ECB- Restricted

Follow-up to the Recommendation ESRB/2019/7 on medium-term vulnerabilities in the residential real estate sector in the Netherlands

Sub-recommendation B(1), Recommendation C and Recommendation D

Reporting deadline: **31 October 2022**

Addressees:

The Netherlands

The macroprudential authority, the designated authority or the competent authority in the Netherlands, as applicable

Introduction

Legal instrument	Recommendation ESRB/2019/7 on medium-term vulnerabilities in the residential real estate sector in the Netherlands
Reporting institution	The Ministry of Finance
Date of reporting	31 October 2022
Confidentiality regime*	ECB-public
Name and contact details of the respondent	Persoonsgegevens

* Please indicate the level of confidentiality you wish to apply to the responses provided herein.

Timeline for completing the template and submitting the follow-up report

The purpose of this template is to request the Netherlands and the macroprudential authority, the designated authority or the competent authority, as applicable, in the Netherlands, to provide the ESRB with a follow-up report on the assessment of implementation of sub-recommendation B(1), Recommendation C and Recommendation D of the Recommendation ESRB/2019/7 (hereinafter the 'Recommendation'), due by **31 October 2022**.

Addressees are kindly invited to complete this template, summarising the actions taken to comply with the sub-recommendation B(1), Recommendation C and Recommendation D or providing adequate justification for inaction. Addressees are expected to provide relevant information and documentation related to the implementation of sub-recommendation B(1), Recommendation C and Recommendation D, including information on the substance and timing of the actions taken.

Instructions to addressees

Each relevant authority should submit the completed template to the ESRB via the ESRB Secretariat. Subsequently, the ESRB Secretariat will arrange for the transmission of the final reports to the Commission, the Council and the European Parliament in accordance with Article 17(1) of Regulation No 1092/2010[1].

For the purposes of reporting to the ESRB, the completed template should be sent to the ESRB Secretariat electronically via DARWIN in the dedicated folder or by email to Persoonsgegevens by **31 October 2022**:

The required follow-up reports by the addressees should contain a reference to all the details referred to in sub-recommendation B(1), Recommendation C and Recommendation D.

