an "act or explain" mechanism in Dutch law in relation to recommendations issued by the macroprudential authority on activating legally binding borrower-based measures, (ii) tighten the existing legally binding limit on the LTV ratio, (iii) amend the methodology for determining the maximum limit applicable to the debt-service-to-income ratio, and (iv) activate capital-based measures to ensure the resilience of credit institutions authorised in the Netherlands in the face of potential materialisation of systemic risk related to RRE. The aim of this recommendation was also to emphasise the need for broader policy action to curb factors facilitating or promoting increasing household indebtedness. In multiple rounds, most recently in 2023, the ESRB assessed compliance by the Netherlands with the ESRB recommendation.[16] It found that the Netherlands was fully compliant with the sub-recommendation

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[12] See **Recommendation of the European Systemic Risk Board of 16 February 2022 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2022/1), 2022/C 174/01 OJ C 174, 28.4.2022, p. 1-15**.

[13] DNB has provided guidelines to other EU Member States to approximate the size of their exposures in the scope of the measure under existing reporting requirements. See **ESRB/2022/1** for further details.

[14] See **Warning of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of the Netherlands (ESRB/2016/10)**.

[15] **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)**

[16] **Compliance report of Country-specific Recommendations of the European Systemic Risk Board of 27 June 2019 - part III September 2023**

concerning capital-based measures, taking into account the current risk weight measure which entered into force on 1 January 2022, but it was either only partially compliant or non-compliant with other sub-recommendations focusing on borrower-based measures.[17]

In February 2024 the ESRB published a follow up report on the vulnerabilities in the RRE sector,[18] in which an in-depth risk and policy assessment was conducted for all individual EEA countries, including the Netherlands. Stock risks inherent to the Dutch RRE sector were classified as high, and despite assessing that the housing market is in a downturn (based on data up to the second quarter of 2023), the report concluded that overall, risks in the housing market in the Netherlands are still high. Macroprudential measures have had some effect in gradually reducing high-LTV lending, and government initiatives aimed at increasing housing supply and affordability are expected to accelerate housing development. While the current policy mix, including LTV and debt service-to-income (DSTI) limits, the 2% countercyclical capital buffer rate and the risk weight floor measure, is seen as appropriate, the report deemed it only partially sufficient. Based on the report, ongoing monitoring and potential tightening may be necessary to address persistent vulnerabilities. The report still considered it important that authorities implement the previous ESRB recommendations, taking into account the position in the economic and financial cycles.

2.1 Vulnerabilities in the RRE sector

The systemic risk inherent in the Dutch housing market has stabilised at elevated levels after increasing over the past few years. The market gained significant momentum as house prices went up sharply for several years in a row, with a swift acceleration in 2021 and 2022. Between 2018 and 2020 house prices grew by an average of 8% year-on-year, according to Statistics Netherlands. The same source indicates that year-on-year growth peaked at 21.1% in January 2022. This was fuelled by low interest rates, as well as structural factors, such as supply constraints and the tax deductibility of interest paid on mortgages, which may incentivise households to over-borrow. At the same time, strict zoning regulations and scarcity of space (mainly in and around cities) have resulted in low elasticity of housing supply. After a short-lived and modest decline in 2022-23, house prices began to rise again in December 2023. The latest available yearly growth rates stood at 7.5% in April 2024 and 8.6% in May. In fact, in April 2024 the house price index exceeded its previous peak, and DNB now expects it to increase further.

Sluggish supply and declining interest rates partly account for the price increases, but signs of overvaluation remain present. The national average transaction price has more than doubled since mid-2013. Symptoms of overvaluation can also be observed in overbidding on the part of buyers. As DNB reports, more than half of transactions are concluded at a purchase price which exceeds the asking price, up from 40% in 2020 when the measure was originally notified. In line with these developments, the average transaction period has significantly

[17] Apart from that, the Netherlands was assessed as partially compliant with the sub-recommendation concerning the legal framework for borrower-based measures, non-compliant with the sub-recommendations related to tightening borrower-based measures and the approach to calibration and fully compliant with the sub-recommendation concerning broader policy action to promote structural changes related to mortgage loans and the residential real estate sector.

