Notification template for borrower-based measures

Please send/upload this template to:

- macropru.notifications@ecb.europa.eu when notifying the European Central Bank (ECB);
- DARWIN/ASTRA when notifying the European Systemic Risk Board (ESRB).

This notification will be made public by the ESRB once the relevant authorities have adopted and published the notified macroprudential measure[1].

E-mailing/uploading this template to the above addresses constitutes 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 the information to be read electronically.

1. Notifying national authority and scope of the notification		
1.1	Name of the notifying authority	*Latvijas Banka*
1.2	Country of the notifying authority	*Latvia*
1.3	Type of borrower-based measure	Please select one of the measures listed below: ☒ Debt-service-to-income (DSTI) ☐ Loan-to-income (LTI) ☒ Loan-to-value (LTV) ☒ Debt-to-income (DTI) ☐ Loan maturity ☒ Other (please provide a short, name-like description here and provide more details in Section 2) *Quantitative requirement regarding the creditworthiness assessment process (for natural persons that derives income from real estate transactions including buy-to-let (BTL)) where income from the real estate cannot exceed 70 % of the total income is changed to qualitative principle-based requirement to treat this kind of borrower's income prudently. Also, quantitative requirement where*

[1] On request by the notifying authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

		declared income in the creditworthiness assessment from consumers' actions relating to real estate cannot exceed 20 % of the total income and the amount of the loan for which the borrower has applied for cannot exceed 70 % of the market value of the loan collateral is changed to qualitative principle-based requirement to apply prudent LTV in case a substantial amount of consumers' income is generated from activities with real estate.
1.4	Type of notification	What do you intend to notify? ☐ Activation of a new measure ☒ Change to an existing measure ☐ Extension of an existing measure ☐ Termination of an existing measure
2.	**Description of the measure**	
2.1	Description of the measure	Provide a detailed description of the measure, including: - The nature and value(s) of the restrictions imposed by the measure, as applicable. If the measure varies depending on certain characteristics of the loan or borrower, please specify all such cases. - Whether exceptions from the measure are allowed. If so, please specify the nature and size(s) of the exceptions, as applicable. *(1) Differentiated (alleviated) 45% DSTI and 8 times DTI limits are introduced in addition to the already existing 40% DSTI and 6 times DTI limits. The alleviated 45% DSTI and 8 times DTI limits are applicable to the mortgage loans for obtaining energy efficient housing with the Energy Efficiency Certificates (hereinafter – EEC) of classes A+, A, B or C.* *The alleviated DSTI and DTI limits are included in the scope of the tolerance margin – 10% of the newly issued loans to borrowers' in one quarter may exceed (sum of) DSTI, DTI, loan maturity and LTV limit for buy-to-let loans.*

		(2) 70% LTV requirement for the BTL (or otherwise deriving income from real estate transactions by the borrower) housing loans is included in the scope of the BBMs to which 10 % tolerance margin is applicable. *(3) 70% LTV requirement for housing loans, if the borrower's income from real estate exceeds 20% of the total income, is revoked. Instead, a qualitative principle-based requirements is in place to apply prudent LTV for such borrowers.* *(4) The requirement stating that up to 70% of borrower's income generated from the operations with real estate can be accounted for in the creditworthiness assessment of the borrower is revoked and changed to qualitative principle-based requirement to treat this kind of borrower's income prudently.* *Please note that amendments (2), (3) and (4) are essentially a revision of already existing measures in order to make them more flexible. The existing 70 % LTV for loans to natural persons that derives income from real estate transactions (including BTL) remains in place.*
2.2	Definition of the measure	Please provide a detailed definition of each variable used in the construction of the indicator which is subject to the restrictions, as applicable (e.g. define what constitutes the value of the loan (L) and what counts towards valuation of the collateral (V) for an LTV indicator). Please include: a) Value of the loan/debt (for loan/debt-to-income), or value of the loan/debt instalments (for loan/debt service-to-income indicators) - What types of loans are included? b) Value of the collateral - What type of collateral can be included? c) Income - Is it gross or net income? What types of incomes are considered? If average income is considered, how long is the period considered? *Definitions of variables have remained unchanged.*