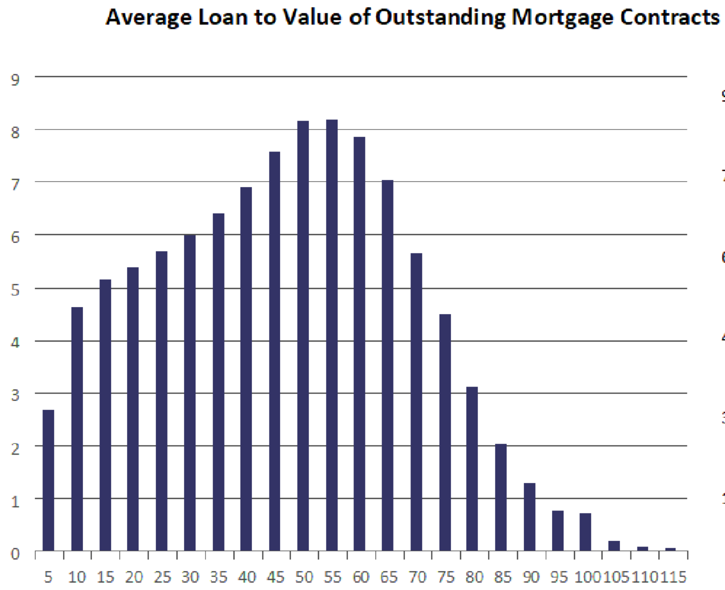
[1] OJ L 331, 15.12.2010, p. 1

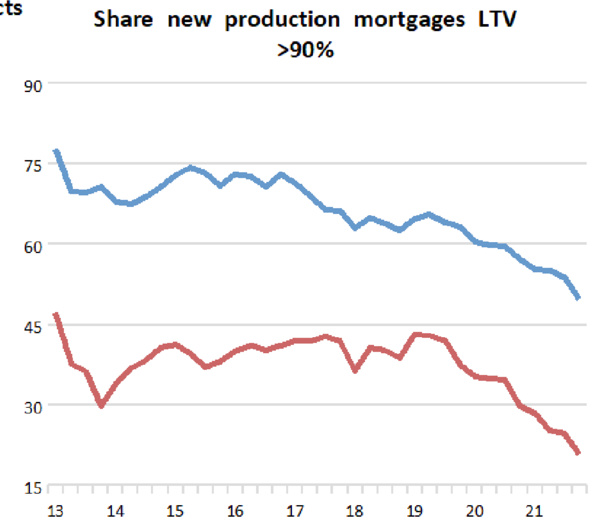
Content of recommendation	Recommendation C
	Activation of capital-based measures It is recommended that the macroprudential authority, the designated authority or the competent authority in the Netherlands, as applicable, ensure, by activating capital-based measures, the resilience of credit institutions authorised in the Netherlands in the face of the potential materialisation of systemic risk related to residential real estate which could lead to direct and indirect credit losses stemming from mortgage loans or arising as a consequence of the decrease in consumption by households with housing loans.
Addressees	**The macroprudential authority, the designated authority or the competent authority in the Netherlands, as applicable.**
Deadline	**31 October 2022**
1. Timeline: Please indicate the time period when the actions required under the relevant recommendation were taken.	**Two-year extension**: On 1 January 2022, DNB introduced a minimum average risk weight for the calculation of regulatory capital requirements applicable to exposures to natural persons secured by mortgages on residential property located in the Netherlands, based on art 458(2)(d)(iv) of the CRR. The stricter requirement is applicable to credit institutions that use the Internal Rating Based (IRB) approach for calculating regulatory capital requirements. The measure would initially be in place until 30 November 2022. Following a public consultation and the notification of the relevant European institutions, DNB announced the two-year extension of the measure in its Financial Stability Report on 11 October 2022 (see: Financial Stability Report - Autumn 2022 (dnb.nl)). With the extension, the measure is in place until 30 November 2024. The extension of the measure was published in the Staatscourant (Government Gazette) on 17 October 2022 (see: Staatscourant 2022, 27251 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl)). **Initial introduction**: DNB first announced its intention to introduce the measure on 15 October 2019. Following a public consultation and the notification of the relevant European institutions, DNB intended to take a final decision in March 2020, and the measure was due to take effect in Fall 2020. On 6 March 2020, DNB received notification from the European Commission of its decision not to object to the proposed measure. However, on 17 March 2020, DNB decided to postpone the introduction of the measure in light of the coronavirus outbreak and its potential impact on the Dutch economy and the financial sector. In October 2020, DNB has announced that the measure will not come into force before the end of 2021. On

	21 June 2021, DNB decided not to further postpone its introduction, and announced that the measure will come into force as of January 2022. On 21 October 2021, the introduction of the measure was published in the Staatscourant (Government gazette) (see: Staatscourant). On 1 January 2022, the measure came into force.
1. Actions taken: Please describe the essence of the actions taken to comply with the relevant recommendation, including how the measure taken ensures the resilience in the face of the potential materialisation of systemic risk.	On 1 January 2022, DNB introduced a minimum average risk weight for the calculation of regulatory capital requirements applicable to exposures to natural persons secured by mortgages on residential property located in the Netherlands, based on art 458(2)(d)(iv) of the CRR. The stricter requirement is applicable to credit institutions that use the Internal Rating Based (IRB) approach for calculating regulatory capital requirements. The measure is currently into place until 30 November 2022. By increasing the loss-absorbing capacity of banks (via a higher capital requirements on residential mortgage exposures) the measure taken ensures that banks increase their resilience in face of a potential materialization of systemic risks stemming from the housing sector.
Compliance Criteria	**Recommendation C**
1. Compliance criterion: Please describe how you applied the principle of proportionality, taking into account the objective and content of this recommendation. [*Article 1(a) of Section 2.2 of the Recommendation*]	DNB considers the measure to be proportionate. The main objective of the measure is to ensure that all banks which play an important role in mortgage lending are resilient against a potential severe downturn in the housing market. This is achieved by imposing an average minimum risk weight for IRB banks, which creates a sufficiently strong and stable amount of capital for residential real estate exposures. The additional amount of capital based on 2021 Q4 data was estimated at EUR 4.5 billion and helps to secure the resilience of the banking sector in a severe downturn scenario. The need for higher capital arises because the risk weights which IRB banks apply to real estate exposures are deemed low in light of growing vulnerabilities at the macro level. The measure is expected to increase the average risk weights of IRB banks by about 5%-points (from around 8% to 13-14%). By differentiating the average minimum risk weight based on