[18] See **ESRB (2024): Follow-up report on vulnerabilities in the residential real estate sectors of the EEA countries.**

decreased since then too, while a scarcity indicator (houses sold divided by houses for sale) has also risen above the levels observed at the time when the measure was first notified and activated. Cumulative house price growth over the past seven years has substantially surpassed growth in household income. As a result, the house price-to-income ratio has increased by 25% since 2015 and stands well above the European average. The ESRB estimates also point to an overvaluation in the RRE market of approximately 20%.[19] In addition, housing prices at the end of 2023 were 18% higher than expected based on the historical trend in borrowing capacity. This could incentivise banks to lend to their maximum capacity, increasing their exposure to a housing market downturn.

Against this background of potential overvaluation, the stock of mortgage loans with high LTV ratios remains substantial. Excluding NHG mortgages, loans with LTV ratios above 55% account for roughly half of banks' mortgage portfolios. In the event of a downward correction in house prices, borrowers with highly leveraged loans may end up owing more than the market value of their home and cut down on consumption for precautionary reasons. This may, in turn, have negative effects on the real economy and the financial system. Borrowers who are not able to continue servicing their debt may default on their loans, resulting in credit losses for mortgage providers. Moreover, as prices drop, high-LTV mortgage loans will end up under water sooner. Underwater homeowners consume less, as was observed during the last housing crisis between 2008 and 2013.

2.2 Vulnerabilities in the household sector

Dutch household indebtedness is among the highest in Europe. It stood at 94% of GDP at the end of 2023, of which the large majority is mortgage debt. On average, household debt in the euro area stood at around 54% in 2023, considerably below the Dutch levels. As growth in house prices has been higher than the growth in incomes, borrowers are becoming increasingly leveraged.

Vulnerabilities related to household indebtedness may be amplified by the current circumstances of high interest rates, especially taking into account the large share of interest-only loans. Even though their share in the stock of loans has decreased over the past few years, interest-only loans gained popularity among new borrowers when interest rates were low. They carry a larger refinancing risk than amortising loans. In the event of a prolonged period of high interest rates, possibly coupled with inflation levels not yet at the medium-term target, households may be forced to reduce consumption to continue servicing their debt. This would have negative effects on the real economy and the financial system.

2.3 Vulnerabilities in the banking sector

Stress tests run by DNB show that, in an adverse scenario, banks' mortgage loan losses would surge. A large proportion of banks' assets are Dutch-originated mortgage loans (21%, the same level as observed at the time of the latest notification of extension of the measure, and 2% lower than in 2019, before it was introduced). Stress tests conducted on bank exposures as at the fourth quarter of 2022 showed that a combination of higher

[19] **ESRB risk dashboard**. Production date: 6 June 2024

default rates and lower collateral values would put banks under strain. Dutch banks could be impacted both directly, through credit losses from loan defaults, as well as indirectly, through reduced consumption by borrowers and second-round effects from the real economy. Moreover, as in the global financial crisis, market participants could be less keen on funding Dutch banks, whose reliance on market funding has reduced but is still above the average for the euro area. This also contributes to their vulnerability to a house price correction. High household indebtedness, pockets of house price overvaluation and relaxed lending standards for mortgage loans are the main vulnerabilities which could materialise in credit losses in the Dutch banking system.

The vulnerabilities posed by these developments have not been reflected in risk weights for mortgage loans at IRB banks, which are among the lowest in the EU. DNB's latest stress test still indicates potential for substantial losses, while the average risk weights of IRB banks' mortgage portfolios remain at a low level and have increased only moderately since first notification of the measure. Moreover, the dispersion in IRB risk weights between banks has increased since the measure was introduced. The risk weight floor ensures banks maintain a certain minimum amount of capital for their mortgage portfolios, and helps prevent that house price increases result in a substantial decrease in risk weights (i.e. rising house prices causing LTV ratios to decline). The measure differentiates the average minimum risk weight of a portfolio based on the LTV of the underlying mortgage loans, making the measure risk-sensitive. The vast majority of exposures to domestic mortgage loans in the Dutch banking sector pertains to IRB banks (96%, compared to 92% in 2022, when the extension was notified). Currently, the average risk weight of IRB banks stands at around 16%, which is 30% higher than it would be without the measure. By way of comparison, for banks that follow the standardised approach the risk weight prescribed by the CRR for exposures fully and completely secured by mortgages on residential property is 35%.

