Template for notifying the intended use of a systemic risk buffer (SRB)

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1. Notifying national authority and scope of the notification	
1.1 Name of the notifying authority	Norwegian Ministry of Finance
1.2 Type of measure intended (also for reviews of existing measures)	This notification concerns changes in the scope and the level of an existing SRB. The existing SRB has not been formally notified pursuant to Article 133 of the CRD, as the framework was not made part of the EEA Agreement until year-end 2019. Norwegian authorities have however provided the ESRB with information on the implemented measure. The current SRB rate stands at 5 % for all exposures for systemically important institutions, and at 3 % for all exposures for all other institutions. The 3 % buffer rate has been effective from 1 July 2014 (then for all domestic institutions), while the 5 % rate has been effective from 1 July 2016. The Ministry opted for a higher SRB rate for systemically important institutions rather than a separate O-SII buffer, in order to ensure cumulative application of the institutions' buffer requirements. Domestic systemically important institutions were however identified in accordance with Article 131 of the CRD. In conjunction with the changes in the SRB, the Ministry intends to replace the higher SRB rate with O-SII buffer requirements. The activation of the latter is notified separately. Until the CRR/CRD IV framework was made part of the EEA Agreement at year-end 2019, the presence of the Basel I floor and the absence of the SME supporting factor (pursuant to the CRD III of 2010) obliged Norwegian institutions to hold more capital to attain a certain capital adequacy ratio. Although these national deviations from the CRR/CRD IV framework were not macroprudential in nature, they did affect the calibration of the existing SRB. In other words, the Ministry took a somewhat pragmatic approach to the SRB calibration in order to avoid excessive requirements for domestic banks. Had the previous calibrations been made without the deviations from the CRR/CRD IV framework, the buffer rate would probably have been set at a higher and more correct level.
2. Description of the notified measure	

2.1 Institutions covered by the intended SRB	All credit institutions authorised in Norway, including the following five subsidiaries of parents established in other Member States: • Nordea Eiendomskreditt AS (549300TTWFTM3HRP0618) • Nordea Finans Norge AS (529900ODSMKVDX83E373) • Nordea Finance Equipment AS (5493005G5TEGCJEWJR17) • Nordea Direct Bank ASA (5967007LIEEXZX8S6851) • Santander Consumer Bank AS (549300A08LH2961IPN13)
2.2 Buffer rate **(Article 133(11)(f) of the CRD)**	4.5 %
2.3 Exposures covered by the SRB	Only domestic exposures.
3. Timing of the measure	
3.1 Timing of the Decision	The final decision will be made by the Ministry of Finance after the notification procedure has been completed.
3.2 Timing of the Publication	The final decision will be announced as soon as it is made by the Ministry of Finance. The Ministry did, however, announce its intention to adopt the measure on 11 December 2019.[1] The announcement was accompanied by the publication of a memo further explaining the justification and grounds for the measure. The memo is attached as an appendix to this notification. Moreover, the Ministry published a consultation document on i.a. the systemic risk buffer on 25 June 2019.[2]
3.3 Disclosure	In addition to the public disclosures mentioned in section 3.2, the Ministry will publish this notification on the same day as it is submitted.
3.4 Timing of Application	31 December 2020
3.5 Phasing in	For institutions not using the Advanced IRB Approach, the buffer rate for all exposures will be 3 pct. until 31 December 2022. This may i.a. ensure that the changes in the systemic risk buffer requirement for institutions not significantly affected by the abolishment of the Basel I floor, enter into effect after Pillar 2 requirements may have been reassessed, in order to promote consistency between Pillar 1 and Pillar 2 requirements. Pillar 2 assessments are conducted every second or third year for these institutions. The transitional rule does not apply to systemically important institutions.
3.6 Review/deactivation of the measure	The measure will be in place until further notice. The systemic risk buffer rate for domestic exposures will be evaluated every second year, as

[1] See the Ministry's press release of 11 December 2019.

