# Compliance report

## September 2023

Country-specific Recommendations of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Belgium (ESRB/2019/4), Denmark (ESRB/2019/5), Luxembourg (ESRB/2019/6), the Netherlands (ESRB/2019/7), Finland (ESRB/2019/8) and Sweden (ESRB/2019/9), respectively

ESRB
European Systemic Risk Board
European System of Financial Supervision

# Contents

# 1 Introduction and summary of findings

**This report provides the third and final assessment[1] of the implementation of the European Systemic Risk Board's (ESRB) country-specific Recommendations on medium-term vulnerabilities in the residential real estate (RRE) sector in:**

1. **Belgium (ESRB/2019/4)[2] – with respect to Recommendation A;**
2. **Denmark (ESRB/2019/5)[3] – with respect to Recommendations A, B and C;**
3. **Luxembourg (ESRB/2019/6)[4] – with respect to Recommendations B and C;**
4. **the Netherlands (ESRB/2019/7)[5] – with respect to Recommendations B, C and D;**
5. **Finland (ESRB/2019/8)[6] – with respect to Recommendations B;**
6. **Sweden (ESRB/2019/9)[7] – with respect to Recommendation A and B;**

**(the "Recommendations") by their addressees.**

**All the Recommendations concern medium-term vulnerabilities in the RRE sector. For ease of comparability and to ensure consistency in the assessment of compliance a single combined compliance report has been produced.**

**Recommendations issued by the ESRB are not legally binding, but are subject to an "act or explain" mechanism in accordance with Article 17 of the ESRB Regulation.[8]** This means that the addressees are under the obligation to inform the European Parliament, the Council, the European Commission and the ESRB of the actions they have taken to comply with the Recommendations or to provide an adequate explanation for their inaction.

**The report assesses addressees' compliance with the Recommendations, or their explanation for inaction, based on their submissions to the ESRB Secretariat using a**

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1 The compliance report covers the assessment of the follow-up reports that were due by 31 October 2022. The **first compliance report** covered the assessment of the first follow-up reports that were due by 31 October 2020 and the **second compliance report** covered the assessment of the follow-up reports that were due by 31 March 2021 and subsequently by 31 October 2021.

2 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Belgium** (ESRB/2019/4) (OJ C 366, 30.10.2019, p. 1).

3 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Denmark** (ESRB/2019/5) (OJ C 366, 30.10.2019, p. 7).

4 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Luxembourg** (ESRB/2019/6) (OJ C 366, 30.10.2019, p. 14).

5 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in the Netherlands** (ESRB/2019/7) (OJ C 366, 30.10.2019, p. 22).

6 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Finland** (ESRB/2019/7) (OJ C 366, 30.10.2019, p. 29).

7 **Recommendation of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Sweden** (ESRB/2019/7) (OJ C 366, 30.10.2019, p. 35).

8 **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** (OJ L 331, 30.4.2018, p. 1).

**dedicated template**. In accordance with Section 2(3) of the respective Recommendations, addressees were requested to provide the ESRB with a report explaining the measures taken to comply with the respective Recommendations or to provide an adequate explanation for inaction by 31 October 2022. For this purpose, the ESRB circulated reporting templates for the Recommendations to the addressees, who completed the templates and returned them to the ESRB.

**The assessment of compliance with the Recommendations was carried out by an Assessment Team** composed of six assessors, including one Chair, designated by the Advisory Technical Committee (ATC) (see Annex I of this report).

The assessment was conducted by duly taking into account:

- the criteria contained in Section 2(2) of the respective Recommendations;
- the methodology set out in the Handbook on the assessment of compliance with ESRB recommendations – April 2016 (the "Handbook"),[9] which describes the procedure for the assessment of compliance with ESRB recommendations;
- the implementation standards prepared by the Assessment Team, which specify the grading of each sub-recommendation based on the compliance criteria (the implementation standards are provided in Annex III);
- the principle of proportionality.

This report reflects the implementation status as of October 2022. The assessment of compliance focuses on actions taken by the addressees during the reporting period. The backward-looking approach employed to assess the measures taken to implement the Recommendations means that the temporal scope of the assessment is limited. However, information received at a later stage during the discussion of the findings of the Assessment Team with the addressees of the Recommendations was also taken into consideration in the final results and is reflected in the description of the assessment of each addressee. The assessment took into account the economic and financial cycles of the addressees during the reporting period. Changes in these cycles have an impact on the measures recommended to the addressees to mitigate the identified vulnerabilities. As the assessment does not contain a forward-looking statement, the addressees are strongly encouraged to continue monitoring developments in these vulnerabilities and to take the necessary steps to address any vulnerabilities that are increasing, while assessing their position in the economic and financial cycles to determine whether the deployment of such measures would be appropriate.

**Overall, three of the six EU Member States were assessed as "fully compliant", two were assessed as "largely compliant" and one as "partially compliant".** The findings of the Assessment Team show that since the previous assessment round most addressees have implemented further actions to comply with the Recommendations, thus improving their overall grade.

9 **Handbook on the assessment of compliance with ESRB recommendations**, ESRB, April 2016.

The level of compliance must be viewed against the fact that, for a total of 18 sub-recommendations, actions were taken by the addressees to address 13 of them.
The Assessment Team considered that compliance with one of the sub-recommendations could not be assessed because its implementation was conditional on amendments to the legal framework required under another sub-recommendation, which had not been implemented by the addressee. In the remaining four cases, the addressees did not take any action. In two of these cases the inaction was considered “sufficiently explained”.

**The overall findings of the compliance assessment are summarised in the colour-coded table below.**

Table 1
**Overall findings**

| DRESSEE | OVERALL GRADE |
|---|---|
| BELGIUM | LC |
| DENMARK | PC |
| LUXEMBOURG | FC |
| THE NETHERLANDS | LC |
| FINLAND | FC |
| SWEDEN | FC |

*Note: FC (dark green) stands for “fully compliant”, LC (light green) for “largely compliant” and PC (orange) for “partially compliant”.*

A summary of the grades assigned to the content of respective recommendations/sub-recommendations is presented in the table below (actions are shown in green and inactions in orange).

Table 2
**Summary of grades**

| Policy recommendations | BE | DK | LU | NL | FI | SE |
|---|---|---|---|---|---|---|
| **1. Legal framework for borrower-based measures (BBMs)** | | | | | | |
| **2. Activation/tightening of BBMs** | A: LC | | | | | |
| 2.1. Pending the establishment/amendment of the legal framework: activation of non-legally binding BBMs | | | B(1): SE | | B(1): FC | |
| 2.2. After the legal framework is established/amended: activation of legally binding BBMs | | | B(2): LC | | B(2):N/A | |
| 2.3. Changes in the approach to the calibration of the measures | | | | B(1): IE | | |
| **3. Activation/tightening of capital-based measures** | | A: FC | | C: FC | | |
| 4.1. Monitoring of vulnerabilities | | B(1): FC | | | | B(1): FC |
| 4.2. Activation/tightening of macroprudential measures based on point 4.1 | | B(2): MNC | | | | B(2): SE |
| | | B(3): MNC | | | | B(3): FC |
| **4. Structural changes related to mortgage loans and the RRE sector** | | C: PC | C: FC | D: FC | | A: FC |

*Notes: The table presents the grades assigned to the content of the measures and not the overall grade for each recommendation or sub-recommendation. FC stands for "fully compliant", LC for "largely compliant", PC for "partially compliant", MNC for "materially non-compliant", SE for "sufficiently explained" and IE for "insufficiently explained". "N/A" indicates that the assessment was not carried out.*
**Legend: Action (green); Inaction (orange).*

The overall grades for each recommendation/ sub-recommendation are shown in the table below. Overall grades take into consideration not only the content of each recommendation and sub-recommendation, but also proportionality and reporting by the addressees.

Table 3
**Overall grades for each recommendation/sub-recommendation**

| Policy recommendations | BE | DK | LU | NL | FI | SE |
|---|---|---|---|---|---|---|
| **1. Legal framework for BBMs** | | | | | | |
| **2. Activation/tightening of BBMs** | A: LC | | | | | |
| 2.1. Pending the establishment/amendment of the legal framework: activation of non-legally binding BBMs | | | B(1): SE | | B(1): FC | |
| 2.2. After the legal framework is established/amended: activation of legally binding BBMs | | | B(2): LC | | B(2): N/A | |
| 2.3. Changes in the approach to the calibration of the measures | | | | B(1): IE | | |
| **3. Activation/tightening of capital-based measures** | | A: FC | | C: FC | | |
| 4.1. Monitoring of vulnerabilities | | B(1): FC | | | | B(1): FC |
| 4.2. Activation/tightening of macroprudential measures based on point 4.1 | | B(2): MNC | | | | B(2): SE |
| | | B(3): MNC | | | | B(3): FC |
| **4. Structural changes related to mortgage loans and the RRE sector** | | C: PC | C: FC | D: FC | | A:FC |

*Notes: The table presents the grades assigned to the content of the measures and not the overall grade for each recommendation or sub-recommendation. FC stands for "fully compliant", LC for "largely compliant", PC for "partially compliant", MNC for "materially non-compliant", SE for "sufficiently explained" and IE for "insufficiently explained". "N/A" indicates that the assessment was not carried out.*
**Legend: Action (green); Inaction (red).*

**In order to better reflect the qualitative differences in implementation provided for in the Recommendations, and thus the different metrics used for their respective assessments, the report is structured as follows.**

Part I outlines the policy objectives taken into account when drafting the Recommendations. Part II describes the methodology used to assess compliance with ESRB recommendations. Part III consists of country-specific assessments of compliance with the respective Recommendations by addressees. Part IV provides general remarks on all Recommendations.

Annex I lists the members of the Assessment Team. Annex II contains a list of abbreviations. Annex III provides the implementation standards for each country-specific recommendation and will be published as a separate document.

# 2 Policy objectives

**Vulnerabilities related to the RRE sector can be a source of systemic risk and may affect financial stability directly and indirectly.** In 2019 the ESRB concluded a systematic and forward-looking European Economic Area (EEA)-wide assessment of vulnerabilities related to the RRE sector, which identified  countries in which medium-term vulnerabilities related to the RRE sector that may be sources of systemic risk had not been sufficiently mitigated.[10] The ESRB subsequently issued Recommendations to six countries that had already received warnings in 2016[11] and issued five new warnings to countries where the vulnerabilities had been newly identified as not having been sufficiently addressed.[12]

**While the vulnerabilities assessment was particularly challenging owing to the impact of the COVID-19 pandemic, vulnerabilities remained elevated in all the countries that received the ESRB recommendations.** Up until 2022 house prices continued to increase in most cases, or even accelerated, meaning that the overvaluation of house prices was unchanged or it had increased. Consequently, there were signs of house price overvaluation in most of the countries assessed. Risks related to household indebtedness were also unchanged or had risen in several countries. This was partly driven by mortgage credit, which continued to grow in most cases. The current reversal of the trends marked by some indicators reflects the materialisation of cyclical risks and should not be seen as a reduction of vulnerabilities or their underlying causes, many of which are of a structural nature. Therefore, despite the change in the macroeconomic environment, authorities should consider taking further actions to address these vulnerabilities. The materialisation of risks opens new windows of opportunity for authorities to act, but any actions taken should be calibrated according to the stage of their real estate and financial cycle.

