DET KONGELIGE FINANSDEPARTEMENT

Royal Ministry of Finance

European Systemic Risk Board
c/o European Central Bank
Sonnenmannstrasse 22
60314 Frankfurt am Main
Germany

Your ref	Our ref	Date
	19/2702 -	02.02.2021

Request for reciprocation of measures taken pursuant to Article 133 of the Capital Requirements Directive and Article 458 of the Capital Requirements Regulation

On 5 November 2020, the Ministry of Finance notified the ESRB and other authorities of intended changes in Norwegian capital requirements for banks, with an aim to adopt amendments effective from year-end 2020. The changes include a new systemic risk buffer (SyRB) requirement at 4.5 per cent for domestic exposures, and temporary average risk weight floors for IRB institutions' residential and commercial real estate exposures at 20 and 35 per cent, respectively. Both the ESRB and the Standing Committee of the EFTA States have assessed the SyRB and concluded that the measure is justified and in accordance with Directive (EU) 2013/36/EU. The Ministry of Finance would like to thank the ESRB for its work following our notifications.

On 4 December 2020, the ESRB published its Recommendation and economic assessment regarding the Norwegian notification of the intention to set a SyRB in accordance with Article 133 of Directive (EU) 2013/36/EU. In its assessment, the ESRB said, inter alia, that "reciprocation of the measure may level the playing field between Norwegian and foreign banks operation in Norway" and that "Even though the reciprocation of the SyRB may result in a small short-term increase in foreign institutions' funding costs, their increased resilience is expected to have a positive impact on other EEA countries' credit markets."

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Request for reciprocation

The Ministry hereby submits a request for reciprocation of the following measures, in accordance with the amended Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential measures and Article 5 of Decision ESRB/2015/4 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities and the issuing of opinions and recommendations by the ESRB:

i) A systemic risk buffer requirement for exposures in Norway, pursuant to Article 133 of Directive (EU) 2013/36/EU, which entered into force for Norwegian institutions on 31 December 2020.
ii) A temporary average risk weight floor for residential real estate exposures in Norway, pursuant to Article 458 (10) of Regulation (EU) 575/2013, which entered into force for Norwegian institutions on 31 December 2020.
iii) A temporary average risk weight floor for commercial real estate exposures in Norway, pursuant to Article 458 (10) of Regulation (EU) 575/2013, which entered into force for Norwegian institutions on 31 December 2020.

Justification of the request

As pointed out both in our notifications and by the ESRB in its assessment of the SyRB requirement, foreign institutions have significant exposures and activities in the Norwegian lending market and should therefore be subject to the same requirements as Norwegian institutions for those exposures. This is particularly relevant for certain Nordic banking groups, which have large branches in Norway. In an integrated financial system like the Nordic banking market, strong policy coordination is needed to ensure the effectiveness of national macroprudential policies. Coordination based on the competence of national authorities to assess which macroprudential measures are necessary to facilitate financial stability given national vulnerabilities, is a matter of common interest. Reciprocity will 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.

Nordic authorities have acknowledged the importance of reciprocity in order to contribute to financial stability and the proper functioning of local markets and the EU common market. Memoranda of understanding between the competent authorities and the relevant ministries, respectively, on this and other issues regarding branches of cross-border banking groups in the Nordic states, entered into effect in December 2016. Both memoranda acknowledge that the general principle shall be full reciprocity, with recognition that the authorities must respect applicable national and Union law. Examples of macroprudential measures set by national authorities that should, in principle, be subject to reciprocation are combined buffer requirements as defined in Article 128 of Directive 2013/36/EU, and requirements laid down pursuant to Article 458 of Regulation (EU) No 575/2013.

Materiality threshold
In line with guidance provided by the ESRB in its handbook on operationalizing macroprudential policy in the banking sector, the Ministry assumes that a materiality threshold of 1 per cent of total risk exposure held by all institutions in Norway (incl. foreign branches), would be an appropriate starting value for identifying which branches that should be subject to reciprocal measures. As data on branches' risk exposure amounts in Norway is limited, however, the Ministry suggests a threshold based only on the risk exposure held by Norwegian institutions, but adjusted to account for branches' share of total lending in Norway, which is approximately 25 per cent. Per Q2 2020, this approach would produce a materiality threshold of:

$$\text{NOK } 2\,400 \text{ Billion} \cdot (1\% / 0.75) = \text{NOK } 32 \text{ Billion}$$

Such a threshold is presumed to encompass the Norwegian branches of the following five Nordic banking groups: Nordea, Danske Bank, Handelsbanken, SEB and Swedbank.

Potential impact
As discussed in the notifications, any increase in capital requirements due to reciprocation of the Norwegian SyRB for the aforementioned banking groups is not expected to be large . In the notifications, as well as in a note sent to the ESRB assessment team on 17 November 2020, the Ministry has provided simple calculations describing the potential impact of reciprocation of the SyRB on the banking groups' consolidated capital requirements.

The five aforementioned banking groups do not report publicly their average risk weights for commercial real estate exposures. However, as mentioned in our notifications, a 2019 study from the Swedish FSA found that the overall average risk weight for these banking groups' CRE exposures was around 23 per cent. If the banking groups employ similar levels for CRE exposures in Norway, the proposed floor may on average imply a significant increase in capital requirements. After the study was conducted however, the Swedish FSA has implemented a CRE risk weight floor of 35 per cent for exposures in Sweden. As mentioned in RRE notification, Nordic authorities have already reciprocated Norwegian RRE measures enacted in 2014. While those measures presumably ensure that the Nordic banking groups must hold capital roughly in line with what the RRE floor will require, they do not ensure that the institutions' average RRE risk weights are above 20 per cent, and the methods of reciprocation vary. In any case, as a result of the 2014 measures, the new RRE risk weight floor should not have a significant impact for Nordic institutions' capital requirements in real terms.

Timing
As noted in our SyRB notification, the Covid-19 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. The CCyB for Norwegian

exposures was reduced from 2.5 per cent to 1 per cent in March in response to the pandemic. The CCyB is the primary tool to be used to alleviate the effects of a shock to the economy. If necessary to avoid tighter lending conditions in the coming months, the remaining CCyB may be released. As Norwegian institutions generally satisfy capital and buffer requirements by ample margins and have been capable of maintaining lending to households and businesses during the pandemic, both the SyRB and the temporary risk weight floors were introduced at year-end 2020, as planned.

For authorities considering to reciprocate the Norwegian measures, we assume that the need for phase-in periods or other transitional rules will be part of their assessment. The challenges and uncertainty associated with the ongoing pandemic may necessitate particular attention to the need for transitional measures. Although we expect that possible increases in consolidated capital requirements for the five banking groups will not be large, any reciprocal measures should of course be introduced in an appropriate manner and adapted to the financial conditions of the affected groups. A flexible adaptation of reciprocal measures, including potential phase-in periods or other transitional measures which also takes into consideration the economic situation in the home countries, would also be in line with the aforementioned memoranda between the Nordic authorities. If there are significant obstacles to full reciprocation, however, the Ministry hopes that alternative measures with effects that are equivalent to the Norwegian measures, may be considered instead.

Attachments
The following supporting documents are attached to this request for reciprocation:

i) The original notifications submitted on 5 November 2020
ii) Adopted amendments to the Norwegian CRR/CRD IV regulation (in Norwegian only)
iii) Recommendation of the ESRB regarding the Norwegian systemic risk buffer, including an economic assessment
iv) Recommendation of the EFTA Standing Committee on the Norwegian systemic risk buffer

Yours sincerely,

Geir Åvitsland
Director General

Marius Østli
Deputy Director General

This document has been signed electronically and it is therefore not signed by hand.

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

Please send this template to

- notifications@esrb.europa.eu when notifying the ESRB;
- macropru.notifications@ecb.europa.eu when notifying the ECB;
- notifications@eba.europa.eu when notifying the EBA.

Emailing this template to the above-mentioned addresses constitutes an official notification, no further official letter is required. In order to facilitate the work of the notified authorities, please send the notification template in a format that allows electronically copying the information.

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.

Template for notifying intended measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

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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 Categorisation of measures	The Ministry intends to implement a stricter national measure regarding risk weights for targeting asset bubbles in the commercial property sector, pursuant to Article 458 (10) of the CRR. A similar measure targeting the residential property sector is the subject of a separate notification
1.3 Request to extend the period of application of existing measures for one additional year **(Article 458(9) of the CRR)**	The measure would be new.
1.4 Notification of measures to which Article 458(10) of the CRR applies ('notification only procedure')	The intended measure is subject to the procedure set out in Article 458 (10) of the CRR, as it seeks to increase average risk weights by less than 25% for a period of two years, see section 2.3.
2. Description of the measure	
2.1 Draft national measures **(Article 458(2)(d) of the CRR)**	The intended measure comprises a floor for average risk weights of 35 % for Norwegian commercial real estate exposures. The floor concerns the exposure-weighted average risk weight in the commercial real estate portfolio. Where the exposure-weighted average risk weight is lower than the floor, the total risk-weighted assets (RWA) should be increased correspondingly. Each institution's increase in risk-weighted assets would be the following: $\Delta RWA = \max(0, 35\% - RW_{CRE})*EAD_{CRE}$ Where RW_{CRE} and EAD_{CRE} are the exposure-weighted average risk weight and exposures at default, respectively, for the commercial real estate portfolio.

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	Norwegian commercial real estate exposures should be understood as corporate exposures collateralised by immovable property in Norway. The measure is intended to be adopted by the Ministry of Finance as an amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014. The legal basis is the Norwegian Financial Undertakings Act of 10 April 2015 § 14-2 (6).
2.2 Scope of the measure **(Article 458(2)(d) of the CRR)**	The risk weight floors would be applicable for all Norwegian institutions using the Internal Ratings Based Approach (IRB institutions). Moreover, the Ministry intends to request the ESRB to issue a recommendation to other Member States to reciprocate the measure, see section 5.3.
2.3 Calibration of the measure	The calibration of the risk weight floor for commercial real estate exposures is aligned with current IRB practices allowed by the Financial Supervisory Authority of Norway (Finanstilsynet). The Norwegian institution employing the most advanced modelling for such exposures, has an average risk weight just over 35 pct., while the other Norwegian IRB institutions have average risk weights of approximately 50-90 pct. Considering the potential losses associated with commercial real estate exposures (see sections 2.4 and 4), a risk weight floor of 35 pct. is considered appropriate, even though it is not expected to affect Norwegian institutions' risk-weighted assets in the short-term. However, it could potentially affect branches of foreign IRB institutions substantially. A risk weight of 35 pct. corresponds to an LGD of 20 pct., which is the minimum level for a fully secured loan under the foundation IRB approach as defined in the new Basel standards (effective from 2022), and a PD of 1 pct. The latter can be considered an absolute minimum level for a long-run PD, given a weight of at least 20 pct. on a crisis level PD of at least 5 pct. Since crises are rare events, there is a danger that institutions underestimate these risks (see section 4.1). Furthermore, a recent study suggests that the capital required with the proposed risk weight floor would be insufficient compared to losses on commercial real estate exposures during the Norwegian banking crisis in 1988-1993, but enough to cover losses incurred in the downturn of 2002-2003.[1] On the other hand, risk weight floors should not be set in a way that weaken banks' incentives to provide low-risk loans. This is of particular importance for lending segments where credit risk varies widely, such as the commercial real estate market. Overall, this suggests that the proposed risk weight floor is at a reasonable level. The measure should also be applicable for institutions established in other Member States (see sections 2.4 and 5.3).
2.4 Suitability, effectiveness and proportionality of the measure **(Article 458(2)(e) of the CRR)**	The calibration of the proposed measure is considered to be proportionate with the intensity of cyclical systemic risks associated with Norwegian property markets, and in particular with the risk of potential asset bubbles in the commercial immovable property sector (see section 4). The measure is suitable to ensure that domestic institutions meet a certain minimum standard as regards risk-weighting at the portfolio level, and would also be the most effective measure to target Norwegian branches of foreign IRB institutions. Reciprocation by other EEA States will be crucial to ensure appropriate treatment of such exposures by foreign institutions, as well as to avoid leakages and regulatory arbitrage (see section 5). Foreign IRB institutions in Norway are mostly Nordic. The five large banking groups domiciled In other Nordic countries (Nordea, Danske Bank and Handelsbanken SEB and Swedbank) that are operating in the Norwegian market, do not report publicly their average risk weights for commercial real estate exposures. However, a recent study from the Swedish FSA has found that the

[1] Andersen, Henrik (2019), *How much CET1 capital must banks set aside for commercial real estate exposures?* Norges Bank Staff Memo 10/2019.

	overall average risk weight for these banking groups' commercial real estate exposures is around 23 pct.[2] If these banking groups employ similar levels for exposures in Norway, the proposed floor may on average imply a significant increase in capital requirements. The Swedish FSA has indicated however that the average risk weight for such exposures in Sweden should be increased, and has proposed Pillar 2 requirements for domestic banks corresponding to floors of 25-35 pct. for certain commercial real estate exposures.[3]
2.5 Other relevant information	N/A
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.[4] The Ministry also published a consultation document on i.a. potential risk weight floors on 25 June 2019.[5]
3.3 Disclosure	In addition to the abovementioned consultation document, to which the public could submit comments until 30 September 2019, the Ministry will publish this notification on the same day as it is submitted.
3.4 Timing of Application (Article 458(4) of the CRR)	31 December 2020.
3.5 Phasing in	No phasing-in is planned.
3.6 Term of the measure (Article 458(4) of the CRR)	The measure is intended to be in effect for a minimum of two years. The Ministry of Finance will assess the need to renew the measure well before the term would expire. After implementation of the measure, the Ministry will monitor and regularly assess risk developments and the need to amend the measure, including the need for deactivation before the term expires.
3.7 Review (Article 458(9) of the CRR)	The appropriateness of the measure will be assessed regularly, and the measure will be reviewed with a view to renew or deactivate it well in advance of the expiration of the 2 year-term.

[2] Finansinspektionen's press release and report of 28 May 2019.
[3] Finansinspektionen's press release of 27 November 2019.
[4] The Ministry's press release of 11 December 2019.
[5] The Ministry's press release of 25 June 2019 (the consultation document is available in Norwegian only).