	the LTV of a mortgage, the measure is especially targeted at an important source of systemic risk in The Netherlands. From an international perspective, Dutch banks are highly exposed to high-LTV loans. These loans are more risky not only in terms of higher credit risk, but also from a systemic perspective. High-LTV loans are more likely to have negative equity following a bust in the housing market, which in the past has induced households to reduce consumption and has prolonged the housing market bust. As a result, the impact of a housing market correction is expected to be larger when the share of high-LTV loans is larger. The measure reflects this negative externality, as the additional capital to be held for mortgage exposures will increase with the share of high LTV loans. In addition, as the measure will impose a higher floor on banks with higher LTV loans, it gives individual banks a disincentive to grant new high-LTV loans. The targeted nature and risk-sensitivity of the measure also contribute to its proportionality. Because residential real estate is one of the main (domestic) sources of systemic risk in The Netherlands, the measure targets exposures secured by residential real estate. As a result, spill-overs to overall credit extension and, indirectly, to the real economy are expected to be limited. The measure affects banks only, for which resilience to the indirect effect of a housing bust is likely to be more of a concern than for insurers and pension funds. In addition, the measure only affects banks which use the Internal Ratings Based (IRB) Approach. After all, risk weights under the standardized approach are higher than the average risk weight resulting from the intended risk weight floor. The floor does therefore not affect portfolios under the standardized approach. IRB banks account for 92% of all mortgage lending by banks in the Netherlands.
1. Compliance criterion: Please provide details on the assessment you took prior to activating capital-based measures about the position of the Netherlands in the economic and financial cycles in order to determine whether activating such measures would be appropriate. [*Article 1(c), Section 2(2) of the*	The decision to postpone the introduction of Article 458 measure (taken in March 2020) reflected the possible materialization of systemic risks after the coronavirus outbreak and its potential impact on the Dutch economy and financial sector. The subsequent decision not to further postpone the introduction of Article 458 measure (taken in June 2021) reflected the strongly positive economic outlook projected for Dutch economy in the period 2021Q2-2023.

Recommendation and par. 1 of the Recommendation C, Annex I]	
1. Compliance criterion: In case the adopted capital-based measures were further tightened or additional macroprudential measures were needed to address the vulnerabilities identified in the Netherlands, please provide a description on how the relevant decision took into account the characteristics of the capital-based measures already activated, the initial calibration of those measures and the results of the assessment of vulnerabilities. [*Par. 2 of the Recommendation C, Annex I*]	No additional measures have been taken.
1. Compliance criterion Please include the assessment of the vulnerabilities related to pockets of overvaluation of house prices and the collateralisation of new and existing mortgage loans, including the distribution of new mortgage loans according to their LTV ratios, with the relevant ratios being calculated in accordance with Annex IV to Recommendation ESRB/2016/14 of the European Systemic Risk Board[2], together with the functioning of the actions undertaken, having regard to the objectives of this Recommendation.	Systemic risk inherent in the Dutch housing market has increased over the past few years. House prices have gone up sharply for several years in a row (8% over the past three years, with growth rates peaking at 21.1% in January 2022 (y-y)). While sluggish supply and declining interest rates partly account for the price increases, there are also signs of overvaluation as evident from high and increasing price-to-income ratios in the housing market. These are now higher than they were at the peak of the previous crisis in 2008. While this is leading to decreasing affordability and pockets of risky lending, as evident from the increasing share of newly grant mortgages with high loan-to-income ratios, the share of newly originated mortgages with high LTV ratios is decreasing (right figure below), despite remaining very high in general, as regards both the new production and the stock of exposures (left figure below).

<table>
<tr>
<td>[Article 2(b), Section 2(2) of the Recommendation]</td>
<td>




</td>
</tr>
<tr>
<td>2. Self-assessment:

In case of action, please provide a self-assessment on whether the actions undertaken are fully compliant, largely compliant, partially compliant, materially non-compliant or non-compliant with Recommendation C.</td>
<td>In our opinion, the actions taken are fully compliant with the recommendation received and fully proportionate to the assessed level of risk.</td>
</tr>
<tr>
<td>3. Justifications:

Please provide, as appropriate, justifications for (i) inaction, (ii) delays in action, or (iii) departure from Recommendation C, as may be relevant.</td>
<td>Not applicable.

an Systemic Risk Board of 31 October 2016 on closing real estate data gaps (OJ C 31, 31.1.2017, p. 1).</td>
</tr>
</table>

Please provide a self-assessment on whether the inaction is sufficiently or insufficiently explained.	
4. Additional information: Please provide other information that is not otherwise covered in the present document and that is relevant for the purposes of the follow-up assessment. Please also attach any relevant documents (if applicable).	Additional information can be found in: - Staatscourant 2022, 27251 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl) - Staatscourant 2021, 44119 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl) - Notification by De Nederlandsche Bank on a stricter measure based on Article 458 of the CRR (europa.eu) - Notification by De Nederlandsche Bank on a stricter measure based on Article 458 of the CRR (europa.eu) - EBA-Op-2022-09 Opinion of the EBA on measures in accordance with Article 458 of Regulation (EU) No 5752013.pdf (europa.eu) - Financial Stability Report - Autumn 2022 (dnb.nl) - Overzicht Financiële Stabiliteit - Najaar 2021 ENG (dnb.nl)