**According to the scoreboard calculated in line with Methodologies for the assessment of real estate vulnerabilities and macroprudential policies: residential real estate,** Belgium, Denmark, Luxembourg, the Netherlands and Sweden displayed pronounced risk in the collateral stretch, while Belgium and Luxembourg showed pronounced and medium risks, respectively, in the funding stretch. The scoreboard indicators for the household stretch suggested that Belgium displayed medium risk, while all the other countries had pronounced risk.

**As the identified vulnerabilities relating to RRE as a source of systemic risk are different across countries, the Recommendations contain different policy actions.**
The Recommendations are addressed to Member States and acknowledge that within a Member State different authorities may be responsible for the activation of the specific measures that are recommended. However, the assessment of compliance is considered as a single package and the final grade is awarded at the level of the Member State and not at the individual national authorities' level.

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10 See "**Vulnerabilities in the residential real estate sectors of the EEA countries**", ESRB, September 2019.

11 The countries to which recommendations were issued on 22 September 2016 were Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden and the United Kingdom.

12 The countries to which warnings were issued on 27 June 2019 were the Czech Republic, Germany, France, Iceland and Norway.

**As regards the implementation of the recommended structural changes related to mortgage loans and the RRE sector, the Assessment Team has not assessed the completeness of the measures or their ability to mitigate vulnerabilities arising from structural risks, but rather whether these measures are going in the right direction and will lead to a reduction in vulnerabilities.** As the assessment does not preclude the national authorities from concluding that further structural changes are needed, the addressees are strongly encouraged to continue monitoring risks stemming from the RRE sector and to review their policy framework in order to curb the structural factors that have driven the vulnerabilities identified as a source of systemic risk.

# 3 Assessment methodology

**The assessment of the implementation of the Recommendations (and of each of the recommendations and sub-recommendations contained therein) was carried out based on the "act or explain" mechanism in accordance with Article 17 of the ESRB Regulation and is consistent with the methodology used for the previous assessment conducted in 2020.**[13] Under this framework, the addressees of the Recommendations can either (i) act in response to each of the recommendations and sub-recommendations and inform the ESRB of such action, or (ii) take no action, provided that they can adequately explain that inaction. The Assessment Team then analyses the information provided and assesses whether the action taken achieves the objectives of each recommendation or whether the explanation provided for inaction is sufficient. This results in a final compliance grade being assigned to each addressee.

**The assessment was based on the submissions made by the addressees by the reporting deadlines specified in Section 2(3) of the Recommendations (31 October 2022) and on further dialogue between the Assessment Team and addressees during the assessment process.**

**The detailed procedure for the assessment of compliance is set out in the Handbook.** The assessment of the Recommendations was carried out by an Assessment Team composed of six assessors and one alternate, with one Chair, endorsed by the ATC[14] (see Annex I of this report). The Assessment Team conducted a four-eyes review, which means that compliance of each addressee was assessed by two assessors. In the first stage of the assessment, the assessors evaluated the compliance of the addressees with all recommendations and sub-recommendations. In the second stage of the assessment, the assessors studied the consistency of the assessments. Assessors were not directly involved in grading the performance of their own authorities. All the addressees were given the opportunity to provide further explanations and information, especially during the remedial dialogue phase.[15] The initial results were subsequently reviewed and cross-checked to prepare the final assessment.

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13 See **Summary compliance report – March 2021**, ESRB.

14 Through a written procedure (ATC/WP/2022/079).

15 The preliminary findings of the Assessment Team were shared and discussed with the addressees in March 2023.

# 4 Country-specific analyses

## 4.1 Belgium

Recommendation ESRB/2019/4 on medium-term vulnerabilities in Belgium's RRE sector was addressed to the Belgian national authorities entrusted with recommendation powers or the application of BBMs.

Compliance with Recommendation A – activation of legally binding BBMs – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being evaluated for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation ESRB/2019/4 contained only one recommendation addressed to the Belgian national authorities, Recommendation A, which refers to the activation of legally binding BBMs to prevent:

(a) a significant or an increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption following adverse economic or financial conditions or adverse developments in the RRE market; or

(b) a significant or an increasing share of new mortgage loans, secured by RRE, that could result in credit losses on these loans in the event of their default and a subsequent decrease in house prices.

In the previous assessment conducted in 2021, the Belgian national authorities were found to comply with the spirit and the final objective of the ESRB Recommendation to a large extent, despite the non-legally binding nature of the BBMs. Therefore, the Belgian authorities were assessed as largely compliant with Recommendation A.

The weightings applied to Recommendation A for Belgium are shown in the table below. Content was weighted 3/4, while reporting and proportionality were assigned a weight of 1/8 each. The implementation standards for Belgium are presented in Annex III, which will be published as a separate document.

Table 4
**Individual weighting**

| Recommendation A | Weighting |
|---|---|
| **Activation of BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

Based on the findings of the assessment, the overall level of compliance with Recommendation ESRB/2019/4 was:

Table 5
**Overall grade**

| Fully compliant | **Largely compliant** | Partially compliant | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

Box 1
## Recommendation A – Activation of legally binding BBMs

### Final grade

Based on the findings below, the overall level of compliance with recommendation A was **largely compliant.**

The content of the measures applied to implement the recommended actions was assessed as largely compliant, proportionality was assessed as fully compliant, and reporting as fully compliant.

Table 6

**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Largely compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Recommendation A*** | *Largely compliant* |

Based on ESRB Recommendation (ESRB/2019/4) requirements, the Belgian authorities were recommended to activate legally binding BBMs to address vulnerabilities in the RRE sector. To comply with these requirements, on 23 October 2019 the Nationale Bank van België/Banque Nationale de Belgique (NBB/BNB), as the macroprudential authority, published a Circular on supervisory expectations on the internal management of Belgian mortgage credit standards (Circular NBB/2019/27), which remains in force and has not yet been amended.

The main objectives of the supervisory expectations are to limit the accumulation of vulnerabilities on Belgian mortgage portfolios while further improving the quality of credit granted by curbing the share of high-risk loans in new Belgian mortgage loans and maintaining access to the mortgage market for solvent borrowers. The circular applies to all banks and insurance undertakings (governed by Belgian law or established as branches) operating in the Belgian mortgage market. A compliance report is requested from all institutions with a domestic mortgage loan stock of at least €1 billion (representing a market share of around 0.4%). Institutions must explain the reasons for non-compliance with these expectations according to the “act or explain” principle. The supervisory expectations of the NBB/BNB have been applicable since 1 January 2020 to all banks and insurance undertakings (governed by Belgian law or established as branches) operating in the Belgian mortgage market with the aim of ensuring a level playing field. According to the Belgian authorities, the first two compliance reports (for the second half of 2020 and 2021), signed and approved by both the institution’s Executive Board/Committee and Board of Directors, have already been received. Compliance reports on annual production will continue to be requested for subsequent years. The implemented measures aim to improve the quality of the new loans granted, ensuring that the average portfolio quality remains sufficient. Different thresholds are set for different sub-segments (buy-to-let (BTL) loans, owner-occupied loans for first-time buyers, owner-occupied loans for other borrowers). Some expectations are also expressed on the presence of pockets of risk in new production, namely loans combining a high loan-to-value (LTV) ratio (above 90%) and another risk indicator (ratios comparing debt service and total debt to the borrower's disposable income) exceeding a certain threshold. As creditworthy borrowers should be able to take out a loan, sufficient flexibility is built into the expectations that institutions should be able to take into account the full profile of the borrowers as well as any mitigating factors when deciding whether to grant credit. Such flexibility lies, inter alia, in introducing tolerance margins (proportions of production tolerated above the applicable thresholds) and the “act or explain” principle. The NBB/BNB does not expect any significant leakage or regulatory arbitrage but will continue to monitor the Belgian mortgage market to detect any potential circumvention. It also considers unintended consequences to be unlikely and does not expect mortgage credit growth to be substantially affected. Recent credit figures evidence the first signs of a decreasing trend in new credit operations as a result of rising interest rates and economic uncertainties. The overall impact will depend on the ability of borrowers to adapt to the institutions’ amended credit policies, the evolution of house prices and the macroeconomic environment. The addressee also notes that developments since the beginning of 2020 should be analysed with due caution as they have been impacted by the elimination of a generous fiscal advantage in Flanders (the “Woonbonus”) in early 2020.

The NBB/BNB does not expect the supervisory expectations to have a significant impact on RRE prices. Nominal prices rose further in the first half of 2022, albeit at a slightly slower pace than in 2021, while real prices are no longer rising in the context of high inflation.

The release of a circular, as a non-legally binding instrument, does not comply with the specific requirement of activating a legally binding BBM. While the supervisory expectations have led to a material improvement in the quality of the new mortgage production by reducing the share of loans with a high LTV, the share of high LTV ratios for the BTL segment (LTV > 80%) in 2021 was still larger than the tolerance margin set by the NBB/BNB. However, BTL loans are typically reserved for customers with substantial financial assets, which would limit the impact in the event of a market shock. According to the addressee, a non-legally binding instrument – and the related “act or explain” mechanism – provides some flexibility by allowing financial collateral to be considered when granting BTL loans to “upscale” clients. Further, a non-legally binding instrument also maintains access to credit for young borrowers through the tolerance margin.

Nevertheless, compliance with the supervisory expectations should be closely monitored by the NBB/BNB, and, in the event of non-compliance, the Belgian authorities should consider implementing legally binding BBMs.

In conclusion, while the addressee has implemented Recommendation A under a different legal form, as non-legally binding BBMs, the material decline of high LTV ratios achieved through a non-legally binding measure is considered to be aligned with the spirit and the objectives of the ESRB Recommendation.

The NBB/BNB also submitted the follow-up report on behalf of the Belgian Minister of Finance. The addressee provided a follow-up report on the assessment of the implementation of Recommendation A by 31 October 2022. A formal compliance report is only requested from institutions with a domestic mortgage loan stock of at least €1 billion (representing a market share of around 0.4%) and proportionality is therefore also considered for reporting. Thus, the addressee was assessed as fully compliant for proportionality and reporting.

Based on the findings above, the overall level of compliance with Recommendation A was **largely compliant**.