2.3	Legal basis and process of implementation of the measure	Specify the legal basis and process of implementation of the measure. Please include: - how the notified measure is implemented; - whether or not the notified measure is legally binding (e.g. a recommendation); o if the measure is non-legally binding, please provide the reasons why this choice was made and provide details of the means by which compliance with this measure can be fostered. *The measures are implemented via amendments in the Regulation of Latvijas Banka for Credit Risk Management (Regulations No 265 of 18 December 2023) (hereinafter – the Regulation). Respective Regulation of Credit Risk Management is issued pursuant to Sections 34.[2] (4) and 55 of the Credit Institution Law. Previously this Regulation was the Financial and Capital Market Commission (hereinafter - the FCMC) Regulation for Credit Risk Management (Regulation No 242 of 22 December 2020). The FCMC is integrated in Latvijas Banka as of 1 January 2023.* *Adjusted measures are legally binding and applicable as of 1 January 2024.*
2.4	Coverage	a. Which types of credit providers will be covered by the measure? e.g. credit institutions (including local branches of foreign credit providers), certain other financial institutions (e.g. pension funds, insurance companies, investment funds), etc. Please specify whether coverage of the measure is limited based on the type of activity of the credit provider, e.g. to mortgage credit providers. *The coverage is unchanged and applies to locally authorised credit institutions as well as those located in other Member States that are authorized to provide financial services in the Republic of Latvia via branch or via direct cross-border activities (as per General Goods Provisions (Freedom of Establishment and Freedom to Provide Services)).*

		In cases where locally authorised credit institution is authorised to provide financial services in other Member States with already applicable local BBMs, the BBMs covered in the Regulation does not apply to avoid overlap.
		b. Which types of borrowers will be covered by the measure? e.g. only natural persons, only legal entities, both natural persons and legal entities, etc. *The BBMs affected by this amendment are applicable only to natural persons.*
		c. Which types of lending will be covered by the measure? e.g. mortgage loans, consumer loans that are provided to consumers with a mortgage, consumer loans, debt securities issued and overall debt of non-financial companies, etc. *The amendment will cover new residential mortgage loans issued after 1 January 2024.*
2.5	Calibration	Provide information on how the measure was calibrated, including the main assumptions used therefor. *Measures were calibrated considering various aspects such as their aim, the actual state of the living fund and developments in the real estate market, including calculations of housing affordability and utility expenses under different scenarios for energy efficient vs energy in-efficient housing. The recent spike in the energy prices proved that utility expenses for energy in-efficient housing may soar rather significantly, and, moving forward, owners of the energy in-efficient housing are more prone to the risk of higher expenses on energy (for example via higher tariffs on carbon intensive energy sources). Important aspect which was considered in the calibration was preserving the solvency of borrowers – an aim was to strive for the balance between adequate stimulus and sound safeguards for credit risk.* *Taking into account the actual state of the living fund (only 15% are houses with EEC with C class or higher (out of F to A+)), as well as the necessity to promote not*

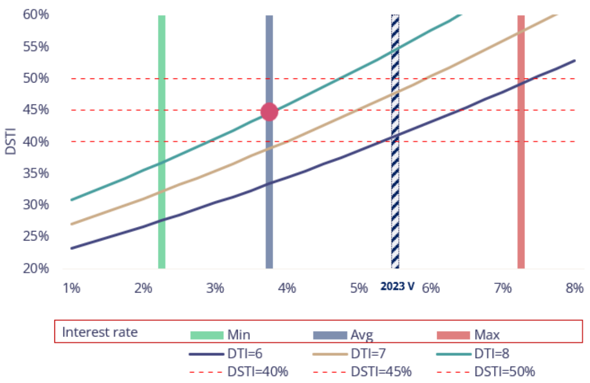
		only new construction of housing, but also renovation, it was decided that adequate scope for alleviations would be housing with an EEC of C class and above. *Alleviation for DSTI was calibrated calculating monthly savings on heating expenses for energy efficient vs equivalent energy in-efficient housing, then relating these savings to average income, thereby obtaining a proxy for a potential DSTI alleviation, which in principle does not impair credit risk. While there are many factors which impact saved costs, we tried to base calculations on the most typical average housing characteristics (e.g. 60 m^2 serial apartment in Riga, heating tariffs set in Riga (actual, average and the highest (in the period from beginning of 2019)), income 1000 EUR (close to average net 1006 EUR wage in 2022)).* *The heating expenses for renovated energy efficient apartment (of class C) were compared with the heating expenses for the equivalent apartment, which is energy in-efficient (of class F), basing on the energy consumption per m^2 in the respective houses. The obtained results of savings on heating expenses were cross checked with the similar calculations by the state-owned development finance institution Altum, which provides financing for improving energy-efficiency of housing. Furthermore, the simulations were performed under different heating tariff scenarios (incl. historically highest and average tariffs since year 2019).* *The saved costs on heating (under three different tariff scenarios) related to the average income gave an indication about the extent of the potential alleviation. Depending on the scenario (the extent of the savings), the alleviated DSTI could be set respectively in the range from 42% to more than 48%. The balanced option of 45% was chosen considering:* *(i) costs of the renovation additional to the credit payments (rising interest rates – more importance on the renovation credit),*

(ii) DSTI at 50% is considered a very high-risk for borrowers' liquidity (average net salary is low, DSTI is not stressed),

(iii) higher DSTI is more relevant in high interest rate environment but should be balanced in the through-the-cycle structural approach.