4. Reason for the activation of the stricter national measure	
4.1 Description of the macro-prudential or systemic risk in the financial system **(Article 458(2)(a) of the CRR)**	**Overview** The key vulnerabilities in the financial system in Norway are high household debt, high house prices and high commercial property prices. Residential real estate and commercial real estate represent the two largest lending segments for Norwegian institutions, and combined constitute more than ¾ of institutions' lending. The significant and prolonged increase in real estate prices have led to a build-up of financial imbalances, and an increase of systemic risk related to credit institutions' real estate exposures in Norway. Finanstilsynet and Norges Bank regularly carry out analyses of systemic risks in Norway. The evidence presented in this notification is based on these authorities' latest risk reports,[6] in addition to the Ministry's own analyses. **Risks stemming from the commercial property market** The prices of commercial properties, especially high-quality properties at prime locations in Oslo, have risen significantly over several years. At the same time, real estate companies' debt has risen. This has contributed to higher vulnerabilities for credit institutions in Norway. In the past, prices of commercial property have proven to be more cyclically sensitive than house prices. This is probably due to the fact that commercial properties are more of an investment object than residential properties. According to IMF there are signs of overvaluation in commercial property prices in Norway. A 2017 IMF report highlighted the fact that the price-to-rent ratio is close to the levels seen before the global financial crisis, and more so than in most other comparable countries.[7] The IMF also point to the continued and significant increase in commercial real estate prices as a vulnerability in its 2020 Financial Sector Assessment Program.[8] Losses on commercial real estate exposures have been low in normal times, but high during crises, both in Norway and other countries. Since crises are rare events, there is a danger that institutions underestimate these risks. Commercial real estate is the sector that has inflicted the most losses for Norwegian institutions during crises. Historically, a strong price rise for commercial property has often preceded a sharp price fall. Since yields are low, an interest rate increase or higher risk premium may lead to a sharp fall in commercial property prices. A downturn in the Norwegian economy could result in higher office vacancy rates. This will impair the debt servicing capacity of commercial real estate companies. If commercial property prices fall at the same time, bank losses may rise considerably. During the Norwegian banking crisis (1988-1993), residential real estate credit was initially affected, but the losses in this sector were relatively small. However, high interest rates and declining consumption led to large losses for banks in the commercial real estate sector. Stress tests conducted by Finanstilsynet imply that banks would suffer losses of more than 6 pct. with a price fall of 40 pct., but the loss estimates are highly sensitive of the size of the price fall. Banks' accumulated losses in the tests is a convex function of a fall in real estate prices. Risks related to developments in Norwegian commercial real estate markets are analysed in detail in a recent report from Finanstilsynet.[9] **Broadly unchanged risks after the Covid-19 pandemic** The Covid-19 outbreak led to a sharp downturn in the Norwegian economy. After the outbreak, commercial real estate prices fell, driven by lower rents. The decline can

[6] See Finanstilsynet's *Risk Outlook June 2019* (chapter 2) and *Risk Outlook June 2020* and Norges Bank's *Financial Stability 2019* (chapter 1).
[7] See *Norway: 2017 Article IV Consultation-Press Release; and Staff Report* (in particular Figure 7), IMF Country Report No. 17/181.
[8] See *Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director for Norway*, IMF Country Report No. 2020/259
[9] See Finanstilsynet's *Risk Outlook June 2019* (theme chapter II).

	largely be explained by the economic downturn. Rents are expected to fall somewhat further in 2020, before rising again as a result of a rebound in the Norwegian economy. Losses ahead on banks' CRE exposures remain uncertain. There is both uncertainty related to how large losses will be under the economic outlook assumed and greater uncertainty than in normal times surrounding the economic outlook. In general, financial imbalances are assessed as approximately unchanged since the outbreak of Covid-19.
4.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b) of the CRR)**	Norwegian and foreign IRB institutions are crucial for the credit supply to households and corporates in Norway. The IRB institutions have a combined market share of approximately ¾ in the Norwegian credit market. A disruption of the credit supply could have severe consequences for the real economy. For example, a negative shock in domestic property markets or tightened consumption may cause a significant increase in credit losses, and in turn constrain institutions' capacity to provide new credit. The negative dynamic that could develop between the institutions and the real economy, may destabilise the financial system and amplify a downturn in the Norwegian economy. As institutions established in other Nordic countries have significant operations in Norway, turbulence in the Norwegian financial system may easily spread to neighbouring systems.
4.3 Indicators prompting use of the measure	The main indicators are: • Institutions' commercial real estate lending relative to all lending • Commercial real estate prices • Office rental prices • Banks' losses on commercial property loans in percent of gross lending • Loan-to-value ratio on commercial property loans • Average risk weights for real estate exposures in IRB institutions Data files are available upon request.
4.4 Justification why the stricter national measure is necessary **(Article 458(2)(c) of the CRR)**	**Objective** The measure will ensure that all Norwegian IRB institutions continue to employ appropriate risk weights at the portfolio level for their commercial real estate exposures in Norway, given the prevailing systemic risks associated with these exposures. The proposed measure may also function as a backstop accounting for uncertainty in IRB models, stemming i.a. from data largely being collected over periods of positive economic development. **The inadequacy of other measures** *Article 124 of the CRR* concerns risk weights under the Standardised Approach, which in Norway remains at 100 pct. This level is considered adequate for institutions using the Standardised Approach. Increasing the risk weight for these institutions would not address the concerns regarding the IRB institutions. *Article 164 of the CRR* enables authorities to increase the LGD floor for IRB institutions' retail exposures, which is not applicable to commercial real estate exposures. *Article 101 of the CRD* concerns the Financial Supervisory Authority's review of institutions'' compliance with their permission to use the IRB Approach. Measures in accordance with this article would not be effective vis-à-vis foreign IRB institutions in Norway. *Articles 103, 104 and 105 of the CRD* allow for addressing the relevant risk in Pillar 2 requirements and other supervisory measures, but general risks should as a rule

	be mitigated by Pillar 1 measures. Pillar 2 measures are also less suited for reciprocation, and may therefore be less effective tools in this context. *Article 133 of the CRD* allows for requiring a systemic risk buffer to target long-term systemic risks. The Ministry of Finance intends to set a buffer requirement at a level which is commensurate with the level and intensity of such risks in the Norwegian financial system, see a separate notification. While structural and cyclical systemic risks may not always be easily distinguishable, the proposed risk-weight floor for commercial real estate exposures is primarily intended to mitigate risks associated with potential asset bubbles and financial imbalances, which have been increasing in recent years. The systemic risk buffer would also apply to exposures in general, and not target real estate exposures specifically. As cyclical systemic risks are particularly present and elevated in regards to real estate exposures, IRB risk weight floors would be the more efficient tools to apply in the current environment. *Article 136 of the CRD* requires the setting of a countercyclical capital buffer to address time-varying systemic risks. The buffer rate in Norway has been increased to 2.5 pct. over the last few years, justified to a certain extent by the same developments that necessitates IRB risk weight floors for commercial real estate exposures. On 13 March 2020, the buffer was reduced to 1 % in response to the Covid-19 pandemic. Moreover, the countercyclical capital buffer does not target commercial real estate exposures in particular, and does not promote an adequate level of average risk weights across all IRB institutions in Norway.
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 458(2)(f) of the CRR and Recommendation ESRB/2015/2)**	The measure will promote domestic financial stability in Norway by contributing to an average risk-weighting of commercial real estate exposures that is considered appropriate in the current risk environment. If authorities of other EEA states reciprocate the measure, it may have a positive impact on other EEA markets where the relevant institutions have activities, since it could increase institutions' loss-absorbing capacity related to Norwegian credit exposures. A misalignment of risks and loss-absorbing capital associated with the Nordic institutions' Norwegian operations may have repercussions for the institutions' ability to serve other markets. For several institutions domiciled in other Nordic countries, lending in the Norwegian market constitutes a significant portion of their total lending. For the large banking groups domiciled in other Nordic countries (Nordea, Danske Bank, Handelsbanken, SEB and Swedbank), lending in Norway accounts for between 15 and 4 pct. of their total lending. They have market shares in the Norwegian lending market of between 13 and 1½ pct., and their operations in the Norwegian commercial real estate market are significant. Foreign institutions' overall market share in the corporate lending market amounts to 37 pct., while their share of the "sale and management of real property" segment (which accounts for 40 pct. of all corporate lending) exceeds 40 pct. Reciprocity in the Nordic region is particularly facilitated by a MoU signed by the relevant Nordic ministries in 2016, which acknowledges ESRB recommendations as a "minimum standard for reciprocity in macro-prudential matters".[10]
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 current capital levels in Norwegian institutions does 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 limited within the Norwegian financial

[10] *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.

	system, owed to a consistent adherence to the principle of "same risk, same regulation". If domestic macroprudential policy measures are not reciprocated, however, there may be risks associated with leakage from the domestic financial system to other EEA systems. The effectiveness of the measures would then be undermined.
5.3 Reciprocation by other Member States **(Article 458(8) of the CRR 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. IRB institutions established in other Member States have significant exposures and activities in the Norwegian commercial real estate lending market, and should be subject to the same macroprudential policy measures as Norwegian IRB institutions. As described in this notification, reciprocation is crucial for the effectiveness of the measure. The study mentioned in section 2.4 indicates that the five large Nordic banking groups' average risk weights for commercial real estate exposures may be significantly lower that the proposed 35 pct. floor. However, it is not known to which extent the Swedish 23 pct. average is comparable to the banks' treatment of Norwegian exposures, or how the average risk weights may vary between the banks. It is in any event to be expected that reciprocation of the proposed floor may imply increases in average risk weights in excess of the 25 pct. threshold mentioned in Article 458 (10) of the CRR for at least a subset of the five institutions.
6. Miscellaneous	
6.1 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
6.2 Any other relevant information	The Ministry of Finance has submitted three other notifications together with this notification. They notify the intended use of measures in accordance with Article 458 (10) of the CRR (a floor for average risk weights for *residential* real estate exposures), Article 133 of the CRD (a systemic risk buffer for exposures in Norway) and Article 131 of the CRD (O-SII buffers). The systemic risk buffer notification is supplemented by a memo published on the website of the Ministry of Finance on 11 December 2019. The memo details the justification for the buffer and the need for reciprocation by other EEA states, which is also relevant for the measure described in this notification

Template for notifying intended measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

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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 Categorisation of measures	The Ministry intends to implement a stricter national measure regarding risk weights for targeting asset bubbles in the residential property sector, pursuant to Article 458 (10) of the CRR. A similar measure targeting the commercial property sector is the subject of a separate notification.
1.3 Request to extend the period of application of existing measures for one additional year **(Article 458(9) of the CRR)**	The measure would be new.
1.4 Notification of measures to which Article 458(10) of the CRR applies (‘notification only procedure’)	The intended measure is subject to the procedure set out in Article 458 (10) of the CRR, as it seeks to increase average risk weights by less than 25 % for a period of two years, see section 2.3.
2. Description of the measure	
2.1 Draft national measures **(Article 458(2)(d) of the CRR)**	The intended measure comprises a floor for average risk weights of 20 % for Norwegian residential real estate exposures. The floor concerns the exposure-weighted average risk weight in the residential real estate portfolio. Where the exposure-weighted average risk weight is lower than the floor, the total risk-weighted assets (RWA) should be increased correspondingly. Each institution’s increase in risk-weighted assets would be the following: $\Delta RWA = \max(0, 20\% - RW_{RRE}) * EAD_{RRE}$ Where RW_{RRE} and EAD_{RRE} are the exposure-weighted average risk weight and exposures at default, respectively, for the residential real estate portfolio.

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	Norwegian residential real estate exposures should be understood as retail exposures collateralised by immovable property in Norway. The measure is intended to be adopted by the Ministry of Finance as an amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014. The legal basis is the Norwegian Financial Undertakings Act of 10 April 2015 § 14-2 (6).
2.2 Scope of the measure **(Article 458(2)(d) of the CRR)**	The risk weight floor would be applicable for all Norwegian institutions with the relevant exposures and using the Internal Ratings Based Approach (IRB institutions). This includes one subsidiary whose parent is established in another Member State.[1] Moreover, the Ministry intends to request the ESRB to issue a recommendation to other Member States to reciprocate the measure, see section 5.3.
2.3 Calibration of the measure	The calibration of the risk weight floor for residential real estate exposures is aligned with existing requirements imposed by the Ministry of Finance and the Financial Supervisory Authority of Norway (Finanstilsynet) on models used by IRB institutions to estimate residential mortgage risk. The floor on average Loss Given Default (LGD) estimates was increased from 10 to 20 pct. in 2014, pursuant to Article 164 of the CRR. Moreover, Finanstilsynet imposed stricter requirements in 2014 detailing how default data from the Norwegian banking crisis are to be taken into account, extra safety margins in the best risk classes and levels of loss ratios.[2] Finanstilsynet said: “Safety margins must be included to allow for the uncertainty inherent in models and data. Finanstilsynet previously made it clear that model estimates should reflect the default and loss experience during the banking crisis in the early 1990s. However, data quality from that period is highly uncertain. Uncertainty about the models’ long-term predictive ability is compounded by the fact that other data used in the models reflect boom years for the Norwegian economy. Hence Finanstilsynet is now outlining assumptions on which models are to be based, detailing how default data from the banking crisis are to be taken into account, extra safety margins in the best risk classes and levels of loss ratios.” In 2014, Finanstilsynet estimated that the requirements would increase risk weights assigned to residential mortgage portfolios to around 20-25 pct. Furthermore, a 2013 study applying data going back to the banking crisis in the early 1990s, suggested that such risk weights should be around 20 to 30 pct.[3] Provided that the systemic risk is not above levels experienced before the Norwegian banking crisis, this indicates that the calibration of the 20 pct. floor is appropriate. This level corresponds to the portfolio-average LGD and PD minima imposed by the MoF and Finanstilsynet, respectively. Today, Norwegian IRB institutions’ average risk weights for residential real estate exposures vary between approximately 18-23 pct. The intended measure would therefore increase the institutions’ average risk weights by a maximum of (20 - 18)/18 = 11 pct. Considering the potential losses associated with such exposures (see sections 2.4 and 4), a risk weight floor of 20 pct. is considered appropriate. The measure should also be applicable for institutions established in other Member States (see sections 2.4 and 5.3).
2.4 Suitability, effectiveness and proportionality of the	The calibration of the proposed measure is considered to be proportionate with the intensity of cyclical systemic risks associated with Norwegian property markets, and in particular with the risk of potential asset bubbles in the residential property sector

[1] Nordea Eiendomskreditt AS.
[2] Finanstilsynet’s press release of 1 July 2014 provides further information.
[3] Andersen, Henrik (2013), *How high should risk weights be on Norwegian residential mortgages?* Norges Bank Staff Memo 10/2013.

measure **(Article 458(2)(e) of the CRR)**	(see section 4). The measure is suitable to ensure that domestic institutions meet a certain minimum standard as regards risk-weighting at the portfolio level, and would also be the most effective measure to target Norwegian branches of foreign IRB institutions. The stricter 2014 IRB measures described in section 2.3 are targeted and generally proportionate with risks associated with Norwegian residential real estate exposures, but do not ensure that all institutions' average risk weights for such exposures will be above 20 pct. Moreover, data from low-loss years may over time feature more prominently in institutions' models, while at the same time the probability of a negative shock in domestic property markets may be increasing. Reciprocation by other EEA States will be crucial to ensure appropriate treatment of such exposures by foreign institutions, as well as to avoid leakages and regulatory arbitrage (see section 5). Foreign IRB institutions in Norway are mostly Nordic. Nordic authorities have reciprocated the stricter 2014 IRB measures described in section 2.3, as facilitated by a MoU signed by Nordic supervisors.[4] Such reciprocation does not however guarantee that the institutions' average risk weights for residential real estate exposures will be above 20 pct. Moreover, the authorities' methods of reciprocation vary. While Danish and Finnish banks are obliged by their authorities to employ risk-weighing in accordance with the 2014 Norwegian measures, Swedish banks are subject to Pillar 2 add-ons corresponding to the estimated effect of the measures.
2.5 Other relevant information	N/A
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.[5] The Ministry also published a consultation document on i.a. potential risk weight floors on 25 June 2019.[6]
3.3 Disclosure	In addition to the abovementioned consultation document, to which the public could submit comments until 30 September 2019, the Ministry will publish this notification on the same day as it is submitted.
3.4 Timing of Application (Article 458(4) of the CRR)	31 December 2020.

[4] *Memorandum of understanding between Finansinspektionen (Sweden), Finanstilsynet (Norway), Finanstilsynet (Denmark), Finanssivalvonta (Finland) and the European Central Bank on prudential supervision of significant branches in Sweden, Norway, Denmark and Finland*, published on the Danish FSA website on 2 December 2016.
[5] The Ministry's press release of 11 December 2019.
[6] The Ministry's press release of 25 June 2019 (the consultation document is available in Norwegian only).