## 4.2 Denmark

Recommendation ESRB/2019/5 on medium-term vulnerabilities in the RRE sector in Denmark was addressed to the macroprudential authority, the designated authority, or the competent authority in Denmark, as applicable, the Danish national authorities entrusted with the monitoring of systemic risks, and the Danish authority entrusted with the activation of BBMs.

Compliance with Recommendation A – Activation or tightening of capital-based measures – and recommendation B – Monitoring of vulnerabilities and activation or tightening of BBMs – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being assessed for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation C – Structural changes related to mortgage loans and the RRE sector – is being assessed for the first time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation A refers to the activation of additional, or the tightening of existing, capital-based measures to ensure the resilience of credit institutions to the potential materialisation of RRE-related systemic risk that could lead to direct and indirect credit losses stemming from mortgage loans or to a decrease in consumption by households.

Recommendation B consists of three sub-recommendations:

Sub-recommendation B(1) refers to the close monitoring of vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards for new mortgage loans over the medium term, including by:

(a) assessing – using loan-level data for new mortgage loans – the ability of borrowers taking out new mortgage loans to withstand adverse economic or financial conditions or adverse developments in the RRE market;

(b) assessing the sustainability of house prices and their potential to fall in the event of adverse economic or financial conditions.

Sub-recommendation B(2) refers to the tightening of existing, or the activation of additional, BBMs, if the results of the monitoring carried out under point (a) of Sub-recommendation B(1) provide evidence that a significant or increasing share of borrowers taking out new mortgage loans might not be able to service their debt or maintain consumption under adverse economic or financial conditions, or following adverse developments in RRE markets.

Sub-recommendation B(3) refers to increasing the legally binding minimum down payment requirement, if the results of the monitoring carried out under point (b) of Sub-recommendation B(1) provide evidence that the overvaluation of house prices has increased, in order to ensure that collateral for new mortgage loans is sufficient to cover credit losses corresponding to the potential decrease in house prices under adverse economic or financial conditions and the estimated decrease in house prices in the event of a negative scenario.

Recommendation C refers to reviewing policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Denmark as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt or cause excessive growth in house prices and mortgage debt.

In the previous assessment conducted in 2021, the overall grade of compliance of Danish addressees with Recommendation ESRB/2019/5 was largely compliant. Recommendation A and Sub-recommendation B(1) were assessed as fully compliant, while Sub-recommendations B(2) and B(3) were assessed as materially non-compliant.

The follow-up report was submitted by the Danish Ministry of Industry, Business and Financial Affairs. The follow-up report on the assessment of implementation of Recommendation A, Sub-recommendations B(1), B(2) and B(3) and Recommendation C of Recommendation ESRB/2019/5 was provided by 31 October 2022.

The weightings applied to the different recommendations and each of the sub-recommendations for Denmark are presented in the table below. Overall, equal weights were assigned to recommendations A, B and C. Equal weights were also assigned to Sub-recommendations B(1), B(2) and B(3). At the level of each recommendation and sub-recommendation, content was weighted 3/4, while proportionality and reporting were each assigned a weight of 1/8.

Table 7
**Individual weighting**

| Category | Weighting |
|---|---|
| **Recommendation A** | 1/3 |
| **Recommendation B(1)** | 1/9 |
| **Recommendation B(2)** | 1/9 |
| **Recommendation B(3)** | 1/9 |
| **Recommendation C** | 1/3 |
| **Recommendation A** | Weighting |
| **Activation or tightening of capital-based measures** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(1)** | Weighting |
| **Monitoring of vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(2)** | Weighting |
| **Activation or tightening of BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(3)** | Weighting |
| **Increase of the legally binding minimum down payment requirement** | 3/4 |

| Category | Weighting |
|---|---|
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation C** | Weighting |
| **Structural changes related to mortgage loans and the RRE sector** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

The implementation standards for Denmark are set out in Annex III, which will be published as a separate document.

Based on the findings of the assessment, the overall level of compliance with Recommendation ESRB/2019/5 was:

Table 8

**Overall grade**

| Fully compliant | Largely compliant | | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

Box 2

## Recommendation A – Activation or tightening of capital-based measures

### Final grade

Based on the findings below, the overall level of compliance with Recommendation A was **fully compliant**.

The content of the measure was assessed as fully compliant and proportionality was assessed as fully compliant given that the addressee provided evidence that it acted in a proportionate manner. Reporting was assessed as partially compliant, because the addressee failed to submit compliance information within the deadline, but the delay did not prevent the completion of the follow-up report.

Table 9

**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Partially compliant |
| ***Grade for recommendation A*** | *Fully compliant* |

On 15 December 2021 the Danish Ministry of Industry, Business and Financial Affairs decided to increase the countercyclical capital buffer (CCyB) from 1% to 2%, with effect from 31 December 2022; and on 30 March 2022 it resolved to increase it from 2% to 2.5%, with effect from 31 March 2023. The phased tightening of the buffer is in line with the Systemic Risk Council's strategy of carrying out gradual increases to attain a neutral CCyB rate of 2.5%. Implementation of the strategy was made possible by the Danish economy's resilience to the impact of the COVID-19

pandemic, and because there is currently a build-up of risks in its financial system. The CCyB's increase targeted a broad range of risks, including RRE-related risks.

Box 3

## Recommendation B – Monitoring of vulnerabilities and activation or tightening of BBMs

### Summary of implementation of Recommendation B

### Final grade

Based on the findings below, the overall level of compliance with Recommendation B was **materially non-compliant.**

The content of the measure was assessed as materially non-compliant as the addressee assessed vulnerabilities related to household indebtedness, overvaluation of house prices and credit standards, as indicated in Sub-recommendation B(1), but did not act on these findings. Proportionality was assessed as insufficiently explained, as there was evidence that the addressee had acted disproportionately, and the explanation provided was not considered to be sufficient. Reporting was assessed as partially compliant, because the addressee failed to submit the compliance information within the deadline, but the delay did not prevent the completion of the follow-up report.

Table 10

**Sub-recommendation B(1) – Monitoring of vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Partially compliant |
| ***Grade for Sub-recommendation B(1)*** | *Fully compliant* |

The addressee monitored vulnerabilities related to household indebtedness, overvaluation of house prices and lending standards.

Despite a significant increase in house prices, growth in credit granted to households remained modest in Denmark during the pandemic. Nevertheless, according to the Systemic Risk Council, high levels of debt are a determinant of vulnerability.

The household debt-to-income (DTI) ratio has been declining since 2008, with income growth offsetting debt increases. Nonetheless, it stood at 241% in 2021, the highest among European countries. Household debt levels are geographically uneven, with larger cities displaying higher DTI ratios compared with the median ratio of 174% in 2020 (213% in Copenhagen, for instance). In fact, 40% of mortgage production in the Aarhus and Greater Copenhagen areas corresponds to loans to highly indebted borrowers, i.e. with an LTV of more than 60% and a DTI of over 4. Even today, more than 50% of the total amount of new loans granted have a DTI of over 4, with 10% of all outstanding mortgage debt in the country stemming from loans granted to highly indebted borrowers.

However, an increasing share of loans being granted have an LTV of less than 60%. Therefore, the number of highly indebted borrowers appears to reflect that a fraction of homebuyers has benefited from past price increases and are bringing substantial amounts of home equity into new real estate purchases, in which case the relevant credit constraint is DTI.

Furthermore, the recent widespread adoption of variable rate mortgages with interest-only payments, especially among highly leveraged households, has exacerbated existing vulnerabilities. Interest-only mortgages account for 47% of outstanding mortgage debt and are expected to continue to rise, thus increasing vulnerability to rising interest rates, income shocks and falling house prices. In fact, Denmarks Nationalbank has concluded that a 5 percentage point interest rate increase relative to 2020 will lead to a 27 percentage point increase in debt service costs for 10% of all homeowners with interest-only and variable interest mortgages. This behaviour attests to the sensitivity of the Danish real estate market to interest rates increases, the effect of which is compounded by a reduction in the real purchasing power of households and higher energy costs, which squeeze household budgets and erode their debt-servicing ability.

While house prices increased during the COVID-19 pandemic, the outlook is clouded by significant uncertainty and downside risks. The cooling of housing market activity in the third quarter of 2022, coupled with the projected slowdown in economic activity and higher unemployment, are challenges for homebuyers. Trading activity has declined and the supply of houses for sale has surged. Looking ahead significant downside risks for house prices loom, fuelled by high inflation, rising interest rates and economic uncertainty. Critically, the reduction in nominal house prices is mainly expected to affect larger cities where households are more indebted, such as the Great Copenhagen area where the decline has been steeper.

The Assessment Team found that to assess the effectiveness of the existing monitoring framework it was necessary to show the distribution of LTV and DTI ratios. This additional information, while not initially available, was provided by the addressees during the remedial dialogue phase.

Based on the findings above, the overall level of compliance with Sub-recommendation B(1) was **fully compliant**.

The content of the measure was assessed as fully compliant, and proportionality was assessed as fully compliant. Reporting as partially compliant, because the addressee failed to submit the compliance information within the deadline, but the delay did not prevent the completion of the follow-up report.

Table 11

**Sub-recommendation B(2) – Activation or tightening of BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Materially non-compliant |
| **Proportionality** | Insufficiently explained |
| **Reporting** | Partially compliant |
| ***Grade for Sub-recommendation B(2)*** | *Materially non-compliant* |

Initially, the addressee did not provide a response for Sub-recommendation B(2), with the competent authority explaining that the lack of reporting was due to Denmark being under a caretaker government following the general election on 1 November 2022. Further, the Danish authorities did not provide additional information during the remedial dialogue phase, which took place in March 2023. When given a final opportunity to provide additional information, the Danish authorities indicated that no measures had been adopted to comply with Sub-recommendation B(2). The government considered that a number of remediating factors were already in place, which curbed the build-up of systemic risks, such as the fall in house prices and a lower debt-to-GDP ratio compared with the period leading up to the financial crisis. According to the addressee, these existing measures explained the inaction.

The Assessment Team found this explanation to be insufficient, considering that the assessment referred to the period from October 2021 to October 2022 and that the period of falling house prices occurred after the reporting period. Thus, it could not explain the inaction of the Danish authorities during the relevant reporting period. Additionally, the Danish authorities referred to a set of measures implemented to strengthen structural robustness in relation to household indebtedness, namely
(i) the supervisory diamond of 2014; (ii) the down payment requirement from 2015;
(iii) the supervisory guidelines on lending to for RRE purposes in areas with high price growth from 2016; and (iv) the guidelines on highly indebted homeowners from 2018 that require homeowners with high DTI and LTV ratios not to take out interest-only loans with variable interest rates. In the response provided, the Danish authorities stated that the measures already in place justified the inaction. It should be noted that these actions had been taken by the Danish authorities before the implementation of the Recommendation and activated before it had been issued. In fact, if these measures had had an impact on the identified risks, this would have been evident before the Recommendation had been issued. The ESRB Assessment Team did not assume that, as a result of the inaction,
the risk had been reduced to the extent it would have been reduced if Sub-recommendation B(2) had been implemented. In particular, the Assessment Team found that the measures taken before

the adoption of the Recommendation could not be considered sufficient to address the risks identified therein and concluded that the explanation was not sufficient to justify the inaction.