[2] See the Ministry's press release of 25 June 2019 (the consultation document is available in Norwegian only).

	specified in an amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014.
4. Reasons for the intended SRB	
4.1 Description of the long-term non-cyclical systemic risk in your Member State **(Article 133(11)a of the CRD)**	The structural systemic risk in Norway is high. First, shocks may propagate and be amplified within the financial system. How quickly shocks amplify depends on structural features. If institutions are similar and interconnected, for instance through similar funding structure or exposures toward the same markets, disruptions in the economy may affect several credit institutions at the same time and in the same way. This increases systemic risks. The commonality of Norwegian institutions' business models is considerable and they are closely interconnected through cross-holdings of covered bonds, which increases the risk that problems may spread quickly to other institutions. The institutions rely significantly on wholesale funding, making them vulnerable to market turbulence. The financial sector is also vulnerable to disruptions stemming from abroad, as a large share of the wholesale funding is in foreign currency. The IMF points to Norwegian institutions' wholesale funding dependency as a key underlying vulnerability in its systemic risk analysis of the Norwegian financial system conducted as part of the 2020 Financial Sector Assessment Program (FSAP).[3] The extensive use of covered bonds as a funding source has, however, also contributed to a lengthening of maturities on credit institutions' overall wholesale funding, which reduces refunding risk. While the total share of wholesale funding has increased somewhat in recent years, the short-term foreign currency funding has been reduced (adjusted for institutions' central bank deposits). In general, macroeconomic disruptions may cause significant losses in the banking sector, for example through vulnerabilities in the sectors where institutions have exposures, or through economic disruptions from abroad leading to lower trade. Norwegian institutions have similar and concentrated exposures in particular towards Norwegian real estate markets, which have long been characterised by high and rising prices. Over many years, market developments have contributed to the level of debt in Norwegian households being very high in international comparison, which makes the households vulnerable to loss of income, increased interest rates and falling house prices. Norwegian households also have one of the highest shares of floating-rate mortgage loans in Europe, which amplifies this vulnerability. In adverse scenarios, households may reduce their consumption, which could lead to lower income and production in firms, leading to further losses in credit institutions. The institutions have large exposures to the commercial real estate market, and such exposures have historically inflicted the largest losses. The Norwegain economy is also characterized by a unilateral corporate sector, with a high dependence on the petroleum sector. Lower petroleum prices or reduced demand may have significant negative effects for the economy as a whole. The Norwegian banking sector is concentrated. The five largest (domestic and foreign) banks account for more than half of total domestic lending.

[3] See *Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director for Norway 2020*, IMF Country Report No. 2020/259

	The ten largest banks account for about 70 pct. of total domestic lending. One bank accounts for about 30 pct. of lending.[4] The pandemic has not led to any major changes in the structural features of the Norwegian financial system, such as the level of interconnectedness or commonality of exposures. Nor has households' debt level or institutions' CRE exposures been significantly reduced. The structural and cyclical dimensions of systemic risk are not easily distinguishable, especially when it comes to debt and real estate prices. Cyclical risk increases when financial imbalances are building up, and developments in indicators relative to historical averages and long-term trends will then be relevant. Structural systemic risk reflects more long-term vulnerabilities in the financial system, and then the *level* of the indicators are more relevant. The high levels of household debt and real estate prices reflect, among other things, structural features of the real estate market, such as the high homeownership compared to other European countries. Institutions' considerable exposures to real estate markets is a further reason why the high debt level and price level must be regarded as a structural risk, in addition to a cyclical risk. When authorities identify changes in the intensity of the cyclical dimension of systemic risk (for example owed to potential price bubbles), however, that risk should be addressed by appropriate measures, such as the CCyB or measures provided for in Article 458 of the CRR. The attached memo on the systemic risk buffer requirement in Norway, published in December 2019, provides further descriptions of the long-term non-cyclical systemic risk.
4.2 Reasons why the dimension of the long-term non-cyclical systemic risk threatens the stability of the financial system in your Member State **(Article 133(11)(b) of the CRD)**	Stress tests conducted by the FSA have over several years indicated that many institutions in low-probability, but not unrealistic, scenarios would have a CET1 capital shortfall relative to overall capital and buffer requirements. The FSA's latest stress test was conducted after the outbreak of the pandemic, in June 2020, and shows that banks' financial soundness will be seriously impaired in a severe and protracted economic downturn. Practically all of the 20 largest banking groups experience a drop in the CET1 capital ratio below overall capital and buffer requirements.[5] For the rest of the banking sector, the FSA test indicated that 48 out of 84 banks would have insufficient capital. Although activity in the Norwegian economy has picked up after the outbreak of the pandemic, uncertainty regarding future economic decelopment remains high and significant losses to the banking sector may still occur. Norges Bank's latest stress test from November 2019 shows that the macro bank (a weighted average of nine large Norwegian banks) manages to meet overall capital and buffer requirements if the CCyB is set to 0 pct., but tightens the supply of new loans.[6] The impact on some banks is more pronounced than on others in the test, and banks with substantial losses may tighten lending considerably. In addition, interconnectedness across banks may lead to further losses. In simulations based on a new model framework developed by Norges