3.5 Phasing in	No phasing-in is planned.
3.6 Term of the measure **(Article 458(4) of the CRR)**	The measure is intended to be in effect for a minimum of two years. The Ministry of Finance will assess the need to renew the measure well before the term would expire. After implementation of the measure, the Ministry will monitor and regularly assess risk developments and the need to amend the measure, including the need for deactivation before the term expires.
3.7 Review **(Article 458(9) of the CRR)**	The appropriateness of the measure will be assessed regularly, and the measure will be reviewed with a view to renew or deactivate it well in advance of the expiration of the 2 year-term.
4. Reason for the activation of the stricter national measure	
4.1 Description of the macro-prudential or systemic risk in the financial system **(Article 458(2)(a) of the CRR)**	**Overview** The key vulnerabilities in the financial system in Norway are high household debt, high house prices and high commercial property prices. Residential real estate and commercial real estate represent the two largest lending segments for Norwegian institutions, and combined constitute more than ¾ of institutions' lending. The significant and prolonged increase in real estate prices have led to a build-up of financial imbalances, and an increase of systemic risk related to credit institutions' real estate exposures in Norway. Finanstilsynet and Norges Bank regularly carry out analyses of systemic risks in Norway. The evidence presented in this notification is based on these authorities' latest risk reports,[7] in addition to the Ministry's own analyses. **Risks associated with high household debt** Norwegian household debt corresponds to approximately 120 pct. of GDP for Mainland Norway. This is a very high level, both historically and in an international context. Household debt has long risen faster than household income, increasing household leverage. As of June 2020, the average debt burden of Norwegian households was approximately 230 pct. Credit institutions' loans to households are mainly residential mortgage loans. The institutions' losses on loans to households have been low, but the high level of debt makes the households vulnerable to increases in interest rates or loss of income. Households' debt service ratio is close to a historically high level despite the low interest rates, and only a small proportion of household debt carries fixed interest rates. Higher interest rates will quickly be reflected in households' debt service. The danger that a large number of households will tighten consumption at the same time, constitutes a systemic risk. This may reduce earnings in the corporate sector and impair their debt-servicing capacity. This may in turn lead to a fall in the economic activity and increase unemployment, and higher losses on banks' corporate exposures. The debt is very unevenly distributed, and many households have raised their debt level considerably during the protracted period of low interest rates. For the most vulnerable households, an increase in interest rates will significantly impair their finances. The IMF noted in its Technical Note on systemic risk oversight and macroprudential policy framework, that household debt in Norway is at or close to an all-time high relative to disposable income, and high relative to other countries.[8]

[7] Finanstilsynet's *Risk Outlook June 2019* (chapter 2) and Norges Bank's *Financial Stability 2019* (chapter 1).
[8] See the IMF's report *Norway: Financial Sector Assessment Program-Technical Note-Systemic Risk Oversight and Macroprudential Policy Framework*, IMF Country Report No. 2020/265

	Owing to high household indebtedness and house price overvaluation, the ESRB issued a warning to Norway in June 2019, in which it points out that the vulnerabilities are a source of systemic risk to the financial system.[9] **Risks stemming from the housing market** Developments in household debt are strongly linked to price developments in the housing market. Higher house prices give a rise in housing wealth, and increase the collateral value of the real estate, which in turn provides scope for increased borrowing secured on residential property. Over time, this interdependence has contributed to strong growth in both house prices and debt. Since the banking crisis at the start of the 1990s, house prices have grown considerably more than disposable income per capita. Analyses from the IMF, OECD and others indicate that residential real estate prices in Norway are overvalued. A 2017 IMF study found that house prices as of year-end 2016 were overvalued by about 16 pct., one of the highest valuation gaps among the countries in the sample.[10] The growth in house prices has softened significantly since 2016, but overvaluations remain, according to a 2019 IMF study.[11] The study estimates the overvaluation as of 2018 to be in the range of 0-10 pct. at the national level, and between 5 and 20 pct. in Oslo. In its 2020 FSSA of Norway, the IMF says that real estate prices has risen strongly over past decades. This is, as the IMF highlights, a continuation of an uptrend that started in the 1990s. Residential real estate prices have increased by 70 pct. over the last decade, while rising more in large cities (particularly in Oslo, where they doubled).[12] Although house price developments have been more moderate over the past two years, high house prices remain a key vulnerability in the financial system in Norway. Sharp and sudden declines in house prices may trigger tightening of household consumption and result in increased losses on banks' loan portfolios. The covered bond market may also be weakened, which may cause funding shocks. **Broadly unchanged risks after the Covid-19 pandemic** The Covid-19 outbreak led to a sharp downturn in the Norwegian economy. After the outbreak, house prices fell for two months consecutively, but rebounded quickly. House prices had reverted to their pre-pandemic level already one month later, and house price inflation and turnover in the housing market remained high through the summer. Household credit growth has levelled off in recent months, after having gradually slowed over the last three years. Financial imbalances are assessed as approximately unchanged since the outbreak of Covid-19.
4.2 Analysis of the serious negative consequences or threat to financial stability **(Article 458(2)(b) of the CRR)**	Norwegian and foreign IRB institutions are crucial for the credit supply to households and corporates in Norway. The IRB institutions have a combined market share of approximately ¾ in the Norwegian credit market. A disruption of the credit supply could have severe consequences for the real economy. For example, a negative shock in domestic property markets or tightened consumption may cause a significant increase in credit losses, and in turn constrain institutions' capacity to provide new credit. The negative dynamic that could develop between the institutions and the real economy, may destabilise the financial system and amplify a downturn in the Norwegian economy. As institutions established in other Nordic countries have significant operations in Norway, turbulence in the Norwegian financial system may easily spread to neighbouring systems.

[9] See *Warning of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector of Norway*.
[10] See *Selected issues* (Chapter: "Are house prices overvalued in Norway?"), IMF Country Report No. 17/181.
[11] See *Norway: 2019 Article IV Consultation-Press Release; and Staff Report*, IMF Country Report No. 19/159.
[12] See *Norway: Financial System Stability Assessment-Press Release; and Statement by the Executive Director of Norway*, IMF Country Report No. 2020/259

4.3 Indicators prompting use of the measure	The main indicators are: • Institutions' residential real estate lending relative to all lending • Household debt-to-income ratio • Household debt service ratio • Share of floating-rate residential mortgage loans • Housing prices relative to disposable income • Institutions' losses on retail market loans in percent of gross retail market lending • Average risk weights for real estate exposures in IRB institutions Data files are available upon request.
4.4 Justification why the stricter national measure is necessary **(Article 458(2)(c) of the CRR)**	**Objective** The measure will ensure that all Norwegian IRB institutions employ appropriate risk weights at the portfolio level for their residential real estate exposures in Norway, given the prevailing systemic risks associated with these exposures. Until now, Norwegian institutions' RWAs have been held up by the Basel I floor. The floor was abolished at year-end 2019. The RWAs will then be determined only by the model-produced risk-weights (except any such exposures subject to the Standardised Approach), and it is therefore more important than before to ensure that all institutions meet a certain minimum standard at the portfolio level. The proposed measure may also function as a backstop accounting for uncertainty in IRB models, stemming i.a. from data largely being collected over periods of positive economic development. **The inadequacy of other measures** *Article 124 of the CRR* concerns risk weights under the Standardised Approach, which in Norway remains at 35 pct. This level is considered adequate for institutions using the Standardised Approach. Increasing the risk weight for these institutions would not address the concerns regarding the IRB institutions. *Article 164 of the CRR* enables authorities to increase the LGD floor for IRB institutions' residential real estate exposures. In Norway this provision has been employed to increase the LGD floor to 20 pct., see section 2.3 above. This is, however, not considered sufficient, as it still enables some institutions to operate with average risk weights below 20 pct. *Article 101 of the CRD* concerns the Financial Supervisory Authority's review of institutions'' compliance with their permission to use the IRB Approach. As described in section 2.3 above, stricter requirements have indeed been imposed on the use of models for residential real estate risk, but this has not ensured that all institutions produce average risk weights of at least 20 pct., which is the level the Ministry considers appropriate. Also, measures in accordance with Article 101 of the CRD would not be effective vis-à-vis foreign IRB institutions in Norway. *Articles 103, 104 and 105 of the CRD* allow for addressing the relevant risk in Pillar 2 requirements and other supervisory measures, but general risks should as a rule be mitigated by Pillar 1 measures. Pillar 2 measures are also less suited for reciprocation, and may therefore be less effective tools in this context. *Article 133 of the CRD* allows for requiring a systemic risk buffer to target long-term systemic risks. The Ministry of Finance intends to set a buffer requirement at a level which is commensurate with the level and intensity of such risks in the Norwegian

	financial system (see a separate notification). While structural and cyclical systemic risks may not always be easily distinguishable, the proposed risk-weight floor for residential real estate exposures is primarily intended to mitigate risks associated with potential asset bubbles and financial imbalances, which have been increasing in recent years. The systemic risk buffer would also apply to exposures in general, and not target real estate exposures specifically. As cyclical systemic risks are particularly *present* and elevated in regards to real estate exposures, IRB risk weight floors would be the more efficient tools to apply in the current environment. *Article 136 of the CRD* requires the setting of a countercyclical capital buffer to address time-varying systemic risks. The buffer rate in Norway has been increased to 2.5 pct. over the last few years, justified to a certain extent by the same developments that necessitates IRB risk weight floors for residential real estate exposures, namely a build-up of financial imbalances in the household sector and high house prices. On 13 March 2020, the buffer was reduced to 1 % in response to the Covid-19 pandemic. Moreover, the countercyclical capital buffer does not target residential real estate exposures in particular, and does not promote an adequate level of average risk weights across all IRB institutions in Norway.
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 458(2)(f) of the CRR and Recommendation ESRB/2015/2)**	The measure will promote domestic financial stability in Norway by contributing to an average risk-weighting of residential real estate exposures that is considered appropriate in the current risk environment. If authorities of other EEA states reciprocate the measure, it may have a positive impact on other EEA markets where the relevant institutions have activities, since it could increase institutions' loss-absorbing capacity related to Norwegian credit exposures. A misalignment of risks and loss-absorbing capital associated with the Nordic institutions' Norwegian operations may have repercussions for the institutions' ability to serve other markets. 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), total lending in Norway accounts for between 15 and 4 pct. of their total lending. They have market shares in the Norwegian lending market of between 13 and 1½ pct. Reciprocity in the Nordic region is particularly facilitated by a MoU signed by the relevant Nordic ministries in 2016, which acknowledges ESRB recommendations as a "minimum standard for reciprocity in macro-prudential matters".[13]
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 current 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 limited within the Norwegian financial system, owed to a consistent adherence to the principle of "same risk, same regulation". In the last few years, however, insurance companies have increased their holdings of residential mortgage loans somewhat, which may in part be a response to relatively low capital requirements for low-risk loans in the Solvency II framework. The Ministry has therefore adopted an amendment to the Norwegian implementation of the Solvency II framework, which better aligns insurance companies' capital

[13] *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.

	requirements with the banking requirements. The amendment was adopted on 5 December 2019, based on an EEA adaptation to the Solvency II framework.[14] If domestic macroprudential policy measures are not reciprocated, however, there may be risks associated with leakage from the domestic financial system to other EEA systems. The effectiveness of the measures would then be undermined.
5.3 Reciprocation by other Member States **(Article 458(8) of the CRR and Recommendation ESRB/2015/2)**	The Ministry of Finance intends to request the ESRB to issue a recommendation to other EEA States to reciprocate the measure. IRB institutions established in other EEA States have significant exposures and activities in the Norwegian residential real estate lending market, and should be subject to the same macroprudential policy measures as Norwegian IRB institutions. Since Nordic authorities already have reciprocated the stricter 2014 IRB measures described in section 2.3, reciprocation of the new risk weight floor should not have a significant impact for Nordic institutions. If institutions operate with average risk weights for residential real estate exposures below 20 pct., any increase is not expected to exceed the 25 pct. threshold mentioned in Article 458 (10) of the CRR. If the current reciprocation is achieved via Pillar 2 add-ons, however, the increase in Pillar 1 average risk weights may exceed 25 pct.
6. Miscellaneous	
6.1 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
6.2 Any other relevant information	The Ministry of Finance has submitted three other notifications together with this notification. They notify the intended use of measures in accordance with Article 458 (10) of the CRR (a floor for average risk weights for *commercial* real estate exposures), Article 133 of the CRD (a systemic risk buffer for exposures in Norway) and Article 131 of the CRD (O-SII buffers). The systemic risk buffer notification is supplemented by a memo published on the website of the Ministry of Finance on 11 December 2019. The memo details the justification for the buffer and the need for reciprocation by other EEA states, which is also relevant for the measure described in this notification.

[14] The Ministry's press release of 5 December 2019.

8. desember 2020

Forskrift om endring i forskrift 22. august 2014 nr. 1097 om kapitalkrav og nasjonal tilpasning av CRR/CRD IV (CRR/CRD IV-forskriften)

Fastsatt av Finansdepartementet [dato] med hjemmel i lov 10. april 2015 nr. 17 om finansforetak og finanskonsern §§ 14-2 og 14-3.

I

I forskrift 22. august 2014 nr. 1097 om kapitalkrav og nasjonal tilpasning av CRR/CRD IV gjøres følgende endringer:

§ 3 tredje ledd skal lyde:

For engasjementer i andre EØS-stater anvendes systemrisikobuffersatsen som er fastsatt av myndighetene i vedkommende stat, såfremt kravet er rettet mot systemrisiko i staten og gjelder for alle foretak. For engasjementer i EØS-stater som har fastsatt et annet systemrisikobufferkrav enn det nevnt i første punktum, skal systemrisikobuffersatsen være 0 prosent. Annet punktum gjelder tilsvarende for engasjementer i EØS-stater som ikke har fastsatt et systemrisikobufferkrav. For engasjementer i andre EØS-stater anvendes den motsykliske kapitalbuffersatsen som er fastsatt av myndighetene i vedkommende stat.

§ 4 skal lyde:

§ 4. Minstekrav for gjennomsnittlig risikovekt

Fra 31. desember 2020 og frem til 31. desember 2022 skal foretak som benytter IRB-metode ha en gjennomsnittlig risikovekt for engasjementer med pantesikkerhet i boligeiendom i Norge som ikke er lavere enn 20 prosent.

Fra 31. desember 2020 og frem til 31. desember 2022 skal foretak som benytter IRB-metode ha en gjennomsnittlig risikovekt for engasjementer med pantesikkerhet i næringseiendom i Norge som ikke er lavere enn 35 prosent.

§ 27 skal lyde:

§ 27. Systemrisikobuffersats *for engasjementer i Norge*

For engasjementer i Norge er satsen for *systemrisikobufferen 4,5* prosent.

§ 28 første punktum skal lyde:

Finansdepartementet skal annethvert år treffe beslutning om nivået på systemrisikobuffersatsen *for engasjementer i Norge*.

§ 31 annet punktum skal lyde:

Råd etter første punktum skal baseres på en vurdering av blant annet foretakets størrelse, foretakets omfang av virksomhet i Norge og i andre land, foretakets kompleksitet, foretakets rolle i den finansielle infrastrukturen og i hvilken grad foretaket er sammenvevet med resten av det finansielle systemet, jf. også § *30* annet og tredje ledd.

§ 47 nytt tredje ledd skal lyde:

Foretak som ikke benytter avansert IRB-metode for å beregne kapitalkrav for kredittrisiko, og ikke er systemviktige etter § 30, skal for alle engasjementer anvende en sats for systemrisikobuffer på 3 prosent frem til 31. desember 2022.

II

Forskrift 12. desember 2013 nr. 1440 om nivå på motsyklisk kapitalbuffer oppheves.

III

Forskriften trer i kraft 31. desember 2020.

