



Assessment of a risk-weight adjustment for exposures secured by mortgages on commercial immovable property in Norway, in accordance with Article 124 of the Capital Requirements Regulation

Introduction

On 25 April 2024 the Norwegian Ministry of Finance notified the European Systemic Risk Board (ESRB) of its decision to adjust the higher risk weight previously set for exposures secured by mortgages on commercial immovable property (commercial real estate (CRE) exposures) for banks using the standardised approach (SA banks), in accordance with Article 124(2) of the **Capital Requirements Regulation (CRR)**.¹ Currently, mortgages on commercial property should not be taken into account when assigning risk weights in accordance with Article 124(2) of the CRR, resulting in a 100% risk weight for most exposures of this type. The Norwegian Ministry of Finance now intends to exempt a subset of exposures, namely those secured by mortgages on agricultural immovable property, which is not considered to be residential immovable property (agricultural CRE exposures) from the current measure from 30 June 2024. The Ministry intends to maintain the higher risk weight for all other types of CRE exposures in Norway.

Pursuant to Article 124(2) of the CRR, the ESRB is required to provide its opinion on the proposed measure to Norway within one month of receiving the notification. The procedural framework for issuing opinions under Article 124 of the CRR is clarified in **Decision ESRB/2015/4**.²

The ESRB's assessment draws on information provided by the Norwegian Ministry of Finance and the Financial Supervisory Authority of Norway (the Norwegian FSA) as well as discussions within the ESRB's Assessment Team and with the Norwegian authorities.

1. Description of the proposed measure

The proposed adjustment consists of the exemption of agricultural CRE exposures from the higher risk weight requirement which, pursuant to Article 124 of the CRR, is already applicable to the CRE exposures of SA banks. A 100% risk weight on exposures secured by mortgages on commercial property was implemented in Norway in 1989 in order to comply with Basel I. When the CRR was implemented in Norway in 2019, the

¹ See 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).

² 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 (ESRB/2015/4), as amended by Decision ESRB/2021/7.

Norwegian authorities made use of the possibility afforded by Article 124 of the CRR to set a higher risk weight for CRE exposures. Specifically, the Norwegian regulation on capital requirements and national adaptation of CRR/CRD IV³ states that mortgages on commercial property shall not be taken into account when assigning risk weights in accordance with Article 124(2) of the CRR. The result is a risk weight of 100% for most of these exposures, although the risk weights applied may differ depending on the category of exposure. The Norwegian Ministry of Finance now intends to exempt agricultural CRE exposures, allowing them to benefit from the provisions of Article 126(1) of the CRR which assigns a 50% risk weight to exposures fully and completely secured by mortgages on commercial immovable property as defined in Article 126(2) of the CRR. The exemption of agricultural CRE exposures from the Norwegian measure pursuant to Article 124 of the CRR will be applicable from 30 June 2024.

The purpose of the proposed adjustment is to reflect the lower riskiness of agricultural CRE exposures in the applicable risk weights and the exemption is not expected to have a significant impact on the resilience of the banking sector in Norway. The total exposure of the banking sector to the agricultural sector is limited at below 3% of all loans to non-financial companies. In addition, the current measure and its proposed adjustment only applies to SA banks, which have a lower market share than banks using the internal ratings-based approach (IRB banks), accounting for about 20% of the market. For this reason, reducing the risk weight for SA banks for only this sector would not have a significant impact on the resilience of banks or, therefore, on financial stability. The impact on capital requirements would vary significantly across institutions but would lead to an average increase of around 0.5 percentage points in the CET1 capital ratio of SA banks that have agricultural CRE exposures. Reflecting the lower risk of the sector in lower risk weight requirements could also promote cheaper funding to agricultural companies.

2. Analysis of the underlying systemic risks

Experience of losses on CRE lending in Norway indicates that risk is extremely volatile. During normal economic periods losses on CRE lending can be very low, but in crisis periods they can represent a major part of total loan losses. During severe crises, as seen most recently during the Norwegian banking crisis of 1988-92, the loss potential for CRE lending turned out to be significantly larger than for the whole bank portfolio. The Norwegian FSA has estimated accumulated losses on CRE exposures during the Norwegian banking crisis at approximately 22%.