[4] See Chart 10 in Mæhlum, Sverre and Magdalena D. Riiser (2019), *How to assess the systemic risk buffer for banks*, Norges Bank Staff Memo 11/2019.

[5] See Finanstilsynet's *Risk Outlook June 2020* (chapter 5).

[6] See Norges Bank's *Financial Stability 2019* (chapter 3).

	Bank, additional losses owing to contagion effects may in some cases be equivalent to a reduction in the banking sector's CET1 ratio of about 2 percentage points. There are several aspects that are not captured by the stress tests, and may contribute to underestimation of institutions' potential losses in realistic scenarios. For example, it is assumed that institutions have access to wholesale funding during periods of stress, and that the funding markets themselves continue to function. Also, the accumulated losses in the stress tests are lower than institutions' actual losses during the Norwegian banking crisis in 1988-1992. The potential for adverse feedback loops between the financial system and the real economy compunds the threat to financial stability if systemic risks are not met by adequate capital buffer requirements. Banks are the most important source of credit in Norway, accounting for over 80 pct. of the provision of domestic credit to the non-financial sector. The Norwegian banking sector's total assets as a share of GDP is also fairly high compared with other countries. Loans account for most of Norwegian banks' assets, and bank loans currently correspond to over 160 pct. of mainland GDP. Bank lending has increased faster than GDP for several years. Moreover, nearly all bank lending is to Norwegian borrowers, at around 95 pct. of banks' total lending. Since the Norwegian banking sector is fairly large and an important source of credit for Norwegian borrowers, problems in the sector may have a significant impact on the real economy. The high debt level in Norway increases the importance of the banking sector for the real economy. Credit-to-GDP is at a historically high level, at around 200 percent, and has been rising for a long period. In particular, households' debt is high, also compared to other countries. Higher debt levels increases the potential negative impact on the real economy when shocks occurring in the financial system.[7]
4.3 Indicators used for the activation of the measure	The main indicators used for activating the measure are the following: - Funding structure of credit institutions - Credit institutions' outstanding bond funding by currency - Ownership of bonds issued by mortgage companies - Composition of credit institutions' lending - Norwegian households' debt burden - Share of Norwegian households with floating mortgage rates - Concentration of credit institutions' lending to the corporate sector by sector breakdown - Sector concentration in Norway's GDP - The banking sector's share of domestic credit to the non-financial sector - Total banking sector assets as a percentage of GDP Most of the indicators are presented in charts in the attached memo. Data files on all main indicators are available upon request.

[7] See for example Casola, Paola Di & Jens Iversen (2019), *Monetary policy with high household debt and low interest rates*.