RECOMMENDATION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 4 December 2020

regarding Norwegian notification of its intention to set a systemic risk buffer rate in accordance with Article 133 of Directive (EU) 2013/36/EU

(ESRB/2020/14)

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 Board[1], and in particular Article 3(2)(j) thereof,

Having regard to 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[2], and in particular Article 133(11), (13) and (14) thereof,

Having regard to the Agreement on the European Economic Area[3], in particular Annex IX 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[4],

Whereas:

(1) Decision of the EEA Joint Committee No 81/2019 of 29 March 2019 amending Annex IX (Financial services) to the EEA Agreement [2020/831][5] incorporated Directive 2013/36/EU into the Agreement on the European Economic Area,

(2) Finansdepartementet (the Norwegian Ministry of Finance), acting as designated authority for the purpose of Article 133(1) of Directive 2013/36/EU, notified the European Systemic Risk Board (ESRB) on 5 November 2020 of its intention to set a systemic risk buffer (SyRB) rate of

1 OJ L 331, 15.12.2010, p. 1.
2 OJ L 176, 27.6.2013, p. 338.
3 OJ L 001 3.1.1994, p. 3.
4 OJ C 97, 12.3.2016, p. 28.
5 OJ L 210, 2.7.2020, p. 54.

4.5% applying to the domestic exposures of all credit institutions authorised in Norway, including the five subsidiaries of parents established in other Member States[6].

(3) The SyRB rate is expected to apply from 31 December 2020. For institutions not using the advanced internal ratings-based approach, the SyRB rate is expected to be set at 3% until 31 December 2022 and at 4.5% thereafter.

(4) The third subparagraph of Article 133(14) of Directive 2013/36/EU provides that where one subset of the financial sector is a subsidiary whose parent is established in another European Economic Area (EEA) country, the ESRB shall issue a recommendation on the measures taken in accordance with that paragraph within one month of receiving the notification.

(5) To assess the measure notified by Finansdepartementet, the ESRB's assessment team referred to in Decision ESRB/2015/4 has issued an assessment note, which is annexed hereto,

HAS ADOPTED THIS RECOMMENDATION:

1. It is recommended that the proposed SyRB rate notified under Article 133(11) of Directive 2013/36/EU is considered justified, suitable, proportionate, effective and efficient for the risk Finansdepartementet is targeting. In particular that:
   (a) the dimension of the identified systemic or macroprudential risk threatens the stability of the financial system in Norway, justifying the introduction of a SyRB rate of 4.5% for domestic exposures;
   (b) the proposed measure is likely to be effective and proportionate to mitigate the risk;
   (c) the proposed measure, including its application to subsidiaries whose parents are established in other EEA countries, does not entail disproportionate adverse effects on the whole or parts of the financial system of other EEA countries or of the EEA as a whole;
   (d) none of the existing measures in Directive 2013/36/EU or in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012[7], excluding Articles 458 and 459 of that Regulation, alone or in combination, are sufficient to address the identified macroprudential or systemic risk taking into account the relative effectiveness of those measures.
2. The attached assessment note entitled 'Assessment of the Norwegian Ministry of Finance notification in accordance with Article 133 of Directive (EU) 2013/36/EU concerning the

6 Point (a) of paragraph 14. of Annex IX to the Agreement on the European Economic Area provides that the terms 'Member State(s)' and 'competent authorities' shall be understood to include, in addition to their meaning in Directive 2013/36/EU, the EFTA States and their competent authorities, respectively.

7 OJ L 176, 27.6.2013, p. 1.

application of a systemic risk buffer set between 3% and 5%' is an integral part of this Recommendation.

Done at Frankfurt am Main, 4 December 2020.

Francesco Mazzaferro

Francesco MAZZAFERRO

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

ESRB
European Systemic Risk Board
European System of Financial Supervision

Assessment of the Norwegian notification in accordance with Article 133 of Directive (EU) 2013/36/EU concerning the application of a systemic risk buffer set between 3% and 5%

Introduction

On 5 November 2020, the Norwegian Ministry of Finance notified the European Systemic Risk Board (ESRB) of its intention to adopt a systemic risk buffer (SyRB) of 4.5% for exposures in Norway under Article 133(11) and (14) of Capital Requirements Directive IV (CRD IV)[1]. The Norwegian Ministry of Finance is the designated authority responsible for the application of Article 133 of CRD IV in Norway.[2] The measure provides for a change in the level and scope of an existing national buffer, with the application of a 4.5% SyRB to the domestic exposures of all credit institutions authorised in Norway, including the subsidiaries of institutions with parents established in other European Economic Area (EEA) countries. However, the existing national buffer has not yet been formally notified pursuant to Article 133 of CRD IV, as the framework was not made part of the European Economic Area (EEA) Agreement until 1 January 2020.

Pursuant to Article 133(14) of CRD IV read in conjunction with the EEA Agreement[3], where one subset of the financial sector is a subsidiary whose parent is established in another EEA country[4], the ESRB must issue a recommendation within one month of receiving the notification of the measures taken. The ESRB must assess the appropriateness of macroprudential policy measures before they are adopted by the EEA countries. The procedural framework for the provision of recommendations under Article 133 of CRD IV is clarified in Decision ESRB/2015/4[5].

The ESRB's recommendation focuses on assessing the systemic structural risks, the justification of the SyRB level, the effectiveness and proportionality of the measure, the likely impact on the domestic market and the EEA as a whole as well as on the justification against the use of alternative measures provided for in CRD IV or the Capital Requirements Regulation (CRR). After describing and providing background information

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1 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 Directive 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

2 In accordance with the Financial Undertakings Act, Sections 1-7 and Sections 14-3, the Norwegian Ministry of Finance is appointed as the designated authority.

3 As amended by Decision of the EEA Joint Committee No 79/2019 of 29 March 2019 amending Annex IX (Financial services) to the EEA Agreement [2019/2133]. OJ L 321, 12.12.2019, p. 170.

4 Upon incorporation of the CRD IV package into the EEA Agreement, the term "EEA country (ies) " refers to both the EU Member States and EEA EFTA countries.

5 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.

on the measure **(Section 1)**, the ESRB has, in particular, assessed the rationale behind and merit of the measure against the following criteria, after which it concludes.

Section 2: Justification for using the SyRB

- Which long-term structural systemic risks have been identified as having the potential to pose a threat to financial stability at the national level? More specifically, the ESRB's assessment focuses on: (1) risks stemming from the propagation and amplification of shocks within the financial system; (2) risks stemming from structural characteristics of the banking sector; and (3) structural risks to the banking sector stemming from the real economy.

Section 3: Justification of the systemic risk buffer level

- Is the buffer level justified considering the identified systemic risk threatening the stability of the financial system at the national level?

Section 4: Effectiveness and proportionality

- Is the measure likely to achieve its intended objective and is the measure proportional?

Section 5: Assessment of cross-border effects and likely impact on the domestic market and EEA as a whole

- Is there an appropriate balance between the costs resulting from implementing the measure and the problem it aims to address, taking into account any potential cross-border spillover effects?

- What are the likely positive or negative effects of the SyRB on the domestic market and the EEA as a whole?

Section 6: Justification against the use of alternative measures in the CRD or the CRR

- Can alternative instruments provided for under CRD IV and the Capital Requirements Regulation (CRR)[6] (excluding Articles 458 and 459 of the CRR), alone or in combination, sufficiently address the identified systemic risk, taking into account their relative effectiveness?

The ESRB's assessment draws on the information provided by, and discussions with, the staff of the Norwegian Ministry of Finance, Norges Bank and Finanstilsynet.

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

Section 1: Description and background of the measure

1.1 Description of the measure

The measure provides for a SyRB of 4.5% for domestic exposures for all credit institutions and financial holding companies authorised in Norway, including institutions that are subsidiaries of parent institutions established in other EEA countries. The buffer aims to target systemic risks in Norway, hence, the requirement will only apply to domestic exposures, in contrast to the current national buffer requirement which applies to all exposures and which is only in effect until 31 December 2020. Most Norwegian credit institutions[7] conduct all or most of their activities in Norway, and will therefore face an institution-specific SyRB of, or just below, 4.5%.

The SyRB is intended to promote domestic financial stability in Norway by safeguarding the resilience of the financial system and by ensuring that banks continue to be adequately capitalised given the high level of long-term systemic risk. The SyRB will be set by the Ministry of Finance pursuant to Article 133(11) and (14) of CRD IV. Although Norway already has a national buffer in place which aims to address these same risks, this is the first time that Norway has submitted a notification of this kind pursuant to CRD IV, given that this framework was only incorporated into the EEA Agreement as of 1 January 2020.

The measure is scheduled to enter into force by 31 December 2020; however, a transitional rule will apply to those banks that do not follow the advanced internal ratings-based (IRB) approach. For those institutions that do not use the advanced IRB approach, the buffer rate for all exposures will be 3% until 31 December 2022. This is to ensure that the changes to the SyRB for those institutions that are not significantly affected by the removal of the Basel I floor only enter into force after the reassessment of Pillar 2 requirements. These reassessments are conducted every two to three years. The transitional rule does not apply to systemically important institutions (SIIs), therefore, for these institutions, the SyRB requirement will apply from 31 December 2020. The SyRB will be introduced by way of an amendment to the Norwegian CRR/CRD IV Regulation of 22 August 2014 and published on the Ministry of Finance’s website, in the Norwegian Official Legal Gazette and on the online legal information system “*Lovdata*”. The measure, together with its justification, will also be published on the official website of the Ministry of Finance. The measure will be in place until further notice. The SyRB rate for domestic exposures will be evaluated every second year, as specified under the CRR/CRD IV.

The Norwegian Ministry of Finance intends to request reciprocation of the measure by all credit institutions in the EEA countries with exposures in Norway, subject to a materiality threshold. Some institutions established in other EEA countries have significant exposures and conduct core activities in the Norwegian lending market. The reciprocation of the Norwegian SyRB measure will primarily be relevant for a small number of large banking groups domiciled in other Nordic countries. The Nordic ministries responsible for matters relating to financial markets have thus signed a Memorandum of Understanding (MoU) on extended cooperation for cross-

[7] By Norwegian institutions, we mean credit institutions only.

border banking activities, which thereby facilitates mutual reciprocation of macroprudential measures. The ESRB will consider this reciprocation request once the request is submitted.

1.2 Background to the measure

The notification of the Norwegian Ministry of Finance concerns a new SyRB requirement in Norway. The change to the CRR/CRD IV framework in Norway would imply a decline in capital requirements for Norwegian banks, which is not intended by the Norwegian authorities, and hence raising the SyRB to 4.5% counteracts this unintended effect. Until the CRR/CRD IV framework was made part of the EEA Agreement on 1 January 2020, the presence of the Basel I floor and the absence of the small and medium-sized enterprises (SME) supporting factor (pursuant to CRD III of 2010) obliged all institutions authorised in Norway to hold more capital in order to reach 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 national buffer. In other words, the Ministry of Finance took a somewhat pragmatic approach to the applicable national buffer calibration in order to avoid excessive requirements for domestic IRB banks. According to the Ministry of Finance, the current national buffer rate would probably have been set at a higher level, had the previous calibrations been made without deviations from the CRR/CRD IV framework.

The existing national buffer, which aims to address these same risks, has not yet been formally notified pursuant to Article 133 of the CRD, as the framework was not made part of the EEA Agreement until 1 January 2020. However, the Norwegian authorities did provide the ESRB with information on the implemented measure. The applicable (until 31 December 2020) national buffer rate currently stands at 5% for all exposures in SIIs[8] and at 3% for all exposures in all other institutions in Norway. The 3% buffer rate has been in effect since 1 July 2014 (at that time for all domestic institutions), while the 5% rate has been in effect since 1 July 2016. The Ministry of Finance opted for a higher national buffer rate for SIIs rather than for a separate buffer rate for other systemically important institutions (O-SII) in order to ensure the cumulative application of the institutions' buffer requirements. However, it should be noted that domestic SIIs were identified in accordance with Article 131 of CRD IV. In conjunction with these buffer rate changes, the Ministry of Finance intends to replace the higher national buffer rate (the add-on in the national buffer requirement for SIIs of 2%) with O-SII buffer rate requirements[9]. The Norwegian Ministry of Finance notified the activation of the latter to the ESRB on 5 November 2020. The Norwegian authorities first informed the ESRB of their intention to notify a new SyRB requirement at the end of 2019 but postponed final notification thereof until 5 November 2020 owing to the COVID-19 pandemic.

The SyRB will apply cumulatively alongside all other capital buffer requirements imposed by the Norwegian authorities. Currently, the capital-based macroprudential measures in place are the following:

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[8] SIIs are currently subject to an add-on in the national buffer requirement for all exposures of 2% (implying a total national buffer requirement of 5%). Once this new systemic risk buffer requirement is implemented on 31 December 2020, this add-on will be replaced by the relevant O-SII buffer requirements.

[9] The O-SII buffer requirement will apply at the highest level of consolidation to two identified O-SIIs as of 31 December 2020: a 2% buffer for DNB Bank ASA and a 1% buffer for Kommunalbanken AS.

- Risk weights: the risk weight applied to residential exposures for banks using the standardised approach in Norway is 35%, while for commercial real estate (CRE) exposures, risk weights are set between 100% and 150%, depending on the counterparty's rating and pursuant to Article 124 of the CRR. Pursuant to Article 164 of the CRR, for banks using the IRB approach, a floor of 20% for the exposure-weighted average loss given default (LGD) applies to retail exposures secured by residential property in Norway.
- A national buffer of 5% applies to all exposures in institutions identified as O-SIIs, (thus meaning that no O-SII buffer is applied) until 31 December 2020, which was not notified pursuant to CRD IV.
- A national buffer of 3% applies to all exposures in all other banks in Norway until 31 December 2020, which was not notified pursuant to CRD IV.
- The countercyclical buffer (CCyB) is currently set at 1%.[10]

In addition, the following measures were notified on 5 November 2020 and are to be implemented as of 31 December 2020 pursuant to CRD IV/CRR.

- A SyRB of 4.5% for domestic exposures, which applies to all Norwegian institutions, including subsidiaries of institutions with parents established in other EEA countries.
- An O-SII buffer requirement will apply at the highest level of consolidation to two identified O-SIIs as of 31 December 2020: a 2% buffer for DNB Bank ASA and a 1% buffer for Kommunalbanken AS.
- As of 31 December 2020, Norway also intends to implement a stricter national measure applicable to all Norwegian institutions that use the IRB approach for determining risk weights pursuant to Article 458 of the CRR. This will entail a floor for average risk weights of 20% for Norwegian residential real estate exposures and of 35% for Norwegian CRE exposures.

According to the Norwegian Ministry of Finance, the SyRB aims to address long-term structural risks (see the following section for further analysis) and it will also help to ensure that active macroprudential buffers remain effective.

Section 2: Analysis of the underlying long-term structural systemic risks

The SyRB aims to address the identified long-term structural systemic risks in the Norwegian financial system, which stem from the propagation and amplification of shocks within the financial system, the banking sector and the real economy.

In the following sections, further details regarding the assessment of structural risks to the banking sector stemming from the real economy (Section 2.1), risks stemming from the propagation and amplification of shocks within the financial system (Section 2.2), and risks stemming from structural characteristics of the banking sector (Section

[10] The CCyB was reduced from 2.5% in March 2020 with a view to addressing the potential impact of the COVID-19 pandemic and to alleviating the effects of the shock to the economy. See the ESRB's website at: **https://www.norges-bank.no/en/topics/financial-stability/macroprudential-supervision/Countercyclical-capital-buffer/measures-other-authorities/**

2.3) are provided. These pre-existing structural risks have been aggravated by the ongoing COVID-19 pandemic and its negative implications on the overall economy. However, the final implications are still highly uncertain.