The content of the measure was assessed as materially non-compliant as the addressee assessed vulnerabilities related to household indebtedness, overvaluation of house prices and credit standards, as indicated in Sub-recommendation B(1), but did not act on these findings, namely by introducing BBMs to address the identified risks. In targeting risks to financial stability stemming from the vulnerabilities assessed by the addressee,
the addressee should have implemented Sub-recommendation B(2) – in particular with regard to non-amortising loans and loans with high LTV and DTI ratios, and designing existing BBMs with financial stability objectives in mind.

Proportionality was assessed as insufficiently explained as there was evidence that the addressee had acted disproportionately, and the explanation provided was deemed to be inadequate. Reporting was assessed as partially compliant, because the addressee failed to submit the compliance information within the deadline, but the delay did not prevent the completion of the follow-up report.

Based on the findings above, the overall level of compliance with Sub-recommendation B(2) was **materially non-compliant**.

Table 12

**Sub-recommendation B(3) – Increase of the legally binding minimum down payment requirement**

| Criteria for action | Grade |
| --- | --- |
| **Content of the measure** | Materially non-compliant |
| **Proportionality** | Insufficiently explained |
| **Reporting** | Partially compliant |
| **Grade for Sub-recommendation B(3)** | Materially non-compliant |

Initially, the addressee did not provide a response for Sub-recommendation B(3), with the competent authority explaining that the lack of reporting was due to Denmark being under a caretaker government following the general election on 1 November 2022. Neither did the Danish authorities provide additional information during the remedial dialogue phase, which took place in March 2023. When given a final opportunity to provide additional information, the Danish authorities indicated that no measures had been adopted to comply with Sub-recommendation B(3). The government considered that a number of remediating factors were already in place, which curbed the build-up of systemic risks, such as the fall in house prices and a lower debt-to-GDP ratio compared with the period leading up to the financial crisis. According to the addressee, these existing measures explained the inaction.

The Assessment Team found this explanation to be insufficient, considering that the assessment referred to the period from October 2021 to October 2022, and the period of falling house prices took place after the reporting period. Thus, it could not explain the inaction of the Danish authorities during the relevant reporting period. Additionally,
the Danish authorities referred to a set of measures implemented to strengthen structural robustness in relation to household indebtedness, namely (i) the supervisory diamond of 2014; (ii) the down payment requirement from 2015; (iii) the supervisory guidelines on lending for RRE purposes in areas with high price growth from 2016; and (iv) the guidelines on highly indebted homeowners from 2018 that require homeowners with high DTI and LTV ratios not to take out interest-only loans with variable interest rates. In the response provided, the Danish authorities stated that the measures already in place justified the inaction. It should be noted that these actions had been taken by the Danish authorities before the implementation of the Recommendation and activated before it had been issued. In fact, if the measures had had an impact on the identified risks, this would have been evident before the Recommendation had been issued. The ESRB Assessment Team did not assume that, as a result of the inaction, the risk had been reduced to the extent it would have been reduced if Sub-recommendation B(3) had been implemented. In particular, the Assessment Team found that the measures taken before the adoption of the Recommendation could not be considered sufficient to address the risks identified therein and concluded that the explanation was not sufficient to justify inaction.

The content of the measure was assessed as materially non-compliant as the addressee assessed vulnerabilities related to household indebtedness, overvaluation of house prices and credit standards, as indicated in Sub-recommendation B(1), but did not act on these findings. In targeting risks to financial stability stemming from these vulnerabilities assessed by the addressee, the addressee should have implemented Sub-recommendation B(3), namely by increasing the legally binding minimum down payment requirement.

Based on the findings above, the overall level of compliance with Sub-recommendation B(3) was **materially non-compliant**.

Box 4

## Recommendation C – Structural changes related to mortgage loans and the RRE sector

**Summary of implementation of Recommendation C**

**Final grade**

Based on the findings below, the overall level of compliance with Recommendation C was **partially compliant.**

The content of the measure was assessed as partially compliant. Proportionality was assessed as partially compliant, as there was some evidence of disproportionality and the addressee's explanation was not deemed to be entirely sufficient. Reporting was assessed as partially compliant, as the addressee failed to submit the compliance information within the deadline, but the delay did not prevent the completion of the follow-up report.

Table 13

**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Partially compliant |
| **Proportionality** | Partially compliant |
| **Reporting** | Partially compliant |
| ***Grade for Recommendation C*** | Partially compliant |

Initially, the addressee did not provide a response for Sub-recommendation B(2), with the competent authority explaining that the lack of reporting was due to Denmark being under a caretaker government following the general election on 1 November 2022. Neither did the Danish authorities provide additional information during the remedial dialogue phase, which took place in March 2023. When given with a final opportunity to provide additional information, the Danish authorities provided a description of several measures related to mortgage loans and the RRE sector that had been implemented to address structural factors.

The Danish authorities stated that that the existing tax deductibility of interest rate expenses would be maintained and argued that this scheme keeps a balance between paying off a mortgage and making investments. If the benefit from tax deductibility is too small investments become unattractive, which is undesirable from a society-broad perspective. They also mentioned that the maximum amount for the highest tax deductibility rate is nominally fixed, which means that over time a larger fraction of the interest rate payments will gradually be subject to a lower tax deductibility rate.

In order to tackle the lack of housing supply, initiatives to increase housing in major cities have been approved by a parliamentary majority. These include affordable housing for students, which would reduce the demand from parents purchasing housing for their children.

Lastly, the Danish authorities mentioned that from 2024 onwards, a new housing taxation system will target growth in house prices. The updated housing valuation will result in heavier taxation on new sales in urban areas that have increased in price since the last housing valuation from 2011. The Danish authorities are of the view that this taxation system will counter excessive growth in house prices in urban areas, as home ownership will become more expensive.

The Assessment Team acknowledged the Danish authorities' actions to tackle structural factors related to mortgage loans and the RRE sector that could lead to systemic risks. Nevertheless, it is of the view that the measures adopted by the Danish authorities are limited, particularly when compared with the measures implemented by other addressees to comply with the same Recommendation, and do not entirely address the identified risks. Thus, the Assessment Team considered that, while the measures adopted by the Danish authorities are heading in the right direction, further measures should be considered to curb structural factors and target systemic risks.

Based on the findings above, the overall level of compliance with Sub-recommendation C was **partially compliant**.

## 4.3 Luxembourg

Recommendation ESRB/2019/6 on medium-term vulnerabilities in the RRE sector in Luxembourg was addressed to the national authorities in Luxembourg entrusted with recommendation powers or with the application of BBMs.

Compliance with Recommendation B – Activation of legally binding and non-legally binding BBMs – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being assessed for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation C – Structural changes related to mortgage loans and the RRE sector – is being assessed for the first time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Sub-recommendation B(1) refers to the activation of non-legally binding BBMs by the Luxembourg national authorities entrusted with the application of BBMs, pending the establishment of the legal framework referred to in Recommendation A.

Sub-recommendation B(2) refers to the activation of legally binding BBMs by the Luxembourg national authorities entrusted with the application of BBMs once the legal framework referred to in Recommendation A has been established.

Recommendation C refers to reviewing policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Luxembourg as a source of systemic risk, as they provide incentives for households to take on excessive mortgage debt, or cause excessive growth in house prices and mortgage debt.

In the previous assessments conducted in 2021, the overall level of compliance of the Luxembourg national authorities with Recommendation ESRB/2019/6 was assessed as fully compliant. The addressee's inaction with regard to Sub-recommendation B(1) was sufficiently explained, as the decision not to introduce non-legally binding BBMs reflects the prioritisation of the legislative process for introducing legally binding measures (in line with Recommendation A), thus the assessment was fully compliant. For Sub-recommendation B(2), the assessment showed that further efforts were still needed despite the implementation of the sub-recommendation, as the adopted measures only include LTV caps. Therefore, compliance with Sub-recommendation B(2) was assessed as largely compliant.

The reports on the actions taken to comply with the Recommendation were submitted by the Comité du Risque Systémique - Secrétariat.

The weighting scheme applied for Luxembourg was as follows. Overall, equal weights were assigned to Recommendations B and C, and equal weights were assigned to sub-recommendations B(1) and B(2). At the level of each sub-recommendation, the content was weighted 3/4, while proportionality and reporting were each assigned a weight of 1/8.

Table 14
**Individual weighting**

| Category | Weighting |
|---|---|
| **Recommendation B(1)** | 1/4 |
| **Recommendation B(2)** | 1/4 |
| **Recommendation C** | 1/2 |
| **Recommendation B(1)** | Weighting |
| **Activation or tightening of non-legally binding BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(2)** | Weighting |
| **Activation or tightening of legally binding BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation C** | Weighting |
| **Structural changes related to mortgage loans and the RRE sector** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

The implementation standards for Luxembourg are presented in Annex III which will be published as a separate document.

Based on the findings of the assessment, the overall level of compliance with Recommendation ESRB/2019/6 was:

Table 15

**Overall grade**

| Fully compliant | Largely compliant | Partially compliant | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

## Box 5

## Recommendation B – Activation of BBMs

### Summary of implementation of Recommendation B

### Final grade

Based on the findings below, the overall level of compliance with Recommendation B was largely compliant.

Table 16

**Sub-recommendation B(1) – Activation or tightening of non-legally binding BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Sufficiently explained |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(1)*** | *Sufficiently explained* |

The addressee has not activated non-legally binding BBMs. The content of the measure was assessed as sufficiently explained, as the decision reflects the prioritisation of the legislative process to introduce legally binding measures (Recommendation A), which was completed shortly afterwards and led to the activation of legally binding measures (Recommendation B(2)). Proportionality was assessed as fully compliant, as the addressee provided evidence that it acted proportionally. Reporting was assessed as fully compliant, as the addressee delivered the follow-up report on time.

Based on the findings above, the overall level of compliance with Sub-recommendation B(1) was sufficiently explained.

Table 17

**Sub-recommendation B(2) – Activation or tightening of legally binding BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Largely compliant |
| **Proportionality** | Largely compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(2)*** | *Largely compliant* |

The addressee has activated the legally binding BBM “LTV limit differentiated by borrower type,” which was introduced in January 2021. The LTV measure applied addresses the potential for cross-sectoral leakages, as it concerns all types of lenders that are relevant for Luxembourg; namely, credit institutions, insurance undertakings and professionals engaged in lending activities. It also applies to all kinds of borrowers, including households and real estate companies. The measure addresses the issue of cross-border leakages, as the Luxembourg authorities have requested reciprocation of the measure.