Section 3: Effectiveness and efficiency of the measure

3.1 How the measure addresses the risk identified

The measure proposed for extension primarily aims to enhance Dutch banks' resilience to a potential severe downturn in the housing market. DNB sees elevated systemic risk in the housing market, with sustained price increases in real estate in recent years. Therefore, from a macroprudential perspective, risk weights assigned to Dutch mortgage loans are deemed low in light of the high systemic vulnerabilities. The ESRB also argued this in its recommendation in 2019 and report in 2024.

The design of the measure is risk-sensitive, in the sense that the floor increases with the LTV ratio of the underlying mortgage loans. Exposure to high-LTV loans is regarded as a major concern, but in the Netherlands the macroprudential authority does not have legally binding powers to reduce the LTVs through borrower-based measures. The specific way in which LTV is mapped to risk weights is motivated by several considerations: (i) it leads to a substantial difference between the risk weights of high and low-LTV loans, which strengthens the risk-sensitivity of the measure; (ii) risk weights increase gradually with the LTV ratio, preventing potential distortions through cliff effects; and (iii) by using a constant risk weight for part of the loan (up to 55% LTV), mapping also ensures that risk weights for low-LTV loans are not too low from a macroprudential perspective. Thus the measure

reflects the systemic risks stemming from high-LTV loans, as the additional capital to be held for mortgage exposures increases as the share of high-LTV loans rises. In addition, because the measure imposes a higher floor on banks with a larger share of high-LTV loans, it disincentivises banks from granting new such loans.

DNB considers that a floor dependent on the LTV ratio is a better option than using a fixed add-on. Imposing a fixed add-on could potentially lead to distorting effects by reducing the incentive for IRB banks to estimate conservative parameters, given that more conservative parameters would result in the sum of IRB risk weight plus the add-on being higher. A floor dependent on the LTV ratio, by contrast, means the capital impact of the measure is larger for riskier (higher-LTV) loan portfolios, which should reduce the attractiveness of these loans for IRB banks. Indeed, recent DNB internal research shows no evidence that the measure has led to riskier mortgage lending over 2022 and 2023.

While the ESRB pointed out in its previous opinion that the measure may induce procyclicality if not regularly re-assessed, DNB has found no signs of this. Given the use of market value to calibrate the measure, the ESRB voiced a concern that it would become less stringent as house prices rise, and more stringent as they fall. DNB did not observe this pattern in the data. Since activation, the average risk weight after applying the risk weight floor has remained at 15-16%, and only slightly increased while the house price index declined. For most banks, IRB risk weights respond more strongly to housing price changes than risk weights calculated with the risk weight floor measure. DNB has emphasised that it will continue monitoring the impact of the measure to ensure its effectiveness and avoid unintended procyclical effects, and that calibration adjustments will be undertaken if a sustained reversal is observed. If the risk were to materialise this would be a reason to withdraw the measure, according to DNB, so the capital could be used to absorb any losses.

DNB ran a number of exercises that helped inform calibration of the measure and assess its appropriateness going forward. These include running a top-down stress test using the adverse scenario from the 2023 European Banking Authority (EBA) EU-wide stress test. This featured a severe downturn in the housing market which includes, among other things, a cumulative decline in RRE prices of more than 30% and a strong increase in interest rates challenging households' debt servicing capacity. In contrast to the bottom-up approach used in the EBA-stress test, a top-down model was designed to provide conservative estimates by using a uniform approach to calculate potential losses for banks. The stress test has now been performed on the domestic mortgage portfolio of six banks subject to the Article 458 measure,[20] as opposed to the entire portfolio of four banks previously. In a sensitivity analysis, DNB projected the potential credit losses for mortgages in line with the highest three-year cumulative increase in credit losses observed in historical data. Both analyses found that banks would incur sizeable losses on their mortgage portfolios and suggest banks would need to hold additional capital to ensure sufficient resilience should systemic risks materialise in the housing market.