2.1 Structural risks to the banking sector stemming from the real economy

The Norwegian authorities have long emphasised that high real estate prices and high household debt are two of the key vulnerabilities in the Norwegian financial system stemming from the real economy. Household indebtedness relative to disposable income is very high in Norway both historically and compared with other countries and, thus, constitutes a systemic risk for the Norwegian banking sector. Norwegian household debt as a percentage of disposable income is the second highest of all OECD countries, at 240%, according to the latest OECD data. Norwegian households use a large proportion of their income to service debt and are therefore vulnerable to a rise in interest rates or a fall in income. The COVID-19 pandemic has the potential to further negatively impact indebtedness, both of households and corporates, particularly once the moratoria and measures of a fiscal nature taken by the governments to protect the real economy from liquidity and solvency risks are ended. Moreover, Norwegian households have one of the highest shares of floating rate mortgage loans in Europe, which exacerbates this vulnerability. In high-debt households, even small disruptions can lead to impaired debt servicing capacity and tightened consumption, according to the Ministry of Finance, which in turn could lead to a fall in corporate earnings and weaken the debt servicing capacity of the corporate sector. If, as a result, banks suffer large losses on loans to the corporate market, banks may have problems maintaining their lending capacity, which can in turn intensify an economic downturn. In addition, the high level of debt in Norwegian households is related to the high prices for residential real estate (RRE). According to several national and international analyses, RRE prices are overvalued, both nation-wide and particularly in Oslo. RRE prices relative to disposable income in Oslo rank among the world's highest, constituting a source of vulnerability. The Norwegian authorities have also highlighted rising CRE prices in recent years, which have increased the vulnerability of the financial system further, as banks have significant exposures to CRE and related industries. A downward price correction could lead to significant losses for banks, as historically, CRE exposures have been the largest source of losses for banks and has contributed to solvency problems in the banking sector during previous crises. A price fall may also have ripple effects on other industries where banks have exposures, such as property development.

In June 2019, the ESRB also issued a warning to the Norwegian authorities,[11] as vulnerabilities in the Norwegian RRE sector were identified as being a source of systemic risk to financial stability. The ESRB has identified Norway as a country with certain medium-term vulnerabilities relating to RRE as sources of systemic risk to financial stability that were deemed not to have been sufficiently addressed.

In the context of the ESRB's warning to Norway, the ESRB's assessment of RRE vulnerabilities also stressed that, besides the very high and increasing household indebtedness compared with other

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[11] **See the ESRB's website at:**
https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning190923_no_warning~d3e4f2c135.en.pdf?4cf3e3031aa71bffaa0bd97a66b311ac

countries, there were signs of house price overvaluations in Norway following a long period of elevated and persistent growth in house prices. The ESRB's assessment emphasised that household indebtedness was very high as compared with other countries and with previous years, and that it had been increasing steadily over the past ten years. The ESRB also pointed out the high share of loans at variable interest rates, which also made households vulnerable to interest rate increases. Moreover, the ESRB underlined the signs of house price overvaluation, following a long period of elevated and persistent growth in house prices. Although in recent quarters house prices had moderated, transaction volumes had not decreased. The rate of home ownership through mortgages was high, which could potentially make households vulnerable to adverse economic and financial conditions or lead to adverse developments in the RRE market, which could have severe repercussions for the stability of the Norwegian financial system and thus lead to negative cross-border spillovers.

Against the background of the identified medium-term vulnerabilities in the RRE sector in Norway, the ESRB's assessment concluded that an economic or financial shock could lead to the materialisation of direct and indirect risks to financial stability. Potential direct risks to the banking system in Norway related to potential credit losses arising from new mortgage loans, since these loans were granted in an environment of possibly overvalued house prices. Moreover, households could experience a negative wealth effect or fall into negative equity if a decrease in house prices were significant. Furthermore, if, for example, unemployment increased and/or growth in household income decreased, some households could find it more difficult to service their debts. The associated negative household income and wealth effects could reinforce the initial shock if households were required to reduce consumption in order to service their housing loans. This could lead to second-round effects and an increase in risks to the credit institutions and the financial system as a whole.

The Norwegian economy is also characterised by a unilateral corporate sector, with a high dependence on the petroleum sector. The petroleum sector constitutes 17% of GDP, with petroleum accounting for more than 40% of total exports from Norway. Lower petroleum prices or reduced global demand could therefore have significant negative effects on the economy as a whole, particularly as Norway is a small, open economy and external shocks could propagate in the Norwegian banking sector. The vulnerability to a fall in oil and gas prices has lessened somewhat in recent years, as much of the petroleum wealth is placed in securities in international financial markets. However, the COVID-19 pandemic may put further pressure on the petroleum market owing to the decrease in global demand as a result of the lockdowns. However, disruptions in the petroleum sector could cause severe ripple effects to find their way to other sectors, leading to significant losses for credit institutions.

2.2 Risks stemming from the propagation and amplification of shocks within the financial system

According to the Norwegian Ministry of Finance, long-term structural systemic risks are high in Norway. Shocks could propagate and become 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 to the same markets, disruptions in the economy may affect several credit institutions at the same time and in the same way. This increases systemic risk.

The Ministry of Finance has highlighted the issue that the Norwegian institutions have similar funding structures and banks are closely interconnected through cross-holdings of covered bonds, which increases the risk of problems spreading quickly to other institutions. As at the end of 2019, the share of wholesale funding in Norwegian institutions increased substantially in the years leading up to the financial crisis, with all Norwegian banks, on average, relying on wholesale funding for 48% of their funding, making them vulnerable to market turbulence. The financial sector is also vulnerable to disruptions stemming from abroad, as a large share of wholesale funding is in foreign currency, albeit short-term foreign currency funding has reduced over recent years (adjusted for institutions' central bank deposits). Extensive use of covered bonds as a funding source has contributed to a lengthening of maturities on institutions' overall wholesale funding, which reduces refinancing risk. However, these covered bonds are largely held by other credit institutions for liquidity purposes, creating close interconnections within the banking system. This can cause other credit institutions to incur direct losses if an institution defaults on its obligations. Indirect losses can equally occur, if many institutions are forced to liquidate covered bond holdings at the same time.

Norwegian banks have similar and concentrated exposures to the real estate sector, where prices have also risen significantly over a long period, which has led to prices being at a high level. The ten largest banks in Norway, which account for more than 70% of total lending, have similar exposures with loans secured on real estate, constituting three-quarters or more of total lending to the Norwegian retail and corporate market (of which 61.2% constitutes RRE lending). Similarly, RRE lending relative to total lending of all Norwegian institutions constitutes about 46%, as at year-end 2019, while the ten largest Norwegian banks provide between 67.3% and 86.6% of their lending to the real estate sector. This excessive exposure concentration makes large parts of the financial sector vulnerable to common shocks in the RRE market. In addition, in comparison to other EEA countries, RRE loans as a percentage of GDP are among the highest.[12] Moreover, these market developments have contributed to a very high level of debt in Norwegian households by international comparison.[13] As of 2019, lending to CRE firms has also been elevated and accounts for the highest share of banks' share to the corporate sector (around 46%), which has, historically, inflicted the largest losses.

In the context of the ESRB's warning issued in 2019, the ESRB's assessment stressed that mortgage lending had been growing over the medium term, which constituted the main driver of growth in lending to households. Moreover, mortgage lending was systemically important for the banking sector, as it represented a high share of total loans granted by credit institutions. The banking sector could also be exposed to risks stemming from the international environment owing to the large share of foreign investors participating in the covered bond market and the interconnectedness of Norway's financial system with the other Nordic countries.

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[12] See the ESRB report entitled "Vulnerabilities in the residential real estate sectors of the EEA countries", ESRB, September 2019.

[13] Systemic risks arising from Norwegian household indebtedness is discussed in Section 2.1.

2.3 Risks stemming from structural characteristics of the banking sector

Risks stemming from structural characteristics of the banking sector are closely linked to those risks that arise from the propagation and amplification of shocks within the financial system (Section 2.2). Risks stemming from structural characteristics of the banking sector may not necessarily induce direct losses, but they may have the potential to become amplification channels in the event of a crisis.

The Norwegian Ministry of Finance highlighted that the main structural risk factors were: (1) the large Norwegian banking sector relative to GDP; (2) the importance of the banking sector for the financing of the Norwegian economy; and (3) the concentration of the domestic banking sector in a few large institutions. The total consolidated banking sector' assets amounted to around 225% of Norway's GDP as in 2019, which is above the average value of assets of EEA countries. With regard to the importance of the banking sector, banks and mortgage companies provided more than 80% of gross domestic lending to the non-financial sector in Norway as at June 2019, indicating the strong dependence of Norwegian borrowers on banks to finance their credit. The large concentration of the domestic banking sector in a few institutions (for example, the Herfindahl concentration index based on Norwegian banks' assets ranks among the highest among the EEA countries, while the five largest banks in Norway hold 56% of total domestic lending, while DNB alone accounts for around 30% of lending) could further amplify the risks in the banking sector. However, while the Norwegian banking sector is concentrated, the Norwegian authorities do not put much emphasis on this feature when assessing the SyRB.

Section 3: Justification of the systemic risk buffer level

Based on financial stability considerations it is necessary, according to the Norwegian Ministry of Finance, that credit institutions overall have the 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, thereby amplifying negative economic developments.

The Norwegian Ministry of Finance has concluded, based on the stress test results and experience from previous crises, that the current absolute capital and buffer requirements are proportional to the overall risks present in the financial system and furthermore that a SyRB of 4.5% for exposures in Norway is the most suitable measure for targeting substantial non-cyclical systemic risks present in Norway, with a view to maintaining current absolute capital and buffer requirements. A SyRB of 4.5% is considered sufficient to meet the risks in the financial system based on experience from previous crises and results from stress tests conducted by the Norwegian Financial Supervisory Authority (FSA) and Norges Bank. In particular, for larger institutions, a SyRB of 4.5% for domestic exposures is appropriate for maintaining the capital ratio at approximately the current level, which is also considered sufficient to address the risks in the financial system. The overall capital requirements implied by a SyRB of 4.5% is also within the range of estimates of socially optimal requirements, as indicated by the Norwegian authorities, and the potential for reciprocation may also contribute towards foreign credit institutions holding a capital level for exposures in Norway that therefore reflects the risks in the Norwegian financial system. It should be noted, however, that the stress tests only cover Norwegian credit institutions and not foreign branches operating in Norway.

The stress tests conducted have, over several years, indicated that the largest banks, on average, under unlikely but not implausible scenarios, would have a CET1 capital shortfall relative to the combined buffer requirements and, hence, might cut back on lending with negative repercussions for the macroeconomy in such scenarios. Norwegian authorities therefore argue that the current real capital requirements should not be weakened. The stress tests also indicate that the second-round effect of a shock may be dampened if institutions can draw on buffers. The size of time-varying buffers may thus significantly affect institutions' behaviour.[14]

Norges Bank and the FSA's latest stress test conducted in November 2019 and June 2020, respectively, are based on a deep international recession with a strong increase in risk premia, and with serious consequences for the Norwegian economy. The results of the latest stress test by the FSA showed that 17 of the 20 largest banking groups experienced a drop in the CET1 capital ratio below the combined buffer requirements even if the CCyB is set to 0%. Several banking groups would have to use significant portions of other buffers in order to maintain the credit supply. In the rest of the banking sector, 48 out of 84 banks would hold capital below the combined buffer requirements, when the CCyB is assumed to remain at 1%. The impact on some banks is more pronounced than on others and banks with substantial losses could tighten lending (see Section 6.1 for further details on the capital effects of the SyRB). The Ministry of Finance stated that although activity in the Norwegian economy had picked up after the outbreak of the pandemic, uncertainty regarding future economic developments remained high, with significant losses to the banking sector still likely to occur. If the institutions were to reduce their absolute capital level, future stress tests could be expected to indicate greater reductions in capital adequacy, such that institutions would be compelled to draw on a larger share of their combined buffer in order to maintain the lending activity levels, as indicated by the Norwegian authorities.

According to the Ministry of Finance, not setting the SyRB to 4.5% (or higher) would be equivalent to lowering Norwegian banks' real capital requirements given the legislative change to the CRR/CRD IV framework, which could very well result in more alarming results from future stress tests, thereby weakening the banking system's resilience to the identified long-term systemic risks. The Ministry of Finance also notes that there are several aspects which are not captured by the stress test results, and which could contribute towards underestimating institutions' potential losses under realistic scenarios. In addition, the Ministry of Finance states that the accumulated losses in the stress tests are lower than institutions' actual losses during the Norwegian banking crisis between 1988 and 1992, in which the losses for the three largest banks resulted in a fall in the CET1 capital ratio by between 5 and 15 percentage points.

[14] At the same time, possible stigma effects could arise in the event of unexpected losses forcing banks to breach their capital and buffer requirements.

Norwegian authorities have provided additional information showing that the overall capital requirement implied by a SyRB of 4.5% is also within the range of estimates of socially optimal requirements, based both on studies by Norwegian authorities and by the Basel Committee on Banking Supervision[15].

Taking the information and the results from the Norwegian authorities into account, the ESRB is of the view that a SyRB level of 4.5% for domestic exposures is appropriate considering the identified systemic risks threatening the stability of the Norwegian financial system. Both the results of the stress test performed as well as historical data on past severe crises in Norway point to a capital level that is achieved with a SyRB of 4.5% as being conducive to maintaining the banking system's resilience to the identified systemic risks.

Section 4: Effectiveness and proportionality of the measure

According to the Ministry of Finance, the SyRB requirement of 4.5% for exposures in Norway will effectively contribute towards maintaining Norwegian institutions' resilience and capacity to absorb losses at the level deemed necessary in the light of the intensity of systemic risks. The new legislation on Norwegian credit institutions' capital requirements was adopted in 2013, based on the CRR/CRD IV framework. It included a national buffer requirement of 3% for all exposures applicable to all Norwegian credit institutions, including the subsidiaries of parents established in other EEA countries, and in effect from 1 July 2014, as well as a 2% add-on for SIIs, in effect from 1 July 2016. Since the CRR/CRD IV framework was not made part of the EEA Agreement until January 2020, the Norwegian rulebook has, in the meantime, deviated from the framework in certain areas, as the obligations pursuant to the EEA Agreement were based on a previous iteration of the framework, namely CRD III of 2010. In particular, the SME supporting factor was not implemented and the Basel I floor has continued to function as a binding back-stop for banks using the IRB approach, according to the Ministry of Finance. These deviations have forced banks to hold more capital in order to reach a certain capital adequacy ratio, and have thus affected the design and calibration of the Pillar 1 requirements for Norwegian banks, including the current SyRB requirement. In preparation for the removal of the deviations, the Ministry of Finance has reassessed the scope and calibration of the SyRB requirement and concluded that the most effective way to mitigate the systemic risk (as outlined in Section 2) would be to set the requirement at 4.5% for domestic exposures only. Beyond improving the consistency between the objective and design of the measure, this constitutes an alignment with the provisions of the CRR/CRD IV framework that facilitate reciprocation for domestic buffer rates.