4.4 Effectiveness and proportionality of the measure **(Article 133(11)(c) of the CRD)**	A well-functioning financial system is of great significance to the Norwegian real economy. Based on financial stability considerations, it is therefore important that credit institutions overall have capacity to absorb losses that may occur as a result of severe shocks and disruptions in both the financial system and the real economy. Any impairment of institutions' solvency could contribute to further uncertainty and a lack of capacity to provide credit to creditworthy customers, and thus amplify a negative economic development. Based on experience from previous crises and results from stress tests conducted by the FSA and Norges Bank, the Ministry has concluded that the overall capital and buffer requirements which until recently have been imposed on the larger Norwegian institutions, have been proportional to the overall risks present in the financial system. That is, the overall requirements should be maintained at approximately the pre-2020 level *in real terms*. As pointed out in section 1.2, a portion of the overall requirements (in real terms) has been expressed somewhat implicitly by the presence of the Basel I floor and the absence of the SME supporting factor. Although this portion of the overall requirements has not had any macroprudential justification, it has effectively functioned as a general add-on in lieu of formal macroprudential measures. Had this general add-on not been present, the existing SRB would probably have been set at a higher and more correct level. A correctly set SRB would be an improvement over the former system, due to more accurate marginal capital requirements for all exposures, and the review mechanism in Article 133 of the CRD would lead to revisions of the SRB rate when non-cyclical systemic risk increase or abate. In order to maintain the overall capital and buffer requirements for the larger Norwegian institutions at the pre-2020 level in real terms, the SRB should be set at 4.5 %. This level is considered commensurate with the intensity of, and potential losses stemming from, structural risks in the Norwegian financial system, and the risk tolerance implied by previous buffer decisions by Norwegian authorities. The overall requirements implied by a SRB at 4.5 % is also within the range of estimates of socially optimal requirements. The Basel Committee has recently surveyed various studies in this area, and found that the estimates generally lie between 10 and 25 pct., while a 2012 Norwegian study produced estimates between 13 and 23 pct.[8] The overall Pillar 1 requirement for non-systemic institutions' activities in Norway will amount to 12.5 % with a SRB at 4.5 % (and the CCyB at 1 %). As it targets risks in Norway, the SRB should only apply to domestic exposures, in contrast to the current requirement that applies to all exposures. Beyond improving the consistency between the objective and design of the measure, this restructuring represents an alignment with the provisions of the CRR/CRD IV framework that facilitate reciprocity for domestic buffer rates. The Ministry intends to fully reciprocate such buffer rates set in other EEA states, also when the absence of a SRB must be interpreted as a domestic buffer rate of 0 pct. Most Norwegian institutions have all or most of their activities in Norway, and will therefore face an institution-specific SRB of or just below 4.5 %, implying an overall Pillar 1 CET1 capital requirement of approximately 12.5 pct. All Norwegian institutions had a CET1 capital adequacy ratio

[8] See the Basel Committee on Banking Supervision (2019), *The costs and benefits of bank capital – a review of the literature*, and Kragh-Sørensen, Kasper (2012), *Optimal capital adequacy ratios for Norwegian banks*.

	above this level as of 30 June 2020. Some institutions may have a need to increase their capital somewhat to maintain a certain margin to the overall Pillar 1 and 2 requirements. As of 30 June 2020, the two systemically important institutions had CET1 capital ratios exceeding their overall Pillar 1 and 2 requirements applicable from year-end of 2020. Since the capital needed for Norwegian institutions to meet the SRB is limited, the impact on institutions' capitalisation is expected to be near neutral. If the SRB is reciprocated by other EEA states, foreign institutions operating in Norway may be subject to small increases in their capital requirements (see section 5.3 below).
4.5 Justification of inadequacy of existing measures in the CRD or in the CRR, excluding Articles 458 and 459 of the CRR, to address the identified risks **(Article 133(11)(e) of the CRD)**	The CRD and the CRR provide for a number of measures to address various forms of systemic risk. Without a systemic risk buffer in accordance with Article 133 of the directive, however, the Ministry considers the available measures to be insufficient to address the long-term structural systemic risks in Norway. The institution-specific pillar 2 requirements pursuant to Article 104 of the CRD should be tailored to each institution's specific situation. They may target certain elements of structural systemic risks, but only to an extent where the risks are not general features of the banking system. Recent amendments (Directive 2019/878) also clarify that the institution-specific nature of these requirements should prevent their use as a tool to address systemic risks. The CCyB pursuant to Article 130 of the directive is designed to address a different form of systemic risk, stemming from pro-cyclicality in the financial system. This requirement has been increased to 2.5 pct. over the last few years, in response to a build-up of financial imbalances. On 13 March 2020, the CCyB was reduced to 1 % in response to the Covid-19 pandemic. Even though the structural and cyclical dimensions of systemic risk may not always be easily distinguishable, the CCyB should not be calibrated to mitigate long-term structural systemic risks. The buffer requirement for other systemically important institutions (O-SIIs) in accordance with Article 131 of the directive, targets institutions that are particularly important for the financial system. As mentioned in section 4.4, the Ministry intends to notify the activation of O-SII buffer requirements. The purpose would be to increase the O-SIIs loss-absorbing capacity, and so reduce the probability for financial difficulties which may have serious consequences for the financial system and the real economy. Two Norwegian institutions are currently identified as systemically important, see section 6.1. Pursuant to Article 124 of the CRR, the risk weights under the Standardised Approach may be set between 35 and 150 pct. for exposures secured by mortgages on residential property, and between 50 and 150 pct. for exposures secured on commercial immovable property, based on financial stability considerations. The risk weight for residential exposures in Norway remains at 35 pct., as this level is considered adequate for institutions using the Standardised Approach. For commercial exposure, risk-weights are set between 100 and 150 pct., depending on the counterparty's rating, as risk weights for such exposures as low as 50 pct. would not be considered adequate. For the Internal Ratings-Based Approach, Article 164 of the CRR stipulates floors at 10 and 15 pct. for the exposure-weighted average LGDs for retail exposures secured by, respectively, residential property and commercial immovable property. For retail exposures secured by