There is significant uncertainty about the outlook for the real economy, inflation and financial markets in Norway. Following the financial crisis, between 2008 and 2022, losses were low for all sectors in Norway, and the period was characterised by significant economic development. However, since September 2021 the Central Bank of Norway has increased its policy rate 14 times, reaching 4.5% in December 2023, to curb inflation, indicating that

³ [Regulations on capital requirements and national adaptation of CRR/CRD IV \(CRR/CRD IV regulations\)](#)

interest rates will probably remain high for some time. Although data quality issues make it difficult to calculate changes in CRE prices, estimated CRE prices have decreased by around 20% from their peak in early 2022.⁴ A gradual moderation in economic activity in Norway over the next couple of years is possible. The full effects of high inflation and higher interest rates have not yet been fully transmitted to the economy, which could lead to further declines in residential property and CRE prices. Falling property prices could result in reduced consumption, thereby weakening earnings for businesses that lease premises. In turn, this would lead to lower profits for commercial property companies and increased credit risk for banks. CRE constitutes a large share of the total lending books of banks and real estate is also the prime collateral involved in lending to other businesses. This is particularly important given the declining CRE prices seen recently. Introducing a lower risk for CRE under the standardised method may cause lending to the segment to increase significantly. Given the current situation this could pose problems arising from banks' significant exposure and the uncertain economic outlook, particularly in terms of adapting to higher interest rates.

The assessment of the risks associated with Norwegian CRE exposures by the Norwegian Ministry of Finance and the Norwegian FSA is broadly in line with the ESRB assessment, which identified risks from the CRE sector as a source of significant systemic risk in the European Economic Area (EEA) in its December 2022 recommendation and its September 2022 general warning.⁵ The ESRB recommended that EU and national authorities improve their monitoring of systemic risks stemming from the CRE sector. While acknowledging that the nature of vulnerabilities varies across EEA countries, the ESRB recommended that based on the findings from their monitoring EU and national authorities should ensure that financing practices in the sector are sound and financial institutions are resilient. The recommendation was based on an assessment of vulnerabilities in the CRE sector that could be a source of risk to financial stability. The findings showed that the sector is vulnerable to cyclical risks related to heightened inflation, a tightening of financial conditions and the pronounced deterioration in the growth outlook following Russia's invasion of Ukraine. Vulnerabilities related to structural changes are also present, including stricter building standards to address climate change, a shift towards e-commerce and the demand for flexibility in leasable office space as remote and hybrid working models become more widespread. Furthermore, the ESRB's analysis showed that adverse developments in the CRE sector can have a systemic impact on both the financial system and the real economy. Such vulnerabilities can be amplified by spillovers across countries and through interlinkages between financial institutions. Banks are particularly exposed to the CRE sector via credit risk on loans. The ESRB also highlighted these vulnerabilities in its September 2022 general warning, pointing to potential vulnerabilities in CRE markets, among other things.

Nevertheless, agricultural real estate exposures have, over time, been one of the sectors within the CRE portfolio with the lowest loss rates in Norway. The agriculture, forestry and fisheries (excluding fish farming) sector has been among the sectors which have experienced the lowest losses since 2008. According to a survey carried out by the Norwegian FSA, losses stemming from lending collateralised by agricultural CRE at up to 50%

⁴ Estimated prices are calculated as rental prices divided by an estimated yield for prime office space in Oslo.

⁵ See "[Recommendation of the European Systemic Risk Board of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area \(ESRB/2022/9\)](#)" and "[Warning of the European Systemic Risk Board of 22 September 2022 on vulnerabilities in the Union financial system \(ESRB/2022/7\)](#)".

of the market value or 60% of the lending value have varied between just 0.00% and 0.02% of outstanding loans over the last ten years. Overall losses stemming from lending collateralised by agricultural CRE have varied between 0.04% and 0.16% of outstanding loans in the same period.

Furthermore, Norwegian agriculture and forestry are eligible for state subsidy and support schemes, which reduces the already-low credit risks for banks still further. Additionally, the earnings of many obligors with exposures secured by mortgages on agricultural properties are supported by subsidy and support schemes, decreasing the likelihood of loan losses for banks. This, together with the lower loss rates observed over time, may be an argument in favour of differential treatment of the sector with regard to applicable risk weight.

3. Analysis of the effectiveness and appropriateness of the proposed measure

The purpose of the proposed adjustment is to reflect the lower level of riskiness of agricultural CRE exposures in the risk weights applicable to these exposures, while keeping the risk weights at a higher level for all other CRE exposures to mitigate the substantial risks to financial stability associated with them.