A domestic buffer rate of 4.5 % is considered commensurate with the intensity of, and potential losses stemming from, structural risks in the Norwegian financial system, and with the risk tolerance implied by previous buffer decisions by Norwegian authorities. Norwegian authorities consider that, for the larger Norwegian banks, which constitute more than half of the domestic banking system, this buffer rate is economically

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15 See the Basel Committee on Banking Supervision (BCBS) , "The costs and benefits of bank capital – a review of the literature", *Working Paper*, No 37, BCBS, June 2019 and Kragh-Sørensen, Kasper, "Optimal capital adequacy ratios for Norwegian banks", *Staff Memo*, No 29, Norges Bank, December 2012.

approximately equivalent to the 3% buffer rate applicable to all exposures before the introduction of the CRR/CRD IV framework. The current buffer rate was set on the basis of significantly more conservative risk weights, owing to the presence of the Basel I floor and the absence of the SME supporting factor. Without these deviations from the CRR/CRD IV framework being in place, the first buffer decision in 2013 would have implied a higher buffer rate than 3% to address the risks present at the time, according to the Norwegian authorities. In other words, the Ministry of Finance took a somewhat pragmatic and simple approach to the buffer calibration in order to avoid excessive requirements for domestic IRB institutions. According to the Ministry of Finance, the buffer rate would probably have been set at a higher level, had the previous calibrations been made without the deviations from the CRR/CRD IV framework and the related absence of the Basel I floor. Thus, based on experience from previous crises and the results from the stress tests conducted by the FSA and Norges Bank, the Ministry of Finance has concluded that the overall capital and buffer requirement, which until now has been imposed on the larger Norwegian institutions, was proportional to the overall risks present in the financial system. That is to say, the overall requirement should be maintained at approximately the pre-2020 level in real terms, as the intensity of the systemic risks is similar to that of 2013, which justifies a SyRB rate of 4.5%.

The stress test results discussed in the notification provide evidence in favour of the appropriateness and effectiveness of the 4.5% level. One of the stress tests is based on Norwegian pre-2020 risk-weighting rules, which required a similar real CET1 capital level as the SyRB at 4.5% for domestic exposures using the current risk-weighting rules under the CRR/CRD IV framework. This means that even with a SyRB of 4.5%, Norwegian banks would have to use significant portions of their buffers in order to maintain credit supply under low-probability, but not implausible, scenarios. Some banks may, nevertheless, tighten lending considerably, as shown by the stress test of the Norwegian Ministry of Finance. Moreover, the Ministry also highlighted that there are several aspects that are not being captured by the stress tests, which may contribute towards underestimating banks' potential losses under realistic scenarios. Therefore, according to the Ministry of Finance, not setting the SyRB at 4.5% (or higher) would be equivalent to lowering Norwegian banks' real capital requirements, which could very well result in more alarming results from future stress tests, and thus weaken the banking system's resilience. It should be noted, however, that the stress tests conducted only cover Norwegian credit institutions. Therefore, the stress test results might give an imperfect assessment of the appropriate level of the SyRB for the whole banking system operating in Norway.

For non-SIIs, there will be an increase in the buffer requirement, from 3% of all exposures to 4.5% of domestic exposures only. The Ministry of Finance intends to adopt a transitional rule to promote consistency between Pillar 1 and Pillar 2 requirements. Thus, for institutions that are not significantly affected by the removal of the Basel I floor, the new SyRB requirement will enter into effect after Pillar 2 requirements have possibly been reassessed, these being conducted every second or third year for such institutions based on the information from the Ministry of Finance. According to the Norwegian authorities, the proposed buffer rate is also economically approximately equivalent to the current 3% buffer rate for the larger Norwegian institutions, which constitute more than half of the domestic banking system.

The ESRB is of the view that the measure is effective and proportionate, as it contributes to mitigating the identified long-term structural risks in the Norwegian banking sector. Based on the stress test results by the

Norwegian authorities, the measure will effectively promote financial stability in Norway by maintaining Norwegian credit institutions' capital at levels sufficient to conserve their current loss-absorption capacity. Lowering Norwegian banks' real capital requirements would be less effective in safeguarding financial stability in the event of a severe stress scenario.

Section 5: Analysis of domestic and cross-border effects

5.1 Effects on domestic institutions and the Norwegian market

The SyRB is expected to promote domestic financial stability by contributing to increasing the resilience and the loss-absorption capacity of the Norwegian banking system. A SyRB of 4.5% will contribute to maintaining the magnitude of disruptions in the provision of credit and other financial services at approximately the pre-2020 level. As the measure implies a continuation of approximately the pre-2020 capital levels, the new buffer requirement is not expected to cause capital constraints or higher funding costs for institutions, nor any change in the credit conditions for households and non-financial corporations, according to the Norwegian Ministry of Finance. This applies, in particular, to domestic institutions in the Norwegian market, as some foreign institutions active in Norway may face an increase in their consolidated capital requirements in the case of reciprocation. However, given the current exceptional uncertainty surrounding the outlook for the financial system and the real economy both in Norway and in EEA countries due to the COVID-19 pandemic, capital constraints for Norwegian institutions cannot be fully excluded at this point.

All Norwegian institutions had a CET1 capital adequacy ratio of above 12.5% as at 30 June 2020, according to the Ministry of Finance. Most Norwegian institutions conduct all or most of their activities in Norway and will therefore face an institution-specific SyRB requirement of, or just below, 4.5%, implying an overall CET1 capital requirement of 12.5% for non-systemically important institutions (non-SIIs). As at 30 June 2020, the two previously mentioned SIIs had CET1 capital ratios which exceeded their overall Pillar 1 and 2 requirements applicable from 31 December 2020. As regards the five subsidiaries of parents established in other EEA countries, currently, three subsidiaries mainly have exposures in Norway and will thus be subject to an increase in capital requirements by close to 1.5 percentage points. However, these institutions have CET1 capital which exceeds the new requirement, as indicated by the Norwegian authorities. The fourth subsidiary holds the lion's share of its exposures in other Nordic countries, so for this institution the SyRB requirement, in nominal terms, will therefore be reduced.

Since the capital needed for Norwegian institutions to meet the SyRB requirement is limited, the impact on institutions' capitalisation is expected to be near neutral, as stated by the Ministry of Finance. While all Norwegian institutions had a CET1 capital ratio above the overall CET1 capital requirement as at 30 June 2020, some institutions may need to increase their capital levels somewhat to maintain a certain margin above the minimum capital and buffer requirements. The transitional rule should ensure that for those banks that do not use the advanced IRB approach, the changes in the SyRB level will not enter into effect until 31 December 2022, after the reassessment of their Pillar 2 requirements. The Ministry of Finance also stated that for Norwegian institutions overall, neither funding costs nor lending growth is expected to be affected significantly. If the SyRB is reciprocated by other EEA countries (see Section 5.2), foreign institutions operating in Norway may be subject to increases in their capital requirements. The ESRB shall consider this reciprocation request at a future date.

The measure is not expected to contribute to leakages or regulatory arbitrage within the Norwegian financial system. Experiences with current 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 limited within the Norwegian financial system, owing to the consistent adherence to the principle of “same risk, same regulation”. According to the Ministry of Finance, the profitability of the Norwegian banking sector is also high compared with other European banking sectors, making a rebalance towards foreign exposures less likely. Norwegian banks have posted a return on equity (RoE) of around 12% over the past years, before it dropped to below 10% in the first half of 2020. In addition, the Norwegian authorities argue that provided that the SyRB requirement is reciprocated by other EEA countries, the measure is expected to reduce the potential for leakages to foreign financial systems as well.

The Ministry of Finance presumes 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. The Ministry of Finance has furthermore not experienced notable rebalances of Norwegian banks’ balance sheets owing to capital requirements, and therefore this is currently not a major concern.

The Norwegian Ministry of Finance did not provide information on the possible impact of the measure on domestic economic growth. Nonetheless, given that most domestic banks have the capital needed to meet the SyRB requirement, the impact is expected to be minor, as institutions’ funding costs and lending rates are not expected to be severely impacted. However, given the exceptionally uncertain outlook for the economy and the financial system caused by the COVID-19 pandemic, a SyRB of 4.5% might potentially have short-term cyclical effects on the functioning of the financial system in Norway. Potential unintended consequences should therefore be mentioned as they might emerge even in spite of the strong capitalisation of the Norwegian banking system prior to the pandemic. While the Norwegian Ministry of Finance highlights, in this context, that structural systemic risks are likely to remain after the pandemic, unintended consequences could arise.

5.2 Cross-border effects and likely impact on the EEA as a whole

The Norwegian Ministry of Finance emphasised that the SyRB requirement would not apply directly to foreign institutions operating in Norway through their branches. However, at a later point, the Ministry of Finance intends to request that the ESRB issue a recommendation to other EEA countries to reciprocate the requirement, subject to an adequate materiality threshold. According to the Ministry of Finance, institutions established in other EEA countries have significant exposures and conduct activities in the Norwegian lending market and should thus be subject to the same requirements as Norwegian institutions. The Nordic ministries responsible for financial markets’ matters have also signed a MoU on extended cooperation regarding cross-border banking activities in the Nordic countries, i.e. to facilitate mutual reciprocation for macroprudential measures, even when this is not required by EU/EEA legislation. In the MoU, the ministries acknowledge the ESRB recommendations as constituting a minimum standard for reciprocation of other countries' macroprudential measures.

According to the information provided by the Norwegian Ministry of Finance, reciprocation of the Norwegian SyRB requirement will primarily be relevant for five large banking groups domiciled in other Nordic countries. These five banking groups (Nordea, Danske Bank, Handelsbanken, SEB and Swedbank) have branches in Norway, with estimated market shares in the Norwegian lending market of between 1.6% and 12.6% (as of year-end 2017),[16] as estimated by the Norwegian authorities. The Norwegian-based activities are significant for several of the institutions and lending in Norway accounts for between 4% and 15% of these institutions' total lending at year-end 2018. Thus, the Ministry of Finance considers that the measure may have a significant positive impact on the Nordic institutions and the other EEA markets where they conduct activities, since it could mitigate the effect of potential losses on Norwegian credit exposures. Reciprocation of the SyRB requirement may result in an increase in the institutions' funding costs or effects on bank lending. However, their improved resilience is expected to have a positive impact on other EEA credit markets in the longer run, given that the Nordic EEA countries are highly integrated.

The Ministry of Finance emphasises in the notification that – under certain conditions – the increase of the SyRB is not expected to be large for the five Nordic banking groups if the SyRB is reciprocated. However, while all banking groups were subject to a buffer requirement of 3% for all exposures as at year-end 2019, the Finnish authorities have decided to deactivate the SyRB requirement in response to the COVID-19 pandemic in March 2020. Therefore, the reciprocation of the Norwegian SyRB requirement might increase capital requirements for banking groups headquartered in Finland.[17] If the Nordic banking groups are to meet O-SII buffers in addition to the Norwegian SyRB, the increase in the capital requirement could be greater, up to 0.7 percentage point, as estimated by the Ministry of Finance. This estimation is however subject to several uncertainties related to the reciprocation request and implementation of the reciprocation by EEA countries. Thus, the SyRB requirement of 4.5% may have non-negligible effects on some institutions, not just due to the high uncertainties and potential impact of the COVID-19 pandemic on their resilience but also given the different legal requirements in Norway compared to the other Nordic countries (CRR/CRD IV versus CRR II/CRD V). Once the ESRB receives the reciprocation request from the Norwegian authorities, the ESRB will provide an assessment of the appropriateness of the reciprocation of the SyRB in a separate recommendation. The assessment will also need to consider potential level playing field effects as well as the additional level of complexity owing to the different regulatory and supervisory frameworks and the resulting potential overlaps in buffer requirements between Norway and the other Nordic countries. In this assessment, potential cyclical effects owing to increases in the capital requirements for some banking groups in Nordic countries may also need to be reflected in light of the uncertainties of the economic

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[16] Even though the data is not very recent, the Norwegian Ministry of Finance emphasised that the data is still descriptive of the current situation.

[17] The Ministry's assessment concluded that a SyRB of 4.5% for exposures in Norway may imply an increase in the consolidated capital requirements of the five banking groups by between 0.22 and 0.06 percentage point based on data as at end-2018, provided that the institutions are not subject to SyRB requirements for exposures in Norway other than the Norwegian SyRB. However, given the uncertainties around the COVID-19 pandemic and the macroprudential policies taken by EEA countries, the increases may turn out to be higher than as of end-2019.

outlook in the short to medium term owing to the COVID-19 pandemic. Therefore, phase-in periods or other transitional rules for reciprocation may need to be discussed in the recommendation, too.

The Ministry of Finance also argues that provided that the SyRB requirement is reciprocated by other EEA countries, the measure is expected to reduce the potential for leakages to foreign financial systems, in addition to ensuring that foreign banks' loss-absorbing capacity is aligned with their risk exposures in the Norwegian market. Even though foreign institutions' market shares in the Norwegian credit market have been fairly stable over the last decade, they have benefitted from somewhat less stringent requirements according to the Norwegian authorities, given the earlier introduction of the CRD IV/CRR framework in the other Nordic countries at year end-2013 and the related absence of the Basel I floor and the presence of the SME supporting factor since then. If the SyRB requirement is not reciprocated, particularly by Nordic EEA countries, the potential for leakages to foreign institutions is considered significant by the Norwegian authorities. As the systemic risks associated with exposures in Norway would not be sufficiently reflected in these institutions' capital requirements, the risk of disruption to foreign financial systems could increase. This would, in turn, be expected to have negative spillover effects also on the Norwegian economy. Thus, removing the Basel I floor and applying the SME supporting factor to Norwegian banks may level the playing field in this context, considering that other measures and requirements for internal models (e.g. the comprehensive package of regulatory standards and guidelines on internal models by the European Banking Authority, the European Central Bank's targeted review of internal models (TRIM) exercise, Pillar 2 requirements etc.) have been introduced in EU countries since the removal of the Basel I floor. Despite these measures, reciprocation of the measure may level the playing field between Norwegian and foreign banks operating in Norway. Its challenges and advantages will need to be assessed in more detail in a separate recommendation.

Although the reciprocation of the requirement may entail a slight short-term increase in the institutions' funding costs, their improved resilience is also expected to have a positive impact on other EEA credit markets. The Ministry of Finance also highlights that the expected positive impact on the EEA as a whole is owed to the general integration of national markets, particularly among the Nordic EEA countries. A setback in the Norwegian economy, which becomes less likely with a SyRB requirement at 4.5%, could have serious negative effects on neighbouring economies.

Section 6: Justification against the use of alternative measures in the CRD or CRR

The Norwegian Ministry of Finance considers the available measures in the CRD or in the CRR (excluding Articles 458 and 459 of the CRR) to be insufficient to address the identified long-term structural risks in Norway.

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

Competent authorities may impose higher risk weights for exposures secured by mortgages on credit institutions that apply the standardised approach, on the basis of financial stability considerations. Pursuant to Article 124 of the CRR, the risk weights under the standardised approach may be set between 35%

and 150% for exposures secured by mortgages on residential property, and between 50% and 150% for exposures secured on commercial immovable property.

Article 124 of the CRR would not be effective in meeting the measure's objectives, given that banks using the IRB approach had a combined market share of 76% in the RRE market and 55% of all loans secured by CRE at year-end 2019. The risk weight for residential exposures in Norway remains at 35%, as this level is considered to be sufficient for institutions using the standardised approach. For commercial exposure, risk weights are set between 100% and 150%, depending on the counterparty's rating, as risk weights for such exposures as low as 50% would not be considered adequate. Increasing RRE risk weights under Article 124 would only further increase the difference between banks using the standardised approach and the IRB approach.

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

Competent authorities may set higher minimum values of exposure-weighted average LGD for retail exposures secured by immovable property, on the basis of financial stability considerations. The exposure-weighted average LGD for all retail exposures secured by residential and commercial immovable property and which does not benefit from guarantees from central governments must not be lower than 10% and 15%, respectively. The LGD is only one of the parameters used in the risk-weight function. Increasing the LGD directly increases the risk weights.