The amount of CET1 capital raised by the measure based on data from the fourth quarter of 2023 is estimated to be €2.4 billion, which would help secure the resilience of the banking sector in a severe downturn scenario. This impact is lower than in 2022 (when the estimated capital built through the measure stood

[20] The seventh bank subject to the measure only recently came within its scope and due to the lack of timely data it was not included in the exercise..

at €4.5 billion), as the difference between the IRB risk weights and the risk weights pursuant to the measure under Article 458 of the CRR decreased for certain banks. However, the impact is still considered proportionate by DNB considering the elevated risks and stress test impact. On aggregate, extending the measure is expected to keep the average risk weights of IRB banks about 4 percentage points higher compared to the IRB risk weights without applying the measure (from around 12% currently, before applying the measure, to 16%).

In addition to the current risk weight measure for which an extension is under consideration, the Netherlands has borrower-based measures in place targeting RRE and capital measures for different or broader purposes. In particular, the LTV limit for mortgages in the Netherlands is currently 100%, which is considered very high, both relative to the degree of potential overvaluation and when compared with other countries.[21] The DSTI limit for mortgages in the Netherlands is a function of household income and the mortgage interest rate. Five banks identified as systemically important, including four IRB banks, need to comply with the other systematically important institutions (O-SII) buffer of 0.25% to 2%.[22] Since its reduction in 2020, the systemic risk buffer (SyRB) has been set to zero for all banks. A 2% countercyclical capital buffer (CCyB) rate has been in place since 31 May 2024, consistent with DNB’s intention to maintain this level in a standard risk environment (a situation in which cyclical risks are not particularly high, but not particularly low either).[23]

Keeping a risk weight floor in place also helps ensure macroprudential buffers remain effective. Capital buffers such as the O-SII buffer and the CCyB use risk-weighted assets as a denominator. If risk weights were to decline further, these buffers would become less effective. A similar consideration may apply to the current measure, should the declining risk weights be driven by rising house prices and falling LTV ratios. However, the effect of lowering LTV ratios on the effectiveness of the current measure would be limited due to the “constant” component (the 12% risk weight up to an LTV of 55%), which constitutes an “absolute” risk weight floor on Dutch mortgages.

While DNB assesses that there are no overlaps with the newly introduced output floor for now, its impact should be monitored in future. On 1 January 2025 CRR III will come into force, which includes the introduction of the output floor with several transitional arrangements, including a five-year phase-in period and a Member State discretion related to the calculation. In DNB’s view, there is no conceptual overlap between the output floor and this measure, as the former addresses model risks, not systemic risk in specific asset classes, and is an aggregate measure. However, in practice, depending on specific balance sheet composition and how banks with internal models apply it in their portfolios, the output floor could potentially indirectly address the model risk for RRE exposures. In specific cases, this could create a potential overlap between this measure and the application of the output floor. Nevertheless, during the requested extension period of this measure under Article 458 of the CRR (until 1 December 2026), the output floor is not expected to “bite” for any of the Dutch IRB banks. Hence, at this

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[21] The LTV limit was gradually reduced from 106% in 2012 to 100% in 2018 but, despite a recommendation from the Dutch Financial Stability Committee, there is currently no expectation that the government, which holds the legally binding powers to implement such measures, intends to lower it further.

[22] The five systemically important Dutch banks and their O-SII buffer rates are: ING Bank (2%); Rabobank (1.75%); ABN Amro Bank (1.25%); Volksbank (0.25%); BNG Bank (0.25%). The first four of these are IRB banks.

[23] See, for example, **DNBulletin**, 27 May 2022.

stage there is no overlap between the output floor and the risk weight floor measure. Still, the ESRB invites DNB to monitor any potential overlaps and ensure calibration remains appropriate even after the output floor has been introduced and phased in.

3.2 How the measure relates to possible alternatives

As required under Article 458 of the CRR, this section assesses whether other macroprudential instruments available under the CRD and the CRR could adequately address the increase in systemic risk, taking into account their relative effectiveness. These instruments need to be considered before resorting to stricter national measures under Article 458 of the CRR. The ESRB's assessment of the existing measure has already considered this question. The main reasons why these other measures are not deemed appropriate alternatives to the envisaged extension of the measure under Article 458 CRR remain the same.

a) Increasing the risk weights for banks applying the standardised approach to credit risk (Article 124 of the CRR)

Relevant authorities can impose higher risk weights for exposures secured by mortgages on credit institutions that apply the standardised approach on the basis of financial stability considerations. Relevant authorities can set a risk weight for exposures secured by mortgages on residential immovable property from 35% to up to 150%. In addition, they can apply stricter criteria for the application of the 35% risk weight.