The Systemic Risk Committee assessed the measure’s effectiveness and highlighted the decline in mortgage credit flows in the second half of 2021 and the first half of 2022. According to the addressee, the LTV caps helped to contain household debt levels.
By constraining household mortgage debt, the differentiated LTV limit helps to ensure that borrowers can service their debt and maintain consumption levels in periods of adversity, while the measure can attenuate the credit risk associated with a credit institution’s portfolio of new mortgage loans.

The national authorities also considered and discussed the activation of income-based measures (such as debt service-to-income (DSTI) or DTI measures). However, the addressee found that in the current environment of monetary policy tightening and rising inflation, income-related policies could have procyclical features, and thus decided not to activate any income-based measures. Instead, they closely monitor income-related lending standards. In addition, the Commission de Surveillance du Secteur Financier is in close contact with banks to quantify the share of vulnerable households based on different scenarios of interest rate increases and to assess the impact on banks’ credit portfolios. The activation of a maturity limit was also analysed and evaluated by the national authorities in 2020. However, the average maturity of 22 years was considered to be in line with other jurisdictions, and potentially undesirable effects on the debt service burden of households in a period of elevated economic uncertainty were considered to be significant. Therefore, they decided to continue to monitor market practices related to maximum-term loans closely.

There has been a decrease in real estate transactions, and a more moderate performance of house prices in the area is expected, coupled with a deceleration in mortgage market growth and a decline in high-LTV lending, which could signal that RRE vulnerabilities in Luxembourg are decreasing. Furthermore, a recent analysis suggested that LTV limits have influenced the flow of mortgage loans, although it remains difficult to disentangle the effects of the COVID-19 pandemic shock from those induced by the activation of the LTV limits. However, the level of household indebtedness in Luxembourg remains fairly high, at approximately 180%. Given that DSTI and loan service-to-income indicators are showing higher weighted averages, the activation of income-related BBMs in combination with the LTV limits may help to alleviate the increased levels of indebtedness. It is recommended that the national authorities continue to regularly monitor the effectiveness of the implemented actions.

The content of the measure was assessed as largely compliant, as the actions correspond to the outcome of the assessment, despite indicating a need for further tightening of BBMs. Proportionality was assessed as largely compliant, as the addressee provided some evidence that it had acted proportionally. Lastly, reporting was assessed as fully compliant, as the addressee delivered the follow-up report on time.

Based on the findings above, the overall level of compliance with Sub-recommendation B(2) was largely compliant.

Box 6

## Recommendation C – Structural changes related to mortgage loans and the RRE sector

### Summary of implementation of recommendation C

**Final grade**

Based on the findings below, the overall level of compliance with Recommendation C was fully compliant.

Table 18
**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation C*** | *Fully compliant* |

The addressee has thoroughly reviewed its policies to curb the structural factors that had contributed to the build-up of vulnerabilities.

An extensive set of policies that address the supply-side shortage in the market have either been implemented or proposed. These include public investments (such as funds to support housing development, social housing and affordable rental accommodation), changes in taxation (a tax on land use, a tax on non-occupancy of houses) and constraints on constructors and developers (e.g. the obligation to designate buildable land to housing and the reservation of part of the total area allocated for housing for affordable housing). The addressee also reviewed its policies that cause excessive growth in house prices and speculation (e.g. the taxation of real estate income and accelerated amortisation rate for investment funds, rental regulations for investment properties). Some of the adopted measures (e.g. a new real estate tax for investment funds, the change in regime for family wealth management companies, and the reduction in fiscal advantages for real estate speculation) aim to further curb the structural factors that provide incentives to take on excessive mortgage debt.

Despite the comprehensive actions taken, the addressee provided evidence that the high levels of household indebtedness and excessive house price growth are still among Luxembourg's main sources of vulnerability for financial stability. Taking these key vulnerabilities into account, the Assessment Team considered that further actions could be taken to curb these sources of systemic risk. As **this assessment does not preclude national authorities from concluding that further structural changes are needed, the addressee was strongly encouraged to continue monitoring the development of risks stemming from the RRE sector and to review its policy framework with the aim of curbing the structural factors that have driven the vulnerabilities identified as a source of systemic risk.**

By adopting these measures, the addressee acted promptly and proportionally, given the ongoing legislative process, which encompasses a set of fiscal measures aimed at creating more affordable housing and addressing both the shortage of supply as well as demand-side factors, to alleviate the increasing vulnerabilities related to rising house prices and the housing shortage. Reporting was assessed as fully compliant, as the addressee delivered the follow-up report on time.

Based on the findings above, the overall level of compliance with Recommendation C was fully compliant.

## 4.4 The Netherlands

Recommendation ESRB/2019/7 on medium-term vulnerabilities in the RRE sector in the Netherlands was addressed to the Netherlands and the macroprudential authority, the designated authority, or the competent authority in the Netherlands, as applicable, entrusted with the activation of capital-based measures.

Compliance with Sub-recommendation B(1) – Tightening of BBMs – and Recommendation C – Activation of capital-based measures – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being assessed for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Compliance with Recommendation D – Structural changes related to mortgage loans and the RRE sector – is now being assessed for the first time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Sub-recommendation B(1) refers to the lowering of the current legally binding limit applicable to the LTV ratio to enhance the coverage of credit losses corresponding to the potential decrease in house prices under adverse economic or financial conditions.

Recommendation C refers to the activation of capital-based measures to enhance the resilience of credit institutions authorised in the Netherlands to RRE-related systemic risk.

Recommendation D refers to reviewing policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in the Netherlands as a source of systemic risk, as they provide incentives for households to take on excessive mortgage debt or cause excessive growth in house prices and mortgage debt.

In the previous assessment conducted in 2021, the overall level of compliance of the Dutch authorities with Recommendation ESRB/2019/7 was assessed as partially compliant. Actions to comply with Sub-recommendation B(1) were assessed as non-compliant. For recommendation C, the Dutch authorities activated a national measure under Article 458 CRR, and the level of compliance with recommendation C was fully compliant.

The reports on the actions taken to comply with the Recommendation were submitted by the Dutch Ministry of Finance for Sub-recommendation B(1), by De Nederlandsche Bank (DNB) for recommendation C and by the Ministry of Finance and the Ministry of the Interior and Kingdom Relations for Recommendation D.

The following weighting scheme was applied for the Netherlands. Equal weights were assigned to Recommendations B(1), C and D. At the level of each recommendation, content was weighted 3/4, while proportionality and reporting were each assigned a weight of 1/8.

Table 19
**Individual weighting**

| Category | Weighting |
|---|---|
| **Recommendation B(1)** | 1/3 |
| **Recommendation C** | 1/3 |
| **Recommendation D** | 1/3 |
| **Recommendation B(1)** | Weighting |
| **Tightening of BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation C** | Weighting |
| **Activation of capital-based measures** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation D** | Weighting |
| **Structural changes related to mortgage loans and the RRE sector** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

The implementation standards for the Netherlands are presented in Annex III, which will be published as a separate document.

Based on the findings of the assessment, the overall level of compliance with Recommendation ESRB/2019/7 was:

Table 20

**Overall grade**

| Fully compliant | Largely compliant | Partially compliant | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

### Box 7

## Recommendation B – Tightening of BBMs and approach to calibration

**Summary of implementation of Recommendation B**

**Final grade**

Based on the findings below, the overall level of compliance with Recommendation B was inaction insufficiently explained**.**

The ESRB recommended that the Dutch authority responsible for BBMs tighten the LTV ratio limit. The Dutch Government has not taken any action on this sub-recommendation.

Table 21

**Sub-recommendation B(1) – Tightening of BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Insufficiently explained |
| **Proportionality** | Insufficiently explained |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(1)*** | *Insufficiently explained* |

For Sub-recommendation B(1), the Dutch authority has not taken any further action on tightening the LTV ratio limit since the previous compliance report. The assessment of the content therefore remained unchanged.

The coalition agreement explicitly states that the LTV limit will not be reduced further as this could lead to a less accessible RRE market for first-time buyers. The government still considers that BBMs, such as the reduction of the LTV limit from 106% to 100% in 2018, are beneficial for mitigating systemic risks in the housing market. It claims that other rules, such as the requirement to repay a mortgage within 30 years and several tax reforms, have also contributed to mitigating risks in the housing market.

However, the Dutch authority has not provided an assessment indicating that there is no need for further tightening of the LTV ratio limit to mitigate systemic risk stemming from the RRE market, even if house price growth and the share of new loans with an LTV of over 90% (albeit declining) remain high. In fact, the systemic risk inherent to the Dutch housing market has increased over the past few years, with house prices rising sharply and signs of overvaluation from the high and increasing price-to-income ratios in the housing market. Consequently, issues of decreasing affordability and pockets of risky lending have arisen. Moreover, according to DNB,[16] banks and households in the Netherlands are particularly vulnerable to a downward correction in the housing market.

As macroprudential policy and its tools should primarily serve to mitigate financial stability risks, which are still significant in the Dutch housing market, the Assessment Team considered the explanation provided by the Dutch authority to be insufficient and thus assessed the content of Sub-recommendation B(1) as insufficiently explained. Therefore, proportionality was assessed as insufficiently explained, as the reasons given for not implementing Sub-recommendation B(1) were considered to be inadequate given the risks stemming from the RRE sector, which could have been lower if the Dutch authorities had further tightened the LTV ratio limit. Reporting was assessed as fully compliant.

During the remedial dialogue process, the Dutch representatives emphasised that housing affordability is a priority for the government. However, from a financial stability perspective, they did not dispute the Assessment Team’s conclusions and will continue to monitor the situation in the RRE market.[17]

16 See **Financial Stability Report – Autumn 2022**.

17 The Dutch representatives also noted that the Financial Stability Committee has been embedded in primary law in accordance with Recommendation A of Recommendation ESRB/2019/7. The Wijzigingswet financiële markten 2022-II (“Financial Markets Amendment Act 2022-II”) was officially published on 21 February 2023 (Staatsblad 2023, 57 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl)) and will enter into force on 1 July 2023 (Staatsblad 2023, 107 | Overheid.nl > Officiële bekendmakingen (officielebekendmakingen.nl)). From the moment of its entry into force, the 1998 Banking Act will provide that the Dutch Central Bank (DNB), through the Financial Stability Committee, will conduct periodic consultations with representatives of the Dutch Financial Markets Authority (AFM) and the Minister of Finance for macroeconomic and financial developments with the aim of identifying risks to the stability of the financial system and suggesting possible directions for solutions to mitigate those risks. Furthermore, DNB may, in agreement with the AFM, make recommendations in this area, in accordance with Article II, sub. C (the new Article 9h of Bankwet 1998). Although Recommendation A is not being assessed in this third round of assessments, the Assessment Team welcomed this progress.