To use benefits from the adjusted DSTI, DTI requirement should be adjusted accordingly, also considering the changing interest rates in the financial cycle. Knowing the link between DSTI and DTI variables under certain interest rate, loan maturity and loan payment schedule assumptions, it was found that DTI of 8 times would be a balanced option, which then allow to use alleviated DSTI through the different interest rate development scenarios through-the-cycle.

DTI and DSTI if loan maturity is 30 years



Our calculations support DTI up to 8 in a scenario where maturity is at its maximum of 30 years and when fixed annuity payments method is used for monthly payments.

Considerations underlying the decision towards DTI up to 8 is:

- *(i) policy support calls for DTI up to 8,*
- *(ii) through-the-cycle structural approach (appropriateness and timing),*
- *(iii) our DTI is not LTI (includes all debt) and therefore already is rather limiting.*

3. Timing for the measure

3.1	Timing for the decision	What is the date of the official decision of the notified measure? 18/12/2023
3.2	Timing for publication	What is the date of publication of the notified measure? 22/12/2023 *Publication in the Official gazette of the Republic of Latvia "Latvijas Vēstnesis".*
3.3	Disclosure	Provide information about the strategy for communicating the notified measure to the market. Please provide a link to the public announcement, if any. *The Regulation is published in the Official gazette of the Republic of Latvia "Latvijas Vēstnesis":* *https://www.vestnesis.lv/op/2023/248.34* *A press release is available:* *https://www.bank.lv/en/news-and-events/news-and-articles/news/16756-latvijas-banka-reviews-regulation-on-credit-risk-management* *The overview of above mentioned BBMs will be available in the following days on Latvijas Banka homepages' dedicated section:* *https://www.bank.lv/en/operational-areas/financial-stability/macroprudential-measures/borrower-based-measures*
3.4	Timing for the application	What is the intended date for application of the measure? What is the intended timeline for phase-in of the measure, if relevant? 01/01/2024
3.5	End date (if applicable)	Until when is it presumed that the measure will be in place? If applicable, please give an end date. Click here to enter a date. *Not applicable.*
4. Reason for activation of the measure		

4.1	Description of the macroprudential risk	Describe the macroprudential risk to be addressed by the proposed macroprudential measure. *The macroprudential risk addressed by these amendments has not changed – the BBMs were introduced to strengthen the resilience of credit institutions and to protect borrowers from potential future shocks, thus contributing to the financial stability.* *In addition to the above-mentioned risk the differentiated DSTI and DTI limits are targeted to address sustainability considerations, including the collateral and solvency risks of borrowers and risk of stranded assets, in case the investments continue to be accumulated in energy efficient housing. If not appropriately accounted for, these risks can materialise in the future and impair financial stability.*
4.2	Indicators used for activation of the measure	Provide the indicators triggering activation of the measure. Provide the data on which the decision is based if possible (preferably in an Excel file). *Please see our calibration considerations in Point 2.5.*
4.3	Effects of the measure	Provide your assessment of the effects of the measure on your domestic banking system, other parts of the financial system, the real economy and financial stability in your country. *These amendments are expected to contribute to a structural shift in demand for energy efficient housing and reverse the trend observed during the past couple of years when demand for cheaper and energy less efficient housing exceeded the demand for energy efficient housing as affordability of the later decreased due to raising building costs and interest rates, as well as sluggish construction and renovation activity.* *The alleviated DSTI and DTI limits will improve affordability of housing loans; however, in the meantime they will continue to safeguard prudent lending standards. Mortgage lending has been rather sluggish*

		recently and over the last decade, and household debt is low, thereby the alleviated limits could provide some stimulus to the lending development. *Structural shift towards energy efficient housing would improve quality and sustainability of the living fund, thereby contributing to the sustainability goals of the country, as well as to living conditions and lower utility expenses of households.* *The borrowers and the banking sector (housing is an important asset for many households and substantial collateral in the banking sector) are expected to decrease exposure to physical and transition climate risks.*
5.	**Sufficiency, consistency and non-overlap of the policy response**	
5.1	Sufficiency of the policy response	For a macroprudential policy to be 'sufficient', the policy responses must be deemed to significantly mitigate, or reduce the build-up of, risks over an appropriate time horizon with a limited unintended impact on the general economy. Note that the ESRB will use this assessment of the macroprudential stance as relevant input in assessing the sufficiency of the macroprudential policy in the Member State. Please provide any additional information that the ESRB should consider in assessing the sufficiency of the policy response. *As already explained in Point 2.5., non-macroprudential structural policy measures should be primarily used for the underlying causes; however, the alleviated DSTI and DTI limits could contribute to the structural shift in demand for energy efficient housing from the macroprudential perspective and have a signalling effect.* *The alleviations were designed considering both the aim to contribute to the structural shift towards sustainable housing, and the aim not to increase credit risk, therefore the calibrated measures reflect balance between these targets.*

