Decision by the Board of the Financial Supervisory Authority on the reciprocation of macroprudential measures set by the Norwegian macroprudential authority

The Board of the Financial Supervisory Authority (FIN-FSA) decided at its meeting on 19 August 2021 to adopt the average risk weight floors for residential and commercial real estate exposures located in Norway, set by Norway's macroprudential authority (Finansdepartementet), to be applied to credit institutions registered in Finland, pursuant to Article 458(5) of the Capital Requirements Regulation (EU) N:o 575/2013 and section 10, subsection 1, paragraph 6 of the Act on the Financial Supervisory Authority. The floor is 20% for Norwegian residential real estate exposures and 35% for Norwegian commercial real estate exposures. The floors will apply, as of 11 September 2021, to credit institutions that have adopted IRB approaches for credit risk and whose Norwegian real estate exposures exceed NOK 32.3 bn and commercial real estate exposures exceed NOK 7.6 bn.

The Board of the FIN-FSA also decided to apply the following principles in the reciprocation of the systemic risk buffer requirement set by the macroprudential authority of Norway:

- The Financial Supervisory Authority, as a rule, adheres to the European Systemic Risk Board (ESRB) recommendation on the reciprocation of the systemic risk buffer measure.
- A decision, pursuant of section 10, subsection 4 of the Act on Credit Institutions, on the application of the systemic risk buffer requirement to Finnish credit institutions will be taken only when there is adequate information on the transposition of the currently applied EU directive on credit institutions (CRD V) into Norwegian legislation and on how the legislative changes and the requirements of CRD V are taken into account in the rationale for setting and the calibration of the Norwegian systemic risk buffer requirement and other macroprudential measures.
- Due to the significant effect of the systemic risk buffer requirement and the uncertainties related to the pandemic and the financial system, the decision on the application of the requirement will enter into force 12 months after the decision is taken, but no earlier than 18 months after the publication of the ESRB recommendation in the Official Journal of the European Union, i.e. on 11 December 2022.

Justification for the decision

Norway's macroprudential authority, the Ministry of Finance (Finansdepartementet), adopted a decision on December 2020[1] to set, pursuant to Article 458 of the Capital Requirements Regulation (EU) N:o 575/201, risk weight floors for Norwegian residential real estate exposures (20%) and commercial real estate exposures (35%).

[1] Finansdepartementet (2020) Changes in banks' capital requirements have been adopted

Finansdepartementet also adopted a decision to set a 4.5% systemic risk buffer requirement for the domestic exposures of credit institutions operating in Norway. The requirement replaced the earlier systemic risk buffer requirement of 3% which was applied to credit institutions' total exposures. The requirements entered into force for the most part in late 2020.

Finansdepartementet requested in February 2021 the European Systemic Risk Board (ESRB) to issue a recommendation on the applications of its requirements to foreign credit institutions' exposures in the Norwegian lending market. The ESRB published on 11 June 2021 in the Official Journal of the European Union a recommendation[2] on the reciprocity for the macroprudential requirements set by the macroprudential authority of Norway. Under the recommendation, the risk weight floors should be adopted for application to the Norwegian residential and commercial real estate exposures of credit institutions registered in other Member States within a 3-month transition period. The Norwegian systemic risk buffer requirement can be adopted for application within a transition period that is longer than the standard transition period, i.e. within 18 months, under the recommendation. The recommendation also states that the Norwegian systemic risk buffer measure may be adopted for application in a way and at a level that takes account of any overlap or difference in the capital requirements applicable in the Member State and Norway, until Directive (EU) 2019/878 (CRD V) becomes applicable to and in Norway[3].

The reciprocation of macroprudential requirements imposed in other countries is justified, as a rule, to strengthen the effectiveness of macroprudential policy and promote a level playing field. It is therefore justified to apply the risk weight floors adopted by the Norwegian macroprudential authority to Finnish credit institutions' Norwegian residential and commercial real estate exposures, in accordance with the recommendation adopted by the ESRB. The purpose of the risk weight floors is to ensure that credit institutions have sufficient capital to cover losses caused by possible disruptions in the Norwegian real estate market. According to the ESRB recommendation, the requirements apply to credit institutions that have adopted IRB approaches for credit risk and whose Norwegian real estate exposures exceed NOK 32.3 bn and commercial real estate exposures exceed NOK 7.6 bn.