Box 8

## Recommendation C – Activation of capital-based measures

**Summary of implementation of Recommendation C**

**Final grade**

**Based on the findings below, the overall level of compliance with Recommendation C was fully compliant.**

The content of the measure was assessed as fully compliant, proportionality was assessed as fully compliant, and reporting as fully compliant.

Table 22

**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for recommendation C*** | *Fully compliant* |

With regard to Recommendation C, the introduction of the Article 458 measure was published in the Government Gazette on 21 October 2021 and came into force on 1 January 2022. The measure was initially in force until 30 November 2022. In October 2022, the Dutch authority announced a two-year extension, and the measure is now in force until 30 November 2024. Its main objective is to ensure that all banks with a significant role in mortgage lending are resilient to a severe downturn in the housing market. This resilience will be achieved by setting an average minimum risk weight for banks using the Internal Ratings Based (IRB) approach, which account for 92% of all mortgage lending by banks in the Netherlands. Accordingly, the measure is expected to increase the average risk weights of banks using the IRB approach by around five percentage points (from around 8% to 13-14%), creating a sufficiently strong and stable amount of capital for RRE exposures. Furthermore, by differentiating the average minimum risk weight based on the LTV of a mortgage, the measure specifically targets a major source of systemic risk in the Netherlands. Loans covered by the Dutch national mortgage guarantee scheme are exempt from the measure because they are already subject to a guarantee.

From an international perspective, Dutch banks are highly exposed to loans with a high LTV, which are more likely to have negative equity following a housing market bust. As a result, household consumption could be severely affected, prolonging the housing market bust, which means that the impact of a housing market correction is expected to be more significant when the share of high-LTV loans is higher. The measure reflects this negative impact, as the additional capital that must be held against mortgage exposures increases with the percentage of high-LTV loans (with a potentially procyclical effect[18]). In addition, the Dutch authority increased the CCyB rate from 0% to 1% on 25 May 2022. Banks will have to comply with this requirement by 25 May 2023.

As in the previous assessment round, the Assessment Team considered the measure taken under Article 458 CRR to be fully compliant with Recommendation C, as house price growth and overvaluation, LTV ratios, and household indebtedness remain at high levels. In addition, the Assessment Team supported the above-mentioned increase in the CCyB rate given the current significant geopolitical and macroeconomic uncertainties.

[18] See **Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013**.

Box 9

## Recommendation D – Structural changes related to mortgage loans and the RRE sector

**Summary of implementation of Recommendation D**

**Final grade**

**Based on the findings below, the overall level of compliance with Recommendation D was fully compliant.**

**The content of the measure was assessed as fully compliant, proportionality was assessed as fully compliant, and reporting was assessed as fully compliant.**

Table 23

**Title**

| Criteria for action | Grade |
| --- | --- |
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Recommendation D*** | *Fully compliant* |

With regard to Recommendation D, households are required to gradually repay their mortgage loans within 30 years to qualify for mortgage interest deductions. Moreover, several reforms have been implemented to remove features of the Dutch tax system that favour certain types of residential property ownership over others. These include:

- the reduction in maximum mortgage interest relief has been brought forward to 2023;
- in the lowest tax bracket, imputed rents will be increasingly taxed for taxpayers with no or low mortgage interest payments (i.e. the Wet Hillen scheme will be phased out by 2049);
- the gift tax exemption for houses has been abolished with effect from 1 January 2023;
- the vacant possession value ratio has been increased with effect from 1 January 2023 to better align the taxation of rental property with its actual economic value for property owners;
- the taxation of BTL properties has been revised with effect from 1 January 2023.

Several measures have also been taken to stimulate the supply side of the housing market. The government is working on more centralised planning of the supply of new housing, removing bottlenecks in the planning process for housing construction and providing public investment to unlock housing projects. In addition, during the remedial dialogue process, the Dutch representatives added that the government had also abolished the social housing tax. These policies should lead to an increase in investment in affordable housing for low-income households. Overall, these supply-side measures are expected to accelerate the whole house-building process from an average of 10 years to an average of six years and one million housing units should be built by 2030 (100,000 units a year).[19]

Given that the Dutch authority has taken a large number of demand and supply side measures and has addressed the identified structural vulnerabilities, the Assessment Team assessed the actions taken to be fully compliant with Recommendation D.
It acknowledged that the impact of the policies may not yet be visible, as indicated by the Dutch authority. Proportionality was assessed as fully compliant, and reporting was assessed as fully compliant as the Dutch authority provided missing information during the remedial dialogue process.

## 4.5 Finland

Recommendation ESRB/2019/8 on medium-term vulnerabilities in the RRE sector in Finland was addressed to the Finnish national authorities entrusted with the activation or calibration of income-related BBMs.

Compliance with Recommendation B – Activation of income-related BBMs – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being assessed for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation B consists of two sub-recommendations:

Sub-recommendation B(1) refers to the activation of non-legally binding BBMs.
It is recommended that, pending the amendment of the existing legal framework as referred to in Recommendation A, the Finnish national authorities entrusted with the activation of income-related BBMs apply non-legally binding BBMs to prevent a significant or increasing share of borrowers taking out new mortgage loans who might not be able to service their debt or maintain consumption in the event of adverse economic or financial conditions, or adverse developments in the RRE market.

Sub-recommendation B(2) refers to the activation of legally binding income-related BBMs. It is recommended that, once the existing legal framework has been amended as referred to in Recommendation A, the Finnish national authorities entrusted with the activation or calibration of

[19] In 2022 74,000 housing units were built.

income-related BBMs activate or calibrate, legally binding income-related BBMs to further address the objectives set out in Sub-recommendation B(1).

In the previous assessment conducted in 2021, the overall level of compliance of the Finnish national authorities with Recommendation ESRB/2019/8 was “partially compliant”. The addressee was deemed to be partially compliant with Sub-recommendation B(1), since non-legally binding BBMs had not been implemented, although the Board of the Finnish supervisory authority (FIN-FSA) had issued communications on loan sizes relative to borrowers’ income and maturities of new mortgage loans. Following the remedial dialogue phase, FIN-FSA announced that a recommendation on the application of non-legally binding limits on DTI or, alternatively, DSTI, were likely to be issued during the first half of 2022. Sub-recommendation B(2) was not assessed since its compliance was conditional on the full implementation of recommendation A.

The follow-up report was submitted by the Finnish Ministry of Finance and FIN-FSA.

The weightings applied for Finland to the different Sub-recommendations are presented in the table below. Sub-recommendations B(1) and B(2) were assigned a weight of 1/2 each. At the level of each sub-recommendation, content was weighted 3/4, while proportionality and reporting were each assigned a weight of 1/8.

Table 24
**Individual weighting**

| Category | Weighting |
|---|---|
| **Recommendation B(1)** | 1/2 |
| **Recommendation B(2)** | 1/2 |
| **Recommendation B(1)** | Weighting |
| **Activation of non-legally binding BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(2)** | Weighting |
| **Activation of legally binding BBMs** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

The implementation standards for Finland are presented in Annex III, which will be published as a separate document.

Based on the findings described in the following sections, the overall level of compliance with Recommendation ESRB/2019/8 was:

Table 25
Overall grade

| | Largely compliant | Partially compliant | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

## Box 10
## Recommendation B – Activation of income-related BBMs

### Summary of implementation of Recommendation B

### Final grade

Based on the findings below, the overall level of compliance with Recommendation B was fully compliant.

Following several communications issued by the FIN-FSA Board recommending that lenders exercise restraint in granting loans to potentially vulnerable applicants, a non-legally binding BBM was implemented through a recommendation of the FIN-FSA Board. This non-legally binding measure is a “stressed” DSTI ratio, which is computed in such a way that potential stress situations are captured and consider all a borrower’s loans. The recommendation entered into force on 1 January 2023.

Table 26

**Sub-recommendation B(1) – Activation of non-legally binding BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(1)*** | Fully compliant |

The addressee activated a non-legally binding BBM, specifically a non-legally binding "stressed" DSTI limit entered into force on 1 January 2023. The decision was taken after several recommendations had been issued by the FIN-FSA Board, instructing lenders to show restraint in granting loans to potentially vulnerable applicants.

The continuously increasing household indebtedness, coupled with an increasing share of new mortgage loans with longer-than-usual maturities and high DTI and DSTI ratios were the reasons for the implementation of the measure. The housing market recovered quickly after the outbreak of the COVID-19 pandemic. In 2021 and 2022 the volume of housing sales and new mortgage loans increased compared with previous years, and house prices continued to rise, particularly in large cities. At the same time, total household debt as a portion of income continued to grow, while the average maturity of new mortgage loans also increased, with maturities longer than 26 years becoming more common.

This DSTI limit was set at 60% and is referred to as "stressed" by the addressee as conditions are applied to ensure that potential stress situations are considered in its computation. In particular, the FIN-FSA Board stated that, in the calculation of a borrower's DSTI ratio, the maturity of the loans should not exceed 25 years, and the interest rate applied in the computation should not be lower than 6%, except for loans with long-term interest rate hedges and for fixed-rate loans. Moreover, the Recommendation stipulates that the servicing costs of all borrowers' loans be considered in the computation of the DSTI ratio.

The Recommendation permits a limited deviation for the housing loans with a stressed DSTI ratio that is greater than 60% of the borrower's net income, which has been set at 15% of the euro-denominated volume of new housing loans granted by the lender during the given calendar year. For loans on which the lender has allowed a deviation above the recommended maximum stressed DSTI limit, it is recommended that particular attention be paid to the borrower's financial situation and that the credit decision be made at a higher management level.

Based on the findings above, the overall level of compliance with Sub-recommendation B(1) was fully compliant.

The content of the measure to implement the recommended actions was assessed as fully compliant, proportionality was assessed as fully compliant, and reporting fully compliant.

Table 27

**Sub-recommendation B(2) – Activation of legally binding BBMs**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | N/A |
| **Proportionality** | N/A |
| **Reporting** | N/A |
| ***Grade for Sub-recommendation B(2)*** | *N/A* |

The activation or calibration of legally binding income-related BBMs in Finland is conditional on amending the existing legal framework, as referred to in Recommendation A. However, given that the current legal framework has not been amended to allow income-related BBMs to be activated or calibrated, Sub-recommendation B(2) cannot be complied with at this stage, and the Assessment Team has not assessed the inaction with regard to Sub-recommendation B(2).

Consequently, following the methodology previously adopted in the summary compliance report of March 2021, Sub-recommendation B(2) does not apply, and its weight in the assessment is zero. Based on the findings above, the assessment does not include the overall level of compliance with Sub-recommendation B(2).