	residential property in Norway, a higher floor of 20 pct. has been applied since 2014. The measure addresses uncertainty associated with internal modelling, and was introduced at the same time as tightened requirements on institutions' residential mortgage models. When the measures were announced, the Financial Supervisory Authority observed that risk weights had fallen in recent years, while higher house prices and higher household indebtedness had increased the risk present in the mortgage market.
5. Cross-border and cross-sector impact of the measure	
5.1 Assessment of cross-border effects and the likely impact on the internal market **(Article 133(11)(d) of the CRD and Recommendation ESRB/2015/2)**	The measure will promote domestic financial stability in Norway by safeguarding the resilience in the financial system, and ensure that banks continue to be adequately capitalized given the level of long-term non-cyclical systemic risk. For several institutions domiciled in other Nordic countries, lending in the Norwegian market constitutes a significant portion of their total lending. For the five large banking groups domiciled in other Nordic countries (Nordea, Danske Bank, Handelsbanken, SEB and Swedbank), lending in Norway accounted for between 15 and 4 pct. of their total lending at year-end 2018.[9] At year-end 2017, the groups had market shares in the Norwegian lending market of between 13 and 1½ pct.[10] The measure may therefore also have a positive impact for the Nordic institutions and the other EEA markets where they have activities, since it could mitigate potential losses on Norwegian credit exposures. Reciprocity will, however, be crucial in order to avoid leakages and regulatory arbitrage, in addition to ensuring that the foreign institutions' loss-absorbing capacity is aligned with their risk exposure in the Norwegian market. Reciprocity in the Nordic region is particularly facilitated by an MoU signed by the relevant Nordic ministries in 2016, which acknowledges ESRB recommendations as a "minimum standard for reciprocity in macro-prudential matters".[11] The profitability of the Norwegian banking sector is high compared with other European banking sectors. Before it dropped below 10 pct. in the first half of 2020, the largest Norwegian banks have over the past years posted a return on equity of around 12 pct. The high return on Norwegian exposures could make a rebalance towards foreign exposures less likely. Moreover, we presume that capital requirements in other EEA countries are in line with the risk level in these countries, thereby providing a level playing field and making it less attractive to shift exposures between countries. We have not experienced notable rebalances of Norwegian banks' balance sheets due to capital requirements, and this is currently not a major concern.
5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	The measure is not expected to contribute to leakages or regulatory arbitrage within the Norwegian financial system. Experiences with pre-2020 capital levels in Norwegian institutions do not suggest that there is significant potential for migration to "shadow banking" or other sectors of the financial system. The scope for regulatory arbitrage is generally very

[9] Source: The banking groups' annual reports for 2018.