The reciprocation of the risk weight floors is not currently estimated to have direct effects on the capital requirements of Finnish banks, as the supervisory constraints related to IRB approaches for credit risk currently in force are tighter than the risk weight floors. The risk weight floor may however become effective, following possible amendments to

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[2] ESRB (2021) Recommendation of the European Systemic Risk Board of 30 April 2021 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2021/3)

[3] In Norway, the earlier version of the EU's Capital Requirements Directive (CRD IV) is applied.

the credit risk models applied by credit institutions and the restrictions related to the models.

The versions of the directive on credit institutions currently applied in Norway and Finland (CRD IV and CRD V) differ particularly as to the rationale for setting capital buffer requirements for domestic systemically important credit institutions (O-SII buffers) and the systemic risk buffer requirement. Under CRD V regulation, the O-SII and systemic risk buffer requirements must be set based on different systemic risks, whereas in CRD IV regulation, the purpose of use and rational for setting the various requirements are not limited as accurately. The Norwegian macroprudential authority justifies the systemic risk buffer requirement partly with risks that relate to the systemic importance of individual institutions and which, under CRD V regulation, should be covered with only O-SII buffers. Therefore, the systemic risk buffer set by the Norwegian authorities and the O-SII buffers imposed on Finnish credit institutions would target partly the same risks, contrary to the provisions of CRD V.

Thus far it is uncertain when and how the CRD V directive will be implemented into Norwegian legislation[4]. In addition to the implementation of CRD V regulation, it is also uncertain how the requirements of CRD V will be taken into account in the rationale for setting and the calibration of the Norwegian systemic risk buffer requirement and other macroprudential measures.

Due to the differences in Finnish and Norwegian legislation and the uncertainty related to the implementation of CRD V regulation into Norwegian legislation, it is justifiable to take a decision on the application of Norway’s systemic risk buffer requirement only when there is adequate information on the transposition of CRD V regulation into Norwegian legislation and on how the legislative changes and the requirements of CRD V are taken into account in the macroprudential measures set by the Norwegian authorities.

Developments in the pandemic and banks’ credit risks are still subject to considerable uncertainty. As a result of the protracted pandemic, Finnish banks’ nonperforming exposures and loan losses may increase significantly, which would weaken Finnish banks’ ability to absorb losses and provide credit. If this coincided with an introduction of tighter capital requirements, the ability of banks to support economic recovery could weaken further. The full application of the Norwegian systemic risk buffer measure would increase the Finnish credit institution sector's total capital requirement by an estimated EUR 1.3 bn (0.5% of risk-weighted assets).

Due to the significant effect of the reciprocation of the systemic risk buffer measure and the uncertainties related to the pandemic and the

[4] A legislative proposal on the implementation of CRD V regulation has been issued to the Norwegian parliament, but its adoption requires the incorporation of the revised directive into the EEA Agreement. The schedule for adoption is not yet known.

financial system, it is justifiable to apply in the application of the requirement a transition period that is longer than the standard transition period. When there is adequate information available on the implementation of CRV regulation into Norwegian legislation to support the decision on reciprocation, it is justifiable to enforce the Norwegian systemic risk buffer requirement within 12 months after the decision was taken, as a similar transition period is applied also to the entry into force of systemic risk buffer requirements set in Finland. On the other hand, decisions on tighter capital requirements should also be in line with the ECB Banking Supervision guidance on buffer requirements issued earlier.[5] Therefore it is justifiable to implement the decision on the application of the Norwegian systemic risk buffer requirement no earlier than after the 18-month transition period stated in the ESRB recommendation, i.e. on 11 December 2022.

[5] ECB Banking Supervision press release 28 July 2020