Article 124 of the CRR would not be effective in addressing the systemic risk identified, given that banks applying the standardised approach account for only a small fraction of mortgage lending by banks in the Netherlands (around 4%). Moreover, the average risk weights of banks using the standardised approach are considerably higher than those of IRB banks and are considered sufficiently high by DNB in relation to systemic risk.

b) Increasing the loss given default floor for banks applying the IRB approach for credit risk (Article 164 of the CRR)

Relevant authorities can set higher minimum values of exposure-weighted average loss given default (LGD) for exposures secured by immovable property on the basis of financial stability considerations. LGD is one of the parameters used in the risk weight function. Increasing the LGD indirectly increases the risk weight and the resulting capital requirements.

The ESRB is of the view that, given the narrower focus of Article 164 of the CRR, which only targets LGD, such a measure would not sufficiently address the intended purpose of the draft measure and could even have unintended results. Increasing the LGD would affect mainly loans with lower LGDs, but these are typically the ones that have lower LTVs and therefore should potentially have lower risk. Also, assuming internal models are correctly calibrated, this would penalise more conservative banks. Furthermore, acting through the LGD would also

affect other microprudential parameters, such as the calculation of expected loss amounts under Articles 158 and 159 of the CRR, which is not the intended purpose of the measure.

c) Using the systemic risk buffer (Article 133 of the CRD)

Member States may introduce an SyRB in order to prevent and mitigate macroprudential or systemic risks not covered by the CRR or Articles 130 and 131 of the CRD, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State. The SyRB can be applied to all banks or to a subset of banks. It can also be applied to a subset of exposures, exposures in third countries or exposures in other Member States.

A sectoral SyRB would be less effective and efficient in addressing the systemic risk identified than the measure proposed for extension, given that its effects could be mitigated by inappropriately low IRB risk weights for mortgage loans. A sectoral SyRB can only be imposed as a percentage of current risk-weighted assets. Declining risk weights could therefore lead to a lower capital requirement for a given SyRB rate, even when RRE vulnerabilities may be increasing. Moreover, DNB considers that it would be much more complex to achieve the risk-sensitive approach of the measure proposed for extension (linked to LTV ratios) using a sectoral SyRB.

d) Using the countercyclical capital buffer (Article 136 of the CRD)

The CCyB addresses some of the procyclicality in the financial system. It is a requirement applicable to domestic exposures. The rate for the CCyB is assessed on a quarterly basis by the designated authority. Designated authorities follow a specific methodology based on an ESRB recommendation.[24] DNB's current analytical framework for setting the CCyB aims for a 2% rate in a standard risk environment (a situation in which cyclical systemic risks are neither particularly high nor particularly low).

The CCyB is not an appropriate tool for addressing systemic risk linked to a subset of exposures and is not applicable to a subset of institutions. The CCyB rate is applied as a percentage of the total domestic risk exposure amount calculated in accordance with Article 92(3) of the CRR. Therefore it is not possible to apply the CCyB requirement to specific subsets of exposures, such as mortgage loans. Moreover, the CCyB would apply to all institutions, whereas the proposed measure targets only IRB credit institutions.

Section 4: Analysis of the net benefits of the measure

4.1 Effects on financial stability, financial system resilience and economic growth

The measure proposed for extension is expected to continue contributing to the resilience of the Dutch banking system, thus potentially enhancing the resilience of the economy as a whole. The Dutch economy

[24] Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1) (OJ C 293, 2.9.2014, p.1).

has a high sensitivity to house price shocks, with banks and households especially vulnerable to a downward correction (see Section 2). Banks would be particularly affected, not only because of their direct exposure to mortgages, but also through indirect effects stemming from the high indebtedness of Dutch households, which makes them vulnerable to a downward correction in the housing market. Stress tests show that banks' expected mortgage loan losses could surge in an adverse scenario (see Section 3.1).

The ESRB is of the opinion that keeping the calibration of the proposed measure unchanged is suitable, given that the vulnerabilities related to Dutch RRE are stabilising at an elevated level. Despite the modest and temporary decline in house prices in 2022-23, prices are now growing again and are expected to continue to do so in the near future. Most indicators, such as the house price index, estimates of the overvaluation in the RRE market, household indebtedness, exposures of banks to the mortgage market and lending standards still indicate elevated risks on the RRE market and high vulnerabilities for banks. As a result, the ESRB is of the view that keeping the calibration of the measure unchanged is suitable in the current circumstances.