[10] Source: Finance Norway (newer market share data is available for Norwegian institutions only).

[11] *Memorandum of understanding between the Finnish, Norwegian and Swedish Ministries of Finance and the Danish Ministry of Business on cooperation regarding significant branches of cross-border banking groups*, published on the Ministry of Finance website on 19 December 2016.

	limited within the Norwegian financial system, owed to a consistent adherence to the principle of "same risk, same regulation". Provided that the systemic risk buffer requirement is reciprocated by other EEA states, the measure is expected to reduce the potential for leakages to foreign financial systems.
5.3 Reciprocation by other Member States **(Article 134(4) of the CRD and Recommendation ESRB/2015/2)**	The Ministry of Finance intends to request the ESRB to issue a recommendation to other Member States to reciprocate the measure. Institutions established in other Member States have significant exposures and activities in the Norwegian lending market, and should be subject to the same requirements as Norwegian institutions. If the Norwegian SRB is reciprocated by authorities of other EEA states, foreign institutions operating in Norway will be subject to increased capital requirements. Reciprocation will primarily be relevant for the five large banking groups mentioned in section 5.1. However, any increase in capital requirements for these groups is not expected to be large. Per year-end 2019, all groups were subject to SRBs of 3 pct. for all exposures. An increase of 1.5 percentage points for exposures in Norway may imply an increase in the consolidated capital requirements of these institutions by between 0.22 (Nordea) and 0.06 percentage points (Swedbank), provided that the institutions would not be subject to other SRBs for exposures in Norway than the Norwegian SRB. If the institutions are to meet O-SII buffers in addition to the Norwegian SRB, the increase may be greater. Nordea is currently subject to an O-SII buffer of 2 pct., which was offset against a SRB of 3 pct. for all exposures, until the latter was deactivated this March in response to the pandemic. If Nordea is to meet both the O-SII buffer requirement and a SRB of 4.5 pct. for exposures in Norway, the increase in capital requirements may amount to about 0.7 percentage points.
6. Combination of the SRB with other buffers	
6.1 Combination with G-SII and/or O-SII buffers (Article 133(4) and (5) of the CRD)	Two domestic credit institutions are currently identified as systemically important in Norway, and subject to an add-on in the existing SRB for all exposures of 2 pct. In conjunction with the changes in the SRB, the Ministry intends to replace the add-on with O-SII buffer requirements. DNB ASA will be required to hold an O-SII buffer of 2 % from 31 December 2020, while Kommunalbanken AS will be required to hold an O-SII buffer of 1 %. The activation of the O-SII buffers is notified separately. The O-SII buffer requirements will apply on an individual, subconsolidated and consolidated basis. As the new SRB will only apply to domestic exposures, it will apply cumulatively with the O-SII buffers.
6.2 Other relevant information	N/A
7. Miscellaneous	
7.1 Contact person(s) at notifying authority	Tormod Fauske Tho, Advisor Phone: +47 22 24 45 11 / +47 22 24 45 21 E-mail: tho@fin.dep.no

7.2 Any other relevant information	The Ministry of Finance has submitted three other notifications together with this notification. They notify the intended use of two measures in accordance with Article 458 (10) of the CRR (floors for average risk weights for residential and commercial real estate exposures) and one measure in accordance with Article 131 of the CRD (O-SII buffers). As mentioned in section 3.2, a memo further explaining the justification and grounds for the systemic risk buffer requirement in Norway is attached as an appendix to this notification. A draft amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014 (available in Norwegian only) is also attached as an appendix. The draft amendment covers rules on both the systemic risk buffer requirement and the temporary measures pursuant to Article 458 of the CRR. Moreover, how to assess the systemic risk buffer has recently been discussed in a staff memo from Norges Bank.[12] **Attached appendices to this notification** • Memo of 11 December 2019 from the Ministry of Finance on the systemic risk buffer requirement in Norway • Draft amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014

[12] Mæhlum, Sverre and Magdalena D. Riiser (2019), *How to assess the systemic risk buffer for banks*, Norges Bank Staff Memo 11/2019.