## 4.6 Sweden

Recommendation ESRB/2019/9 on medium-term vulnerabilities in the RRE sector in Sweden was addressed to the Swedish national authorities entrusted with the monitoring of systemic risks, the Swedish macroprudential authority entrusted with the activation of BBMs and the macroprudential authority, the designated authority, or the competent authority in Sweden, as applicable.

Compliance with Recommendation A – Structural changes related to mortgage loans and the RRE sector – is being assessed for the first time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation A refers to reviewing policies with the aim of curbing the structural factors that have driven the vulnerabilities identified in Sweden as a source of systemic risk as they provide incentives for households to take on excessive mortgage debt or cause excessive growth in house prices and mortgage debt.

Compliance with Recommendation B – Monitoring of vulnerabilities and activation or tightening of macroprudential measures – was assessed in the first two rounds of the assessment of compliance with the Recommendations and is now being assessed for the third time for actions taken as of 31 October 2022, based on the report provided by the addressees.

Recommendation B consists of three sub-recommendations:

Sub-recommendation B(1) refers to the close monitoring of vulnerabilities related to household indebtedness and overvaluation of house prices over the medium term, including, inter alia, by:

(a) assessing the ability of borrowers taking out new housing loans to withstand adverse economic or financial conditions or adverse developments in the RRE market, using loan-level data for new mortgage loans;

(b) assessing potential credit losses on existing mortgage portfolios, as well as potential second-round effects on financial stability in the event of adverse economic or financial developments.

Sub-recommendation B(2) refers to the tightening of existing, or the activation of other, BBMs, if the results of the monitoring carried out under point (a) of Sub-recommendation B(1) provide evidence that a significant or increasing share of borrowers taking out new housing loans might not be able to service their debt following an adverse economic or financial development.

Sub-recommendation B(3) refers to the tightening of existing, or the activation of other, capital-based measures to ensure sufficient capital for mortgage loans granted by credit institutions authorised in Sweden, if the results of the monitoring carried out under point (b) of Sub-recommendation B(1) provide evidence that potential credit losses on existing mortgage loans in the event of adverse economic or financial conditions or adverse developments in the RRE market, as well as credit losses on other loans as a consequence of the decrease in consumption by households with housing loans, have increased on the back of cyclical, economic and financial factors.

In the previous assessment conducted in 2021, the overall level of compliance of the addressees with Recommendation ESRB/2019/8 was largely compliant. The Swedish authorities took actions to comply with all Sub-recommendations – Sub-recommendation B(1) was assessed as largely compliant, Sub-recommendation B(2) was assessed as partially compliant and Sub-recommendation B(3) was assessed as fully compliant.

The follow-up report was submitted by the Swedish Supervisory Authority, Finansinspektionen (FI) for Sub-recommendations B(1), B(2) and B(3), and by Sveriges Riksbank for Sub-recommendation B(1).

The weightings applied to the different sub-recommendations for Sweden are presented in the table below. Overall, equal weights were assigned to Recommendations A and B and, within Recommendation B, equal weights were assigned to each Sub-recommendation. At the level of each Sub-recommendation, the content was weighted 3/4, while proportionality and reporting were each assigned a weight of 1/8.

Table 28
**Individual weighting**

| Category | Weighting |
|---|---|
| **Recommendation A** | 1/2 |
| **Recommendation B(1)** | 1/6 |
| **Recommendation B(2)** | 1/6 |
| **Recommendation B(3)** | 1/6 |
| **Recommendation A** | Weighting |
| **Structural changes related to mortgage loans and the RRE sector** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(1)** | Weighting |
| **Monitoring of the RRE risk framework** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(2)** | Weighting |
| **Tightening of existing BBMs or activation of others** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |
| **Recommendation B(3)** | Weighting |
| **Activation or tightening of capital-based measures** | 3/4 |
| **Proportionality** | 1/8 |
| **Reporting** | 1/8 |

The implementation standards for Sweden are presented in Annex III, which will be published in a separate document.

Based on the findings of the assessment, the overall level of compliance with Recommendation ESRB/2019/9 was:

Table 29
**Overall grade**

| Fully compliant | Largely compliant | Partially compliant | Materially non-compliant | Non-compliant | Sufficiently explained | Insufficiently explained |
|---|---|---|---|---|---|---|

Box 11
## Recommendation A – Structural changes related to mortgage loans and the RRE sector

### Summary of implementation of Recommendation A

Based on the findings below, the content of the measure was assessed as fully compliant, as the actions taken correspond with the content of the Recommendation. Proportionality was assessed as fully compliant, as the addressee provided evidence that it had acted proportionally. Reporting was assessed as fully compliant, as the follow-up report was delivered on time by the addressee.

The Assessment Team considered that the overall level of compliance with Recommendation A was fully compliant.

Table 30
**Title**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Recommendation A*** | *Fully compliant* |

The structural changes reported by the Swedish Ministry of Finance include:

- digitalisation of development plans and plan descriptions to promote effective and quality-assured processes;
- monitoring of housing shortages at the municipality level to support municipal planning for housing provision;
- review of claims of national interest for the conservation of nature and the cultural environment to release more land for planning and building;
- legislative amendments for municipalities to produce a larger number of detailed development plans;
- review of the social housing policy;
- legislation to facilitate the mass construction of residential buildings;
- tax measures to improve mobility in the housing market, such as deferred taxation of capital gains for individuals changing home and the elimination of interest payments on the deferred capital gains.

Overall, these structural changes implemented from 2016 to 2022 have contributed to increasing the supply of land for building purposes and the housing stock while boosting new construction activity by facilitating bureaucracy and building permits. As a result, the structural changes reported are expected to exert a downward pressure on rising housing prices. Moreover, the tax measures applied should reduce the impact of previous distortions, which provided tax incentives for taking out mortgages and increased the demand for housing loans.

Box 12

## Recommendation B – Monitoring of vulnerabilities and activation or tightening of macroprudential measures

### Summary of implementation of Recommendation B

Based on the findings below, the overall level of compliance with Recommendation B was **fully compliant**.

Table 31

**Sub-recommendation B(1) – Monitoring the RRE risk framework**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(1)*** | *Fully compliant* |

FI and Sveriges Riksbank have established a well-functioning monitoring framework to assess vulnerabilities affecting household indebtedness and the overvaluation of house prices. The monitoring framework includes the use of loan-level data for new mortgages and aggregate data on banks' mortgage portfolios, mortgage surveys, collection of statistical data for other types of credit, the assessment of borrowers' disposable income and the execution of stress tests for mortgage portfolios under adverse scenarios.

In addition, the Swedish government carried out a public investigation on a micro-level register containing information on household income, loans, collection debts, debt at the enforcement agency, and financial and tangible assets. The study, initiated by Sveriges Riksbank, also included the needs of FI. The investigation proposed a comprehensive list of variables. It also suggested that Sveriges Riksbank, FI and government officials should be granted access to the microdata for purposes of analysis. Statistics Sweden has been proposed to host the database and produce statistics based on the microdata.

FI has stepped up its work to address the issue of data frequency pointed out in the previous assessment to better analyse the changes in credit conditions and assess household resilience more efficiently. The addressee conducted its latest household loan mapping survey from August to October 2022 to match liquid assets and loan obligations for each individual per credit institution. The survey includes information on different types of loans, including mortgages and savings in the

same credit institution.
It is important to note that the loan mapping survey takes place at a different point in time from that of the established mortgage survey, which, while improving the frequency of some data (e.g. liquid assets held by individuals), makes the information less comprehensive, as households may hold loans and savings in different institutions. In addition, FI has enriched its monitoring framework by obtaining loan-level data on the mortgage stock to complement the information received from the aggregate data.

Based on the findings of the latest annual survey, which covers all new mortgages taken during 29 August to 5 September and 16 September to 3 October 2022, new borrowers' surpluses were, on average, lower when they took out a loan compared with borrowers in 2021. Therefore, their vulnerability to a drop in income has also increased compared with previous years. In addition, the share of single-person borrowers who would incur a negative financial position in the event of loss of income, such as unemployment, tripled between 2021 and 2022, which is a cause for concern given the weak outlook for the economy. Furthermore, those buying or living in tenant-owned apartments are subject to additional vulnerability, as many tenant-owned associations may need to increase their fees to meet interest rate rises and higher running and maintenance costs.

Overall, the trend of new borrowers taking on large mortgages in recent years continued in 2022. However, the share of new mortgagors with both a high DTI and a high LTV ratio has fallen slightly. While the average DTI ratio decreased somewhat in 2022, the average LTV ratio remained unchanged from 2021, reflecting that house prices are at roughly the same level as in 2021. Compared with last year's survey, the average market value of the homes purchased by new mortgagors decreased by less than 1%. However, in general, most borrowers continue to have some margin between income and expenses. The latest analysis shows that the share of households experiencing a deficit will remain low, given the current expectations for interest rates, inflation and energy prices.

In FI's stress tests, roughly 5% of new mortgage borrowers could experience negative cash flows towards the end of 2023. These borrowers will be forced to use their bank savings or considerably reduce their consumption to maintain their current level of housing consumption. The situation is similar for new mortgagors from 2021 – a cohort with high debt to income who purchased their houses close to the price peak. For older cohorts of mortgage borrowers, the situation is in general much better as they have seen their incomes grow and have repaid their loans, dampening the interest rate shock they are experiencing. Mortgage borrowers in 2021 and 2022 account for roughly 15% of all Swedish mortgagors (7.5% of households) and 20% of mortgages (in volume terms).

Compared with the mortgage survey conducted in 2021, house prices were slightly lower but broadly similar at the time of the mortgage survey in 2022. The average LTV ratio was therefore similar to that seen into 2021 in 2022 and marginally lower that the ratio between 2017 and 2020. The LTV ratio averaged 65% for new mortgage borrowers, 0.5 percentage points higher than in 2021. The share of new mortgages with an LTV of over 70% was largely unchanged between 2021 and 2022.

The average DTI ratio for new borrowers, calculated using gross income, decreased from 327% in the 2021 survey to 321% in 2022. If the DTI is computed using net income, this ratio would decrease from 440% to 433%. Despite the decline, the DTI ratio is still higher than it was before the pandemic and at its second highest level since the mortgage survey started. The share of new mortgagors with a DTI ratio of over 300% decreased between by around 2 percentage points between 2021 and 2022 to stand at 56.2%. After increasing between 2018 and 2021, the percentage of households with a DTI ratio of over 450% fell slightly in 2022 (13.3%). This share is, however, still lower than before FI tightened its amortisation requirements in 2018. In the years before 2018, the percentage of households taking out new mortgages loan with a DTI ratio of over 450% was around 15%.