Under Article 124(2) of the CRR, the designated authority has to periodically, and at least annually, assess whether the risk weight of 50% for exposures secured by mortgages on commercial immovable property referred to in Article 126 of the CRR located in one or more parts of the territory of the Member State of the relevant authority is appropriately based on (i) the loss experience of exposures secured by immovable property and (ii) forward-looking immovable property markets developments. These factors are specified in more detail in **Commission Delegated Regulation (EU) 2023/206**.⁶ Where, on the basis of the assessment, the authority concludes that the risk weights set out in Article 126 do not adequately reflect the actual risks related to exposures to one or more property segments fully secured by mortgages on commercial immovable property located in the territory of the Member State of the relevant authority, and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in its Member State, it may increase the risk weights applicable to those exposures. In the case of Norway, the increased risk weights reflect the fact that the standard risk weight of 50% is not deemed to be appropriate for CRE exposures based on their loss experience and forward-looking CRE market developments. However, given the different risk characteristics of agricultural CRE exposures, the Norwegian Ministry of Finance deems it appropriate to use the standard 50% risk weight for these exposures.

The risk weight measure, with the proposed exclusion of agricultural CRE exposures, is assessed as appropriate for addressing the risks associated with the CRE exposures of SA banks. Lowering the applicable risk weight of agricultural CRE to 50% would reflect the lower loss experience of agricultural CRE exposures and the reduced credit risk of the agricultural sector given its eligibility for state subsidy and support

⁶ 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, pp. 1-5).

schemes. In the current economic climate, characterised by high uncertainty overall, but particularly so for the CRE market, it is appropriate to maintain the risk weight for non-agricultural CRE exposures at its current level. A reduction of the risk weights across the board would diminish resilience in the banking sector and might lead to increased lending in the sector. If there are any changes in the relevant loss experience data or the macro-financial environment and its associated risks, the calibration of the risk weight should be reviewed.

The ESRB is of the view that the measure is effective and proportionate. The Norwegian Ministry of Finance considers that since the measure was implemented in 1989 it has proved to be effective in ensuring prudent risk management by credit institutions. It has also increased loss absorbency for a subset of exposures for which heightened vulnerabilities have been identified. Other Member States that have experienced comparable CRE market developments and identified similar vulnerabilities have also set a higher risk weight for CRE exposures, pursuant to Article 126(1) of the CRR. The exclusion of agricultural CRE exposures from the measure is justified by the different risk characteristics of this sub-sector and will not significantly impact the measure's effectiveness. While the proposed adjustment would lower the loss absorbency requirements for this particular subset of exposures, overall capital requirements should only marginally decrease for Norwegian banks. As the change is considered to have a non-significant impact on the financial system in general, the proposed measure is assessed as being consistent with previous and current policy overall.

The measure does not overlap with the other macroprudential policy tools used by the Norwegian authorities. The few other instruments which target – or partially target – CRE risks in Norway have different functions. The systemic risk buffer, currently set at 4.5% for domestic exposures in Norway, is a broad measure which targets the inherent systemic risk in the entire banking system and is calibrated on the basis of current risk weights. The countercyclical capital buffer, currently set at 2.5%, primarily reflects the assessment of cyclical vulnerabilities in the broader financial system for a wide range of relevant credit exposures. The application of a higher risk weight for SA banks pursuant to Article 124(2) of the CRR should ensure additional loss absorbency for a targeted subset of exposures for which particular vulnerabilities have been identified. In addition, a risk weight floor of 35% for CRE exposures is also in place pursuant to Article 458 of the CRR, and is a backstop that only affects IRB banks. Although this floor is significantly lower than the risk weight set for SA banks, it may be justified by the additional scrutiny that IRB methodologies are subject to and the heterogeneity of banks' CRE portfolios. In addition, according to the Norwegian authorities the risk weights actually applied by IRB banks to CRE exposures are, on average, much higher than the floor.

Conclusion

The ESRB is of the view that it is appropriate, effective and proportionate to exclude the agricultural CRE exposures of SA banks from the scope of the current measure pursuant to Article 124(2) of the CRR. The change would not materially reduce the effectiveness of the measure and the resilience of the affected banks against the targeted risk. Under the current circumstances the adjusted measure does not entail disproportionate adverse effects on financial stability in either Norway or the EEA, nor is it expected to form or create an obstacle to the proper functioning of the internal market.

The ESRB encourages the Norwegian designated authority to monitor and periodically reassess the situation, adjusting the risk weights in line with changes in systemic risks. This is even more important in the light of the high degree of uncertainty in the current macro-financial environment. The ESRB recalls that the Norwegian Ministry of Finance is obliged under Article 124(2) of the CRR to periodically, and at least annually, assess the appropriateness of the risk weights set out in Article 126 of the CRR. If these do not adequately reflect the actual risks related to the exposures, and if it is considered that their inadequacy could adversely affect current or future financial stability in Norway, the designated authority should consider adjusting the risk weights accordingly.