The targeted nature and risk-sensitivity of the measure is aimed at avoiding spillovers to overall lending and the real economy, contributing to its proportionality. Because RRE is one of the main domestic sources of systemic risk in the Netherlands, the measure targets exposures secured against this asset class. It affects banks only, for whom resilience to the indirect effect of a housing bust is likely to be more of a concern than for insurers and pension funds, especially as banks make up about 70% of the domestic mortgage market and are highly exposed to the RRE market, with 21% of their assets being domestic mortgages. The measure aims to strengthen banks' resilience and is not meant to influence house prices.

4.2 Effects on both domestic and cross-border lending

DNB does not expect the measure to have a significant negative impact on cross-border lending. The role of foreign lenders in the Dutch mortgage market is currently small. Nevertheless, DNB requests the ESRB to recommend that other Member States continue to reciprocate the measure, as their banking sectors may be or become exposed to the systemic risk in the Dutch housing market directly or indirectly through their branches. Reciprocation will contribute to maintaining a level playing field.

Risk weights of Dutch banks are expected to remain relatively low compared with other Member States. Even though the measure substantially increases risk weights for mortgage loans of Dutch IRB banks, these are expected to remain relatively low compared with other Member States. Spillovers to other Member States are therefore expected to be limited.

Contagion risk to other Member States is expected to be mitigated by increasing the resilience of the Dutch banking sector. The Dutch financial sector is highly interconnected with the European and global financial system; this measure is expected to reduce potential contagion to other Member States by strengthening its resilience.

4.3 Potential for leakages and regulatory arbitrage

Banks have limited opportunities to reduce the impact of the measure through model optimisation. This is because calibration depends on the LTV ratio of the underlying mortgage loans, not on model outcomes. The incentive for shifting to riskier lending is also limited, since risk weights increase as the LTV ratio increases.

Insurers and pension funds have been active in mortgage lending, as well as banks. Non-banks, especially insurers, have been increasing their mortgage lending over the past few years. Even though DNB has not observed any acceleration in this since the measure was introduced, the share of non-bank lending should continue to be monitored. Furthermore, borrower-based measures are applicable to both banks and non-banks in the Netherlands, limiting leakages.

Conclusions

The measure proposed for extension primarily aims at continuing to enhance the resilience of Dutch banks to a potential severe downturn in the housing market. Dutch banks are highly exposed to the Dutch mortgage market. The ESRB has drawn attention to high mortgage loan indebtedness, high LTV ratios and the significant share of borrowers with total debt exceeding the value of their home in recent years. At the same time, the ESRB has found that the IRB risk weights assigned to Dutch mortgage loans, which are among the lowest in the EU, do not accurately reflect the elevated systemic risk in the housing market. The ESRB is therefore of the view that extending the current measure is necessary to ensure the resilience of Dutch banks should systemic risk materialise in the real estate market.

The ESRB is of the view that the systemic vulnerabilities stemming from the RRE market are still not fully reflected in estimated IRB risk weights for mortgage loans in the Netherlands. The measure proposed for extension, which imposes a floor on risk weights linked to LTV ratios, will therefore help increase the resilience of Dutch banks to a possible materialisation of systemic risk in the RRE market. Because all macroprudential buffers are based on risk-weighted assets, it is essential the risk weights applied reflect the systemic risk profile of underlying assets. The ESRB is therefore of the view that the current measure should be extended.

The ESRB is of the opinion that keeping the calibration of the measure unchanged is suitable, given the stable but elevated vulnerabilities related to the Dutch RRE market. Since first notification of the measure, systemic risk inherent in the Dutch housing market has further increased and recently stabilised at an elevated level. The ESRB is of the view that keeping the calibration of the measures unchanged is suitable at the current juncture. Nevertheless, the ESRB notes that the measure may become less stringent as RRE vulnerabilities continue to increase. DNB should continue to monitor the resilience of both the household and banking sectors and take appropriate policy action if needed to mitigate risks related to the RRE market in the Netherlands, while avoiding procyclical effects on the real economy and the financial system. The ESRB also invites DNB to monitor the potential overlaps between the measure and the output floor.