5.2	Consistency of application of the policy response	For a macroprudential policy to be 'consistent', the policy instruments must be deemed to meet their respective objectives, as outlined in ESRB/2013/1[2], and they must be implemented in accordance with the common principles set out in the relevant legal texts. Note that the ESRB assessment of consistency will consider whether the same systemic risks are addressed in a similar way across and within the Member States over time. Please provide any additional information that the ESRB should consider in assessing the consistency of the policy response. *The intermediate objectives (mitigation and prevention of excessive credit growth and leverage) as specified in the ESRB recommendation ESRB/2013/1 remains unchanged also with these amendments.*
5.3	Non-overlap of the policy response	For a policy instrument to be 'non-overlapping', it should aim to address a systemic risk that either differs from the risk addressed by other active tools in the same Member State, or to be complementary to another tool in that Member State which addresses the same systemic risk. - Are other policy instruments used to address the same systemic risk? - If yes, please explain the need for more than one instrument to address the same systemic risk and how the different instruments interact with each other. *Currently there are no other macroprudential instruments used to address the same risk.*
6. Cross-border and cross-sector impact of the measure		

[2] Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1) (OJ C 170, 15.6.2013, p. 1).

6.1	Assessment of cross-border effects and the likely impact on the Internal Market (Recommendation ESRB/2015/2[3])	Assessment of the cross-border effects of implementation of the measure. a. Assessment of the spillover channels operating via risk adjustment and regulatory arbitrage. The relevant indicators provided in Chapter 11 of the ESRB Handbook on Operationalising Macroprudential Policy in the Banking Sector[4] and the [Framework to assess cross-border spillover effects of macroprudential policies] of the ECB Task Force on cross-border spillover effects of macroprudential measures can be used. b. Assessment of the: ○ cross-border effects of implementation of the measure in your own jurisdiction (inward spillovers); ○ cross-border effects on other Member States and on the Single Market of the measure (outward spillovers); ○ overall impact on the Single Market of implementation of the measure. *Cross-border effects and impact on the internal market is expected to be non-material as the cross-border activities within EU of the largest Latvian credit institutions are rather limited. Overall, 92 % in Q3 2023 of the total housing portfolio is issued to local residents (with the collateral residing in Latvia).* *Furthermore, it should be taken into account that the differentiated DSTI and DTI will refer to relatively small part of the existing housing as according to Latvijas Banka's estimates the housing EEC certificates with energy efficiency classes C and above constitutes only 15% of the total living fund.*
6.2	Assessment of leakages and regulatory arbitrage within the notifying Member State	Referring to your Member State's specific characteristics, what is the scope for "leakages and regulatory arbitrage" in your own jurisdiction (i.e. circumvention of the measure/leakages to other parts of the financial sector)? Is there scope for "leakages and regulatory arbitrage" in other jurisdictions? *As described in Point 2.4., the BBMs are applicable to both locally authorised credit institutions, and the credit*

[3] Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/3) (OJ C 97, 12.3.2016, p. 9).
[4] Available on the ESRB's website at www.esrb.europa.eu.

		institutions located in other Member States that are authorized to provide financial services in the Republic of Latvia via branch or via direct cross-border activities (as per General Goods Provisions (Freedom of Establishment and Freedom to Provide Services)), therefore the regulatory arbitrage is considered as minimal. The BBMs are applicable at the highest consolidation level in Latvia, therefore possibility of leakages is minimal. Non-bank lenders, outside the scope of any banking group, constitute less than 8% of total domestic private non-financial loan portfolio (Q2 2023).
6.3	Request for reciprocation	Do you intend to ask the ESRB to issue a recommendation to other Member States to reciprocate the measure? No - If yes, please provide in Section 6.4 the justification for that reciprocity. - If no, what are the reasons for not requesting reciprocation? *The scope of BBMs already includes direct cross-border lending and lending through local branches of credit institutions authorised in other Member States, therefore reciprocation is not necessary.*
6.4	Justification for the request for reciprocation	To request reciprocation, please provide the following: a. a concise description of the measure to be reciprocated; b. the financial stability considerations underlying the reciprocity request, including the reasons why the reciprocity of the activated measure is deemed necessary for its effectiveness; c. the proposed materiality threshold and justification for that level. If the ESRB deems the request for reciprocation to be justified, the description provided will form the basis for translation into all EU official languages for the purposes of an update of ESRB Recommendation 2015/2.

		Not applicable.
7.	**Miscellaneous**	
7.1	Contact person(s)/mailbox at notifying authority	*Kristina Bojare, phone +371 67022128, kristina.bojare@bank.lv*
7.2	Any other relevant information	*Not applicable.*
7.3	Date of the notification	Please provide the date on which this notification was uploaded/sent. 04/01/2024