However, most borrowers continue to have some margin between income and expenses. FI's analysis shows that the share of households experiencing a deficit will remain low given current expectations for interest rates, inflation, and energy prices. Should economic conditions become considerably worse, with inflation remaining higher for longer than expected, interest rates increasing by more than expected and energy prices returning to the levels expected last fall, the stressed scenario shows that the share of borrowers experiencing a deficit would rise to almost 14% by the end of the year.
The combination of higher interest rates and higher energy and living costs would shrink borrowers' margins substantially, significantly increasing potential financial stress for households. The fact that this share is not more significant could be partially explained by banks' discounted interest rates which have been around 6%-7%, which means that interest rate rises were implicitly considered in their credit screenings. Other expenses and standardised amounts are not exposed to similar stress in credit screenings.

In summary, the effect of the current economic conditions on borrowers is considerable, as they face, among other challenges, higher interest rates and higher living expenses. As a result, many borrowers will have to make adjustments to their saving and consumption behaviours. However, FI's analysis shows that most new borrowers continue to have some financial margin and good repayment ability. In addition, amortisation requirements include flexibility for borrowers struggling to repay, and lenders may grant exemptions to these requirements if there are grounds to do so.

The Assessment Team is of the view that the authorities should continue to monitor the vulnerabilities related to household indebtedness and the overvaluation of house prices over the medium term.

Based on the findings above, the overall level of compliance with Sub-recommendation B(1) was **fully compliant**.

The content of the measures was assessed as fully compliant as the addressee showed evidence that it is closely monitoring the vulnerabilities related to household indebtedness and overvaluation of house prices over the medium term, using loan-level data for new mortgage loans. The addressee also evaluates potential credit losses on existing mortgage portfolios and possible second-round effects on financial stability in the event of adverse economic or financial developments. Proportionality was assessed as fully compliant since the addressee provided evidence that it has acted proportionately and reporting was assessed as fully compliant.

Table 32

**Sub-recommendation B(2) – Tightening of existing BBMs or activation of others**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Sufficiently explained |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(2)*** | Sufficiently explained |

Based on an FI report commissioned by the Swedish government, the addressee has decided not to tighten existing BBMs or activate new ones in order to contain credit risk. Therefore, the BBMs already implemented (i.e. the LTV limit and the two amortisation requirements) remain in place with the same content and calibration.

This decision was based on the assessment carried out by FI, which shows that mortgage holders tend to have a significantly higher income than the average household and substantial financial margins to repay their debt obligations. The report concludes that changing the rules for amortisation would not provide proper support to those households at risk of severe financial difficulties as a result of high electricity bills or increases in other expenses. To effectively support these households, targeted measures via fiscal policy should be preferred.

Moreover, this macroprudential policy stance is relevant given the current economic conditions – with higher inflation, increasing interest rates and declining house prices. Therefore, there may be reasons to temporarily change the amortisation requirements in exceptional economic situations. FI did this at the start of the pandemic when it temporarily suspended amortisation requirements from April 2020 to August 2021. However, the current economic situation differs significantly from that prevailing in the spring of 2020. Economic forecasts may be negative and the outlook uncertain, but not to the same extent as at the beginning of the pandemic. Moreover, at this point in time, a softening of the amortisation requirements would act against the direction of monetary policy. Therefore, FI does not believe that a general temporary exemption from amortisation requirements would be a well-balanced measure in the current situation.

New mortgage borrowers' resilience and their ability to make payments on their loans remain good. Despite an increase in interest rate sensitivity, most new mortgagors have sufficient margin to service their loans even if their finances weaken. Against this background, FI deems it unnecessary to tighten the BBMs further or activate new ones at this stage.

Based on the findings above, the overall level of compliance with Sub-recommendation B(2) was **inaction sufficiently explained**, as the inaction by the addressee is justified by the resilience of borrowers, by their ability to meet their debt obligations, and by their financial margins that would absorb an interest shock. Proportionality was assessed as fully compliant, as the addressee provided evidence that it had acted proportionally. Reporting was considered fully compliant, as the addressee delivered its follow-up report on time.

Table 33

**Sub-recommendation B(3) – Activation or tightening of capital-based measures**

| Criteria for action | Grade |
|---|---|
| **Content of the measure** | Fully compliant |
| **Proportionality** | Fully compliant |
| **Reporting** | Fully compliant |
| ***Grade for Sub-recommendation B(3)*** | *Fully compliant* |

FI decided to increase the CCyB to 2% in June 2022. Following the standard 12-month implementation period, the new buffer rate will be applicable starting in June 2023. This decision is consistent with FI's policy to maintain a positive, neutral CCyB rate of 2%.

It is important to note that the calibration of the CCyB rate at 2% was also based on an overall assessment of the development of systemic risks and the phase of Sweden's economic and financial cycle. Economic recovery was ongoing, credit losses were low and the banks had sufficient capacity to meet the demand for loans from non-financial corporations. However, rising inflation has driven up interest rates globally, and Russia's invasion of Ukraine has led to increasing energy and commodity prices, contributing to further inflationary pressure. This has resulted in a slowdown in the economic recovery and interest rate expectations have increased significantly. Furthermore, the continued growth in lending to households and the rapid increase in corporate debt indicate that systemic risks are building up. Therefore, this setting supports further increases in the CCyB to above the neutral level.

FI also extended the risk weight floor of 25% for Swedish mortgages until the end of 2023 (Article 458 of Regulation (EU) No 575/2013).

Based on the findings above, the overall level of compliance with Sub-recommendation B(3) was **fully compliant**.

The ESRB recommended that the Swedish authority tighten existing capital-based measures or activate new ones to ensure sufficient capital for mortgage loans granted by credit institutions authorised in Sweden. Country-specific monitoring results provide evidence that potential credit losses on existing mortgage loans may arise in the event of adverse economic or financial conditions or developments in the RRE market.
Therefore, the authorities decided to increase the CCyB to 2% in June 2022, so the content of the

measures was considered fully compliant. Proportionality was assessed as fully compliant, as the addressee provided evidence that it had acted proportionally. Reporting was assessed as fully compliant, as the addressee delivered its follow-up report on time.

# 5 Conclusions

The Assessment Team assessed the compliance of the six EU Member States (Belgium, Denmark, Luxembourg, the Netherlands, Finland, and Sweden) that received ESRB Recommendations on medium-term vulnerabilities in the RRE sector. The compliance assessment findings are as follows: three addressees were fully compliant (Finland, Luxembourg, and Sweden), two addressees were largely compliant (Belgium and the Netherlands) and one addressee was partially compliant (Denmark).

Overall, the number of inactions was identical in relation to the previous compliance report, at 4 out of 18 sub-recommendations compared with 4 out of 19 sub-recommendations. Recommendation C for Denmark, Recommendation C for Luxembourg, Recommendation D for the Netherlands, and Recommendation A for Sweden on structural measures were assessed for the first time in November 2022.

Over the past few years there has been a build-up of cyclical risks, particularly in the RRE sector, and these risks remained elevated throughout 2022. The RRE markets have experienced significant growth in house prices as a result of low financing costs, high demand and the appeal of housing as an investment opportunity. Consequently, several Member States witnessed inflated house price valuations in early 2022.

Borrowing costs for loans to finance house purchases have increased recently as a result of higher interest rates, which has led to a significant slowdown in mortgage lending and house prices across Europe. These developments are not reflected in this assessment of compliance as it follows a backward-looking approach, and its scope is limited to the actions taken by the addressees during the reporting period. However, changes in the economic and financial cycles have an impact on the measures recommended to the addressees to mitigate the identified vulnerabilities. Since the outbreak of Russia's war in Ukraine and the subsequent surge in bank lending rates for house purchases, mounting evidence suggests that the real estate cycle has reached a turning point in many EU countries. Consequentially, RRE prices have shown signs of deceleration despite their continued growth in 2022. Nominal house prices in the EU rose at an annual rate of 3.6% in the fourth quarter of 2022, a decrease from the 10.2% growth rate seen a year earlier.[20] These trends are expected to continue, with house prices declining further in the course of 2023. In particular, house prices in the countries under assessment have experienced a significant correction. The authorities are encouraged to take into account new developments, such as decreasing house prices and the rapid rise in interest rates for mortgage lending, when adopting measures to address identified vulnerabilities.

This shift in the RRE cycle is further supported by recent surveys, revealing a decline in consumer confidence indicators related to the intention to purchase real estate within the next two years and to the intention to improve existing real estate within the next 12 months. Additionally, the euro area bank lending survey conducted in December 2022[21] indicates a tightening of credit standards for

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[20] Available **here**.

[21] Available **here**.

household loans used for house purchases in the fourth quarter of 2022, primarily as a result of increasing credit risk.

Nevertheless, the level of accumulated risks remains significant in most EEA countries. Financial stability could benefit from a stagnation or a continuation of the orderly correction of RRE prices and credit developments in the near term. However, according to the same forecast, economic growth is expected to start to pick up and inflation to moderate in most EU countries in 2024. Consequently, RRE vulnerabilities could start to build up again in the medium term in the event of a rebound of confidence in the economy. Macroprudential authorities need to remain vigilant and implement mitigating macroprudential measures when necessary.

In conclusion, while this assessment provides a comprehensive overview of the Member States' compliance with the Recommendations, it should not mark the end of their work. While the compliance assessment provides valuable insights and identifies areas of improvement, the dynamic nature of the RRE sector requires ongoing scrutiny and proactive measures to rectify any persisting weaknesses. By maintaining a proactive approach, improving their data collection and analysis capabilities, and fostering cooperation between relevant authorities, these countries can strengthen their RRE sectors, mitigate potential risks in the future, and enhance informed decision-making to safeguard long-term financial stability.

# Annex I: Composition of the Assessment Team

(approved by the ATC via Written Procedure ATC/WP/2021/0044)

| Chairperson | Institutions |
|---|---|
| **Fátima Silva** | Banco de Portugal |
| **Assessment Team** | |
| **Francesco Caloia** | De Nederlandsche Bank |
| **Simon Dagrain** | Commission de Surveillance du Secteur Financier |
| **Zouhair Kechoute** | Banque centrale du Luxembourg |
| **Martin Kotlář** | Česká národní banka |
| **Maria Vergeti** | Bank of Greece |
| **Nuno Aguiar (alternate member)** | Banco de Portugal |

# Annex II: Implementation standards for country-specific Recommendations

The implementation standards for country-specific Recommendations will be published as a separate document.

# Imprint and acknowledgements

This compliance report is based on the results of an assessment conducted by the Assessment Team and was prepared by:

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The cut-off date for the data included in this report was April 2023.

For specific terminology please refer to the **ESRB glossary** (available in English only).

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| PDF | ISBN 978-92-9472-348-2, doi: 10.2849/74730, DT-04-23-921-EN-N |