According to the Norwegian Ministry of Finance, a 20% floor on retail exposures secured by residential property in Norway addresses uncertainty associated with internal modelling. The measure was introduced in 2014, together with tightened requirements for institutions' residential mortgage models, and since then the Norwegian FSA has observed a fall in risk weights. However, it has been noted that higher house prices and higher household indebtedness has increased the risk present in the mortgage market.

Given the narrower focus of Article 164, which only targets the LGD and not the probability of default (PD), such a measure would not sufficiently address the identified long-term structural risks in Norway. In particular, it could even lead to unintended results by affecting banks' risk weights in a disproportionate manner given that the IRB risk- weight formula is a linear function of the LGD parameter.

c) Using Pillar 2 (Articles 101, 103, 104 and 105 of CRD IV)

Competent authorities may apply supervisory measures to address risks that are not sufficiently covered by Pillar 1, including risks that an institution poses to the financial system. These powers can be applied under the supervisory review and evaluation process (SREP), one of the components of Pillar 2.[18]

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[18] It should be noted that the European legislator, under CRD V, decided to discontinue the macroprudential use of Pillar 2, with this decision taking effect on 29 December 2020 in the European Union.

However, the institution-specific Pillar 2 requirements pursuant to Article 104 of the CRD must be tailored to each institution's specific situation. The SREP has a microprudential focus and therefore may not be effective in capturing macroprudential concerns. On a bank-by-bank basis, the Norwegian authorities did not identify any risks that the banks would pose to the financial system. However, the Norwegian authorities identified long-term structural risks in Norway as a macroprudential or systemic risk that poses a threat to financial stability at the national level.

At this stage, there are no grounds for activating Pillar 2 as a macroprudential tool to address the identified long-term structural risks in Norway. Given that the SREP process is mainly a microprudential assessment, and since the proposed measure is motived by macroprudential concerns arising from related systemic risks that cannot be sufficiently captured under Pillar 1, the application of the measure established under Article 133 CRR remains warranted.

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

The countercyclical capital buffer (CCyB) can be used to counter some of the procyclicality in the financial system. The CCyB is aimed at increasing the resilience of the banking system during periods of excessive credit growth. Thus, the CCyB addresses cyclical risks and is based on the relationship between growth in total credit and GDP growth. The CCyB rate is set on a quarterly basis by the designated authority that follows a specific methodology based on an ESRB recommendation.[19] The Norwegian Ministry of Finance has gradually increased the CCyB rate for credit risk exposures located in Norway to 2.5% (effective from year-end 2019) over the last few years, in response to a build-up of financial imbalances. The CCyB rate is applied as a percentage of the total amount of risk exposures calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013. In March 2020, the Norwegian Ministry of Finance decreased the CCyB to 1% to address the potential negative impact of the COVID-19 pandemic, particularly to prevent tighter lending standards from amplifying a downturn. The Norwegian Ministry of Finance also highlighted that the CCyB is the primary tool to be used to alleviate the effects of a shock to the economy. Thus, if necessary, the authorities signalled their willingness to release the remaining CCyB to avoid tighter lending conditions in the coming months.

The CCyB is not an appropriate tool for addressing the identified long-term structural systemic risks in Norway. Even though the structural and cyclical dimensions of systemic risk may not always be easily distinguishable, the CCyB requirement should not be calibrated to mitigate long-term structural systemic risks. The framework for assessing the level of the CCyB in Norway is based on a broad set of indicators, which also consider financial imbalances, such as the pricing of risk and lending conditions, real estate market vulnerabilities and vulnerabilities in the household and corporate sector, as indicated by the Norges Bank.[20] While the indicators considered for the CCyB are cyclical systemic risk indicators, Norwegian authorities consider structural risk

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[19] Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1).

[20] See Norges Bank (2019), A framework for advice on the countercyclical capital buffer. Norges Bank Papers no. 4.

indicators for the SyRB requirement, which entail more persistent financial system vulnerabilities. The application of the CCyB would not reduce the identified structural systemic risks that are assigned to the risk categories as described above.

e) Using the global or other systemically important institution buffer (Article 131 of CRD IV)

The buffer requirement for SIIs is applied to financial institutions that pose substantial systemic risks to the banking system. The buffer for SIIs aims to reduce SIIs' PD, which may have serious consequences for the financial system and the real economy, while strengthening their market confidence by increasing their loss-absorption capacity. The buffer reduces the cost for the general public in the event of a bank's insolvency and thus acts as an additional cushion for the stability of individual SIIs.

The Norwegian Ministry of Finance notified the activation of the O-SII buffer requirement on 5 November 2020. The EBA issued a guideline (EBA/GL/2014/10) to identify O-SIIs by assessing their systemic risks in the EEA countries' banking sector. The guideline is based on a minimum mandatory framework of criteria and indicators. Currently, two Norwegian institutions are identified as SIIs, based on the two-step procedure outlined in the guideline. Even though a number of Norwegian banks contribute, to some degree, to the concentration risk in Norway, the O-SII buffer should not be extended for individual institutions, as the risks identified impact all Norwegian institutions and not just the large institutions, which need to be identified in accordance with the aforementioned EBA guideline. At the same time, Norway has no global SIIs.

The O-SII buffer is not the appropriate tool to address the identified structural systemic risks, as the identified risks affect all Norwegian banks and not just SIIs. The measure intends to set a SyRB for all Norwegian banks, not just the identified SIIs. In addition, the O-SII buffer applies to all exposures, not just domestic exposures, where systemic risks have been identified in Norway.

Conclusions

According to the Norwegian Ministry of Finance, the main purpose of the SyRB requirement of 4.5% for domestic exposures is to maintain Norwegian credit institutions' resilience to loan losses and other disruptions that may arise as a result of structural vulnerabilities and other long-term systemic risks in the Norwegian economy. The key vulnerabilities in the Norwegian economy result from a combination of risks stemming from: (1) the propagation and amplification of shocks within the financial system; (2) from structural characteristics of the banking sector; and (3) from structural risks to the banking sector stemming from the real economy. The Ministry of Finance has highlighted that the key vulnerabilities are high real estate prices and high household indebtedness in Norway, which can reinforce each other, also due to the pronounced interconnectedness, the large size and the high concentration of the banking sector.

The ESRB is of the view that the level of the measure is appropriate given the identified systemic risks threatening the stability of the Norwegian financial system. The calibration of the level of the measure is obtained both from Norwegian stress test results and losses in connection with historical crisis events, which is also within the range of socially optimal capital requirements based on studies by Norway as well as the Basel Committee on Banking Supervision. A SyRB set at 4.5% for domestic exposures is the appropriate level considered commensurate with the intensity of structural risks in the Norwegian financial system, as a level of capital below that would weaken the banking system's resilience to the identified systemic risks and could adversely contribute towards impacting financial stability in Norway.

The ESRB considers the measure to be effective and proportionate. The measure intends to maintain the loss-absorption capacity and the resilience of Norwegian institutions to long-term non-cyclical risks and, therefore, contributes to safeguarding financial stability both in Norway and in the EEA as a whole. Based on the losses in previous crises and the results from the stress tests, the Ministry of Finance has concluded that the overall SyRB requirements are proportional to the overall risks present in the Norwegian financial system. Thus, to guarantee the effectiveness of the SyRB, the overall capital requirements should be maintained at approximately the pre-2020 level in real terms, which requires a SyRB of 4.5%.

The ESRB considers the effects of the planned measure on the Norwegian domestic market and its credit institutions to be limited. Applying the measure also to subsidiaries of institutions established in other EEA countries is necessary to provide a level playing field in the domestic market and to avoid leakages and regulatory arbitrage. The information provided by the Norwegian Ministry of Finance highlights that the capital needed for Norwegian credit institutions, including subsidiaries of parents headquartered in other EEA countries, to meet the SyRB requirement of 4.5% is limited, which is why the impact on domestic institutions' capitalisation is expected to be near neutral. For banks that do not using the advanced IRB approach, the measure will apply from 31 December 2022 only. This transitional period, applicable to banks that are not significantly affected by the removal of the Basel I floor, should ensure that the changes in the SyRB requirement enter into effect after a reassessment of the Pillar 2 requirements, so that the impact on domestic banks and their lending capacity remains limited.Given the exceptionally uncertain outlook of the economy and the financial system caused by the COVID-19 pandemic, a SyRB of 4.5% may potentially have short-term cyclical effects on the functioning of the financial system in Norway. These unintended consequences might emerge in spite of the strong capitalisation of the Norwegian banking system prior to the pandemic.

Based on the information provided, the ESRB concludes that the measure would not entail disproportionate adverse effects on the EEA as a whole or other financial systems. The planned reciprocation of the SyRB intends to reduce the potential for leakages to foreign institutions. The Ministry of Finance furthermore intends to request the reciprocation of the SyRB for all EEA institutions with exposures to Norway in order to reduce the potential for leakages to foreign institutions, which would otherwise be considered to be significant. The ESRB shall be dealing separately with the implications of the reciprocation request in a recommendation. The high uncertainties surrounding the COVID-19 pandemic as well as the additional level of complexity owing to the different regulatory and supervisory frameworks and the resulting potential overlaps in buffer requirements between Norway and the other Nordic countries (CRR/CRD IV versus CRR II/CRD V) will also need to be considered when assessing the potential impact of the measure on foreign banks. Even though the reciprocation of the SyRB may result in a small short-term increase in foreign institutions' funding costs, their increased resilience is expected to have a positive impact on other EEA countries' credit markets. According to the Norwegian Ministry of Finance, the increase of the

SyRB is – under certain conditions – not expected to be large for some Nordic banking groups if the SyRB is reciprocated, as most of those institutions were already subject to a buffer requirement of 3% for all exposures as at year-end 2019. However, as Nordic countries have taken macroprudential measures to address the impact of the COVID-19 pandemic, the increase in the capital requirement may be higher in case of reciprocation. Nonetheless, the measure should not have a disproportionate negative effect on the EEA as a whole and the reciprocation could be seen as levelling the playing field.

The ESRB is of the view that none of the existing measures in the CRR and CRD IV, excluding Articles 458 and 459 CRR, alone or in combination, are sufficient to address the identified macroprudential or systemic risk in Norway, taking into account the relative effectiveness of those measures. Measures such as those listed under Articles 124 and 164 of the CRR, as well as the Pillar 2 requirements (Articles 101, 103, 104 and 105 of CRD IV), the countercyclical capital buffer (Article 136 of the CRR) or the O-SII and G-SII buffer (Article 131 of CRD IV), are considered inappropriate, as they do not provide the intended incentives, are too broad-based, or do not address the relevant type of risk, exposure or credit institution.

E U R O P E A N   E C O N O M I C   A R E A

S T A N D I N G   C O M M I T T E E
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RECOMMENDATION BY THE STANDING COMMITTEE OF THE EFTA STATES

No. 1/2020/SC on the notification by Norway from 5 November 2020 of the use of a Systemic Risk Buffer according to Article 133 of Directive 2013/36/EU on access to the activity of credit institutions and prudential supervision of credit institutions and investment firms, as incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 79/2019.

Whereas:

1. On 5 November 2020, the Norwegian Ministry of Finance ("Finansdepartmentet"), hereinafter "the Ministry", which is the national designated authority in charge of the application of a systemic risk buffer, hereinafter "SyRB", as referred to in Article 133 of Directive 2013/36/EU, which was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No. 79/2019, notified the EFTA Standing Committee of its intention to raise the current SyRB on domestic exposures, hereinafter "the notification".

2. Currently, credit institutions in Norway are subject to a SyRB of 3% on all exposures, except for two systemically important institutions which are subject to a SyRB of 5% on all exposures. The notified measure is a SyRB of 4.5% and will apply to domestic exposures of all credit institutions authorised in Norway, including five subsidiaries of parents established in other Union's Member States. The buffer is intended to target systemic risks in Norway and promote domestic financial stability by safeguarding resilience in the financial system, along with ensuring continued adequate capital in banks in light of Norway's high-level of long-term systemic risk. Separately, the Ministry also notified its intention to set a buffer for two credit institutions categorised as Other Systemically Important Institutions (O-SIIs), pursuant to Article 131 of Directive 2013/36/EU. This will be set at a rate of 2% for one institution and 1% for the other.

3. The notified SyRB would apply from 31 December 2020 for all credit institutions, except credit institutions which do not use the "Advanced IRB Approach", as they would have a transitional period where the current buffer remains 3% on all exposures until 31 December 2022. The measure will be re-evaluated by the Ministry every second year.

4. As the notified measure also concerns subsidiaries of parent undertakings established in other EEA States, the procedure described in subparagraph 3 of Article 133(14) of CRD IV, as adapted by Decision of the EEA Joint Committee No 79/2019, applies. The Ministry, as the designated authority in charge of the application of a SyRB, shall therefore notify its intention to the relevant authorities of the other EEA States along with the Standing Committee of the EFTA States and the European Systemic Risk Board (ESRB). The Standing Committee and the ESRB shall, within one month of the notification, issue a recommendation on the measures taken.

5. The SyRB is intended to mitigate long-term structural systemic risks in the Norwegian financial system. These risks stem mainly from propagation and amplification of shocks within the system itself, the Norwegian banking sector and the real economy.

6. In its reasoning for the notification, the Ministry points out that long-term structural systemic risks are comparatively high in Norway. Contributing to this high level of systemic risks, institutions in Norway have similar funding structures, rely significantly on wholesale funding (48% of their funding, including foreign wholesale funding), making them vulnerable to market turbulence. Additionally, they are interconnected, including through cross-holdings of covered bonds, and have similar and concentrated exposures towards real estate markets. For instance, about 60% of total lending of Norwegian credit institutions consists of lending for (residential and commercial) real estate. Under these circumstances, disruptions in the economy are amplified as they can severely affect multiple credit institutions both at the same time and in the same manner. This potential for amplification of risks is further substantiated by Norwegian banks' similarity in choice of business models, and interconnectivity through cross-holdings of covered bonds.

7. The Ministry has pointed out that the high real estate prices, both residential and commercial, along with high household debts in Norway are some of the key vulnerabilities in the Norwegian financial system that stem from the real economy. In that regard it should be noted that, in a historic context, household indebtedness in Norway, relative to disposable income, has been comparatively high which again results in systemic risk for the banking sector. The risk involved in Norwegian households using much of their income to service debt is further intensified by the fact that most Norwegian mortgages have floating interest rates, making even small disruptions capable of leading to severely impaired debt-servicing. Historically, exposures to commercial real estate (CRE) risks in previous crises have not only caused some of the Norwegian banking system's biggest losses but also contributed to solvency problems in the banking sector. The Standing Committee further notes that in June 2019, the ESRB issued a warning to Norwegian authorities where vulnerabilities in the Norwegian residential real estate (RRE) sector were identified as a source of systemic risk to financial stability and that those vulnerabilities needed to be addressed.[1]

8. The Ministry has pointed out that the credit institutions also operate in the Norwegian economy which is characterised by a relatively uniform corporate sector which is highly dependent on the petroleum sector. Since the petroleum sector constitutes 17% of GDP and 40% of total exports from Norway the possibility of lowered petroleum prices or

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[1] See https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning190923_no_warning~d3e4f2c135.en.pdf?4cf3e3031aa71bffaa0bd97a66b311ac

reduced global demand are a significant risk to the economy as a whole. This risk has been mitigated to some extent in recent years by investing profits from the petroleum sector in securities in international financial markets. However, the COVID-19 pandemic and the ongoing transition to a greener economy may increase both short-term and long-term pressure on this systemically important sector. Such pressure could potentially cause a ripple effect to other sectors to which credit institutions are exposed. The Standing Committee notes in this respect that Norges Bank in its Financial Stability Report of 2020 states that ”[i]n the Norwegian oil sector, oil service companies in particular pose a risk to banks, and banks have incurred substantial losses on lending to this industry over the past five years”.[2]

9. According to the Ministry, the size, importance and concentration of the Norwegian banking sector amplify the systemic risks to the Norwegian economy. First, the banking sector's size compared to GDP is considerable, standing at approximately 225% of 2019's GDP. Second, the banking sector is highly important for the financing of the economy, as it serves more than 80% of gross domestic lending to the non-financial sector. Third, the banking sector is concentrated with the five largest banks accounting for 56% of total domestic lending.

