

EBA/Op/2024/01

19 December 2023

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

1. On 20 November 2023, the European Banking Authority (EBA) received a notification from Latvijas Banka to adjust an existing measure in accordance with Article 124(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (Capital Requirements Regulation, CRR).¹
2. The notified measure adjusts the risk weight for exposures secured by mortgages on commercial immovable property for institutions applying the Standardised Approach (SA institutions) from the current level of 100% to 80%.
3. In accordance with the third subparagraph of Article 124(2) of the CRR, within one month of receiving notification from the designated or competent authority entrusted with the national application of Article 124 of the CRR, the EBA is required to provide its Opinion to the Member State concerned.
4. In accordance with Article 14(2) of the Rules of Procedure of the EBA,² the Board of Supervisors has adopted this Opinion.

Background of the measure

5. The original measure, introduced in 2007, set a risk weight of 100% for exposures secured by mortgages on commercial immovable property registered in Latvia. It was set to address concerns on the local commercial immovable property market related to liquidity and the risk of higher losses and longer recovery periods for credit institutions in case of foreclosures.

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

² Decision of the EBA concerning the Rules of Procedure of the Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

The default risk weight defined in Article 126 CRR for exposures secured by mortgages on commercial immovable property is 50%.

6. Due to improvements in market liquidity and in loss rates in recent years, Latvijas Banka deems an adjustment of the risk weight from 100% to 80% justified.
7. The new measure is expected to apply from 30 June 2024.³
8. The measure has no set expiry date. The risk weight calibration will be reviewed regularly by the Latvijas Banka, based on an annual assessment.

Economic rationale for the measure

9. According to the notification, commercial immovable property constitutes a significant share of the lending of Latvian credit institutions. As of December 2022, credit institutions operating in Latvia (incl. branches of institutions registered in other Member States) reported a total gross carrying amount of EUR 3.3bn (of which 1.6bn EUR by SA institutions) in loans secured by mortgages on commercial immovable property. This represented 53% of institutions' total non-financial corporations (NFC) loan portfolio.
10. According to the notification, the measure originally introduced in 2007 has been effective in ensuring prudent risk management by institutions and increased capital requirements for a subset of exposures in relation to which heightened vulnerabilities have been identified.
11. Since the original measure had been introduced, market liquidity has generally improved, and loss rates have decreased compared to the period of the Global Financial Crisis and its aftermath.
12. Data from the national credit register was used to make up for a lack of data on losses reported via COREP (template C 15.00), which allows institutions not to report details on losses related to exposures secured by mortgages on immovable property if the immovable property collateral was not used to reduce the risk weight of the underlying exposure, according to Latvijas Banka.
13. Data from institutions applying the IRB approach show an implied risk weight of 75% for exposures secured by mortgages on immovable property, supporting the case for adjusting the risk weight for SA institutions to 80%.
14. According to the assessment of Latvijas Banka, any cross-border effects and impact on the internal market are expected to be minimal given the limited volume of current cross-border lending.

³ As amended by an updated notification received on 4 December 2023 with the implementation date changed from 01/01/2024 to 30/06/2024

15. No leakages or regulatory arbitrage are expected, given the structure of the Latvian financial system and the incremental effect of the risk weight reduction.
16. Latvijas Banka does not see a risk to financial stability due to the reduction of the risk weight, due to the high level of capitalisation of the Latvian banking sector with institutions maintaining a high capital headroom above regulatory requirements. A recently announced countercyclical capital buffer will apply from the end of 2024, requiring institutions in Latvia to hold 0.5% of total RWA and 1% of total RWA by June of 2025. The countercyclical capital buffer, once fully phased in, will more than compensate for the decrease in capital requirements associated with the reduction of the risk weight.

Assessment and conclusions

17. The EBA acknowledges the concerns raised by the Latvijas Banka regarding the financial stability risks stemming from exposures secured by mortgages on commercial immovable property. These exposures represent a large share of banks' total NFC portfolio.
18. Based on the information provided, the EBA does not object to the measure setting the risk weight for exposures secured by mortgages on commercial immovable property to 80% until the next adjustments to risk weights in accordance with Article 124(2) of Regulation (EU) No 575/2013.
19. The EBA takes note of data availability issues identified by Latvijas Banka related to institutions' reporting of losses on exposures secured by immovable property (COREP C 15.00).
20. The EBA invites the Latvijas Banka to closely monitor the situation in light of the high uncertainty in the macroeconomic environment. The EBA would like to remind the Latvijas Banka that it is obliged to regularly, and at least annually, assess the appropriateness of the risk weights and adjust them if deemed necessary, in accordance with Article 124(2) of Regulation (EU) 575/2013, as further specified by Commission Delegated Regulation (EU) 2023/206.⁴

⁴ Commission Delegated Regulation (EU) 2023/206 of 5 October 2022 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the types of factors to be considered for the assessment of the appropriateness of risk weights for exposures secured by immovable property and the conditions to be taken into account for the assessment of the appropriateness of minimum loss given default values for exposures secured by immovable property (OJ L 29, 1.2.2023, p. 1–5).

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

Done at Paris, 19 December 2023

[signed]

José Manuel Campa

Chairperson

For the Board of Supervisors