10. In its assessment of the Ministry's reasoning, the Standing Committee has taken note of the International Monetary Fund's (IMF) Financial System Stability Assessment for Norway of 2020.[3] In line with the Ministry's assessment of the main issues pertaining to a high level of systemic risk, the IMF report recognizes that Norwegian banks' high exposures to domestic real estate, both residential and commercial, along with wholesale funding, are among the key underlying vulnerabilities. The IMF further notes that the banking sector's interconnectedness could result in significant shock amplification and that a deterioration in borrowers' debt servicing capacity could arise from a sharp slowdown in economic growth. As regards dependency on the petroleum market, the IMF notes that the impact of an abrupt transition to a low-carbon economy could be high given Norway's reliance on the production and export of oil.

11. In light of how the Norwegian banking sector is structured and the risks to which it is exposed, as described above, the Ministry considers it necessary that credit institutions overall are capable of absorbing losses that may occur as a result of severe shocks and disruptions in both the financial system and the real economy. It concludes that a SyRB of 4.5% for exposures in Norway is the most suitable measure to target substantial non-cyclical systemic risks present in Norway.

12. In assessing the Ministry's conclusion, the Standing Committee notes that stress tests conducted by the Norwegian authorities have shown that in situations that have low probability but are not unrealistic, many institutions would have a CET1 capital shortfall relative to overall capital and buffer requirements. The latest stress tests, performed by Norges Bank and Finanstilsynet (FSA) in November 2019 and June 2020 respectively, are based on a deep international recession with a strong increase in risk premia, causing serious consequences for the Norwegian economy. The FSA's stress test shows that in the course of the stress period the CET1 capital ratio of practically all of the 20 largest banking groups would fall below the overall CET1 requirement, including buffer

[2] Norges Bank (2020), *Financial Stability Report*, p. 52.
[3] International Monetary Fund (2020), *Financial System Stability Assessment for Norway*, IMF Country Report no. 20/259, August.

requirements and the Pillar 2 requirement. Additionally, 48 out of 84 of the other Norwegian credit institutions would not meet the overall capital requirements.

13. The Standing Committee further notes that the Ministry expects that, in the absence of the notified measure, future stress tests would reveal greater reductions in capital adequacy, forcing institutions to draw on a larger share of their combined buffer in order to maintain the lending activity. This would weaken the banking system's resilience towards the identified long-term systemic risks. If the SyRB requirement is set at 4.5% for domestic exposures, this would maintain adequate capitalisation based on the abovementioned risks, without leading to material increases in effective requirements for the larger institutions compared to the pre-2020 level. In this regard, the Ministry further notes that there are several aspects that are not captured by the stress test results, which may contribute to the credit institutions' potential losses being underestimated. For instance, it is assumed that credit institutions continue to have access to wholesale funding during periods of stress. Moreover, the Ministry notes that accumulated losses in the stress tests are lower than credit institutions' actual losses during the Norwegian banking crisis in 1988-1992. The Ministry also argues that the overall requirements implied by a systemic risk buffer of 4.5% for domestic exposures is also well within the range of estimates of socially optimal requirements.[4]

14. Having carefully considered the evidence provided by the Ministry, including the results of stress tests performed by the Norwegian authorities, as well as historical data on past severe crises in Norway, the Standing Committee is of the view that a SyRB level of 4.5% for domestic exposures can be considered appropriate for addressing the identified systemic risks threatening the stability of the Norwegian financial system. The Standing Committee further believes that under the current conditions a capital level that is achieved with a SyRB of 4.5% is necessary to maintain the banking systems' resilience towards the identified systemic risks. The Standing Committee notes in this respect that the Executive Board of the IMF concluded from its Financial System Stability Assessment of Norway in August 2020 that '[t]he authorities should guard against a weakening of capital requirements'.[5]

15. In assessing the effectiveness and proportionality of the measure, the Standing Committee notes the Ministry's view that a SyRB requirement of 4.5% for exposures in Norway will effectively contribute to maintain Norwegian institution's resilience and capacity to absorb losses at the level deemed necessary in light of the intensity of systemic risks. The CRR/CRD IV framework was recently incorporated into the EEA Agreement and in preparation for the Norwegian framework to align with the current framework, the Ministry has assessed the scope and calibration of the SyRB requirement, and concluded that the most effective way to mitigate the systemic risk will be to set the requirement at 4.5% for domestic exposures only. Beyond improving the consistency between the objective and design of the measure, this represents an alignment with the provisions of the CRR/CRD IV framework that facilitate reciprocation for domestic buffer rates.

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[4] Basel Committee on Banking Supervision (2019), *The costs and benefits of bank capital – a review of the literature*, Working Paper 37, June.

[5] International Monetary Fund (2020), *Financial System Stability Assessment for Norway*, IMF Country Report no. 20/259, August, p. 2.

16. The Ministry believes that for the larger Norwegian banks, constituting more than half the domestic banking system, a systemic risk buffer rate of 4.5% on domestic exposures is almost equivalent to the previous 3% buffer rate applicable to all exposures in terms of real capital requirements. They consider it proportional not only to the potential losses stemming from the structural risks in the Norwegian financial system, but also the intensity of those risks and the risk tolerance implied by their previous buffer decisions. It is furthermore worth noting that the current buffer rate of 3% on all exposures was calibrated when the Basel I floor applied and when there was no SME supporting factor. In the absence of the Basel I floor and with the SME supporting factor applying, the previous systemic risk buffer rate would, according to the Ministry, probably have been set at a higher rate in light of the level of systemic risk. As concluded by the Ministry, based on experience from previous crises and results from stress tests, the overall capital and buffer requirement has been proportional to the overall risks present in the financial system. Accordingly, the overall requirement should be maintained at approximately the pre-2020 level as the intensity of the systemic risks is similar to 2013, which would justify a SyRB rate set at 4.5%.

17. According to the Ministry, the COVID-19 pandemic has not led to any major changes in the structural features of the Norwegian financial system, and Norwegian credit institutions continued to satisfy capital and buffer requirements by an ample margin and were able to maintain lending to households and businesses during the COVID-19 pandemic. Meanwhile, in March 2020, the Ministry has lowered the countercyclical capital buffer from 2.5% to 1% as a short-term response to the potential impact from the COVID-19 pandemic.

18. In light of the above, the Standing Committee is of the view that the measure in question is both effective and proportionate as it contributes to mitigating the identified long-term structural risks in the Norwegian banking sector. The Standing Committee notes that the clearest evidence for this conclusion is found in the stress test results of the Norwegian authorities, which suggest that the measures will be effective for promoting financial stability in Norway by maintaining the capital level of Norwegian credit institutions at the necessary level for the conservation of their current loss-absorption capacity. In support of this conclusion about the proportionality of the measure, the Standing Committee notes that this implies that in actual terms there will be no significant increase of capital requirements for Norwegian credit institutions. For several of the subsidiaries of parent undertakings established in other EEA Member States the capital requirements will increase by close to 1.5 percentage point, but the Standing Committee notes that according to the Ministry these credit institutions have capital levels in excess of the requirements implied by a SyRB rate of 4.5% on Norwegian exposures. The Ministry acknowledges that some Norwegian credit institutions may need to increase their capital ratio somewhat to maintain a management buffer on top of the overall Pillar 1 and 2 requirements. Meanwhile, the transitional period until 31 December 2022 for banks not using the Advanced IRB approach, should ensure that the changes in the SyRB requirement do not result in undue increases in capital requirements for credit institutions that are not significantly impacted by the abolishment of the Basel I floor, and whose Pillar 2 requirements may have to be recalibrated once the higher SyRB applies to them after the transition period. This approach should mitigate distortions that the notified measure may cause and ensure that any adverse impacts on domestic banks and their lending capacity remain limited.

19. The Standing Committee has also considered the Ministry's reasons for discarding other measures foreseen in Directive 2013/36/EU or in Regulation (EU) No 575/2013 (excluding Articles 458 and 459 of that Regulation), alone or in combination, as an appropriate way to address the identified macroprudential or systemic risk, taking into account the relative effectiveness of those measures.

20. Article 124 of Regulation (EU) No 575/2013 allows competent authorities to set higher values for risk weights of real estate exposures of credit institutions that use the standardised approach, based on financial stability considerations, the loss experience of exposures secured by immovable property, and forward-looking immovable property markets developments. The Ministry considers the risk weight of 35% for residential real estate exposures in Norway adequate for institutions using the Standardised Approach. For commercial real estate exposures, higher risk-weights have already been set, based on paragraph 2 of this Article, varying between 100% and 150%, depending on the counterparty's rating.

21. Under Article 164 of Regulation (EU) No 575/2013, competent authorities may, where appropriate on the basis of financial stability considerations and forward-looking immovable property markets developments, set higher minimum values of exposure-weighted average Loss Given Default for exposures secured by immovable property in their territory. For retail exposures secured by residential property in Norway, a higher Loss Given Default floor of 20% has been applied since 2014 to address uncertainty associated with internal credit risk models.

22. The Standing Committee notes that Articles 124 and 164 of Regulation (EU) No 575/2013 have already been used to some extent to address certain risks. It also notes that the notified measure intends to address broader long-term systemic risks than the specific property market developments that can be targeted under Articles 124 and 164 of Regulation (EU) No 575/2013. These systemic risks are the similar funding structures of credit institutions, their interconnectedness and their similar and concentrated exposures towards real estate markets and the Norwegian economy with a not very diversified corporate sector, while household debt levels are high.

23. Where a competent authority determines that credit institutions with similar risk profiles are or might be exposed to similar risks or pose similar risks to the financial system, it currently may, under Article 103 of Directive 2013/36/EU, apply the Supervisory Review and Evaluation Process (SREP) to those institutions in a similar or identical manner. Article 104 of Directive 2013/36/EU provides a set of supervisory powers to the competent authority in the application of Article 103 of that Directive, including additional own fund requirements. The Ministry argues that institution-specific pillar 2 requirements pursuant to Article 104 of Directive 2013/36/EU should be tailored to each institution's specific situation, and that such requirements may target certain elements of structural systemic risks, but only to an extent where the risks are not general features of the banking system. In support of this view, it considers that Directive 2019/878 clarifies that the institution-specific nature of Pillar 2 requirements should prevent their use as a tool to address systemic risks. The Standing Committee notes that Pillar 2 measures are indeed primarily meant to address institution-specific risks and are also less transparent than a systemic risk buffer.

24. Article 131 of Directive 2013/36/EU mandates designated authorities to identify other systemically important institutions (O-SIIs) and set or reset an O-SII buffer for those

institutions. The Ministry has separately notified the intention to set O-SII buffers for two systemically important institutions. It considers these buffers complementary, as the O-SII buffers address part of the risk of a concentration of systemically important institutions, while the systemic risk buffer addresses other long-term non-cyclical systemic risks. According to the Minstry, a number of other credit institutions are big enough to potentially amplify systemic risks in the Norwegian banking sector, while remaining too small to be identified, by the Ministry, as domestic systemically important on an individual basis. The Standing Committee considers that Article 131 of Directive 2013/36/EU is not meant to address all types of long term non-cyclical systemic or macroprudential risks. The O-SII buffer would not be the appropriate tool to address long term non-cyclical systemic or macroprudential risks affecting the banking sector as a whole.

25. The countercyclical buffer referred to in Article 136 of Directive 2013/36/EU applies to all non-financial private sector exposures located in a jurisdiction. The Ministry argues that the countercyclical buffer is designed to address a different form of systemic risk, stemming from cyclicality in the financial system. The Standing Committee concurs with this assessment.

26. After examining the arguments put forward by the Ministry, the Standing Committee agrees with the Ministry that existing measures in Directive 2013/36/EU or in Regulation (EU) No 575/2013 (excluding Articles 458 and 459 of that Regulation), alone or in combination, would be relatively less effective in sufficiently and adequately addressing the identified risk.

27. As regards the potential impact on the internal market, the Standing Committee notes that there is no indication that the notified measure has a disproportionate effect on the five subsidiaries of credit institutions established in other EEA States. Additionally, in order to reduce the potential for leakages to foreign institutions that are active in Norway through branches, the Ministry plans to request reciprocation of the SyRB for all EEA institutions with exposures to Norway. The Standing Committee considers that this is important in view of the comparatively strong presence on the Norwegian lending market of banks from other Nordic countries, with a view to preventing regulatory arbitrage and avoiding leakages through branches. There are specific Memoranda of Understanding in place to promote cross-border financial stability and ensure adequate prudential supervision of significant branches of financial institutions operating in the Nordic-Baltic region.[6] The Standing Committee notes that the reciprocation request and the higher capital requirements this would imply for foreign credit institutions will be assessed by the ESRB when the Ministry will request the ESRB to recommend to its members to reciprocate the measure.

28. Given the high degree of interconnectedness with the financial systems of other Nordic countries, the Standing Committee expects the notified measure to be conducive to financial stability to the extent that regulatory arbitrage and leakages can be avoided by reciprocation of the notified measure for material exposures of foreign credit institutions to the Norwegian market, including the operations of any significant foreign bank branches.

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[6] See https://www.regjeringen.no/contentassets/ff0c28c162ca43f39b585d7c9f94dab5/nbsg-mou_2018.pdf

29. Considering all the factors above, as required by Art. 133 of CRD IV, having reviewed the notification with Norway and consulted with relevant parties to this process, the EFTA Standing Committee concludes that the systemic risk buffer of 4.5% on domestic exposures does not entail disproportionate adverse effects on the whole or parts of the financial system of Norway or of the EEA as a whole. Neither does it form or create an obstacle to the proper functioning of the internal market.

HAS ADOPTED THIS RECOMMENDATION:

1) The systemic risk buffer notified on 5 November by the Norwegian Ministry of Finance ("Finansdepartmentet") according to Article 133(11) of Directive 2013/36/EU as adapted by Joint Committee Decision No. 79/2019, is justified, suitable, proportionate and effective to address the systemic risks for which it is intended. The Standing Committee of the EFTA States further notes that:

   a. the dimension of the identified systemic or macroprudential risks constitutes a threat to the stability of the Norwegian financial system of such nature that the introduction of a systemic risk buffer rate of 4.5% for domestic exposures is justified;

   b. the notified measure is likely to be effective and suitable to mitigate the risk in a proportionate manner;

   c. other macroprudential measures in Directive 2013/36/EU or in Regulation (EU) No 575/2013, alone or in combination, would be relatively less effective in sufficiently and adequately addressing the identified risk;

   d. the notified measure, including its application to subsidiaries whose parents are established in other EEA States, does not entail disproportionate adverse effects on the financial system of Norway or of the EEA as a whole and does not constitute an obstacle to the proper functioning of the internal market.

2) The Standing Committee of the EFTA States does not recommend any changes to the notified measure in view of its effects on subsidiaries of credit institutions established in other EEA States.

Done at Brussels, 4 December 2020

For the Standing Committee

The Chair

DocuSigned by:

J. Movan

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The Secretary-General

DocuSigned by:

Henri Getaz

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