EBA/Op/2023/12

21 November 2023

Opinion of the European Banking Authority on measures in accordance with Articles 131 and 133 of Directive 2013/36/EU

Introduction and legal basis

1. On 10 October 2023, the European Banking Authority (EBA) received a notification from the European Systemic Risk Board (ESRB) on the intention of the Ministry of Business, Industry, and Financial Affairs of Denmark to apply Article 133 of Directive 2013/36/EU of the European Parliament and of the Council[1] to activate a new systemic risk buffer (SyRB). The intended SyRB applies to all institutions authorised in Denmark. The new SyRB will apply to a subset of sectoral exposures located in Denmark.

2. The EBA's authority to deliver an opinion is based on Article 133(12), second subparagraph, of the Directive 2013/36/EU, and Article 131(5a), in conjunction with Article 131(15), both of that Directive.

3. The EBA may within six weeks of receiving the notification provide the Commission with its opinion in accordance with Article 16a of Regulation (EU) No 1093/2010.[2]

4. In accordance with Article 14(2) of the Rules of Procedure of the EBA, the Board of Supervisors has adopted this Opinion.[3]

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176 27.6.2013, p. 338).

[2] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331 15.12.2010, p. 12).

[3] Decision of the EBA concerning the Rules of Procedure of the Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

Description of the measure

5. The proposed measure introduces a systemic risk buffer (SyRB) for a subset of exposure categories identified in point (b) of Article 133(5) of Directive 2013/36/EU. According to the notification, the newly introduced SyRB will apply to all credit institutions authorised in Denmark, including two subsidiaries the parent of which are established in another Member State. According to the information provided, only one of these subsidiaries has exposures targeted by the measure at the moment of notification. The subsets of exposures located in Denmark, to which the SyRB will apply, are all type of exposures to non-financial corporations operating in real estate activities and in construction - development of building projects activities. The economic activity sectors have been identified with NACE Rev.2 codes L and F41.1.[4] The measure excludes exposures to social housing associations and housing cooperative associations. The intended date of application is 30 June 2024, and the decision will be reviewed at the latest after two years. The SyRB rate is set at 7%.

6. The subset of exposures has been identified considering its size, riskiness, and interconnectedness. According to the notification, lending to real estate companies accounts for 14% of total lending by credit institutions and 37% of total corporate lending as of the first quarter of 2023. Historically, credit exposures to real estate companies have recorded large losses. At the same time, real estate companies account for a significant share of economic activity in Denmark and developments in the real estate sector have contributed to amplifying cyclical fluctuations in economic activity. Danish pension funds are also exposed to the real estate markets which increases the risk of contagion.

7. According to the Ministry, current macroeconomic conditions imply a risk of a significant correction in commercial real estate markets. The income and the valuation of such real estate assets are sensitive to rises in interest rates and activity of real estate firms is cyclical. While a general correction has not been observed yet, there is an unusually low number of transactions. As of the first quarter of 2023, 80% of real estate company loans were with variable interest rates, exposing these companies to a risk of further increases in interest rates. Additionally, a weakening of macroeconomic conditions could put pressure on the rental income of real estate companies and increase risks to servicing loans.

8. Danish credit institutions, and especially medium sized institutions, have significant exposures to the targeted segment. According to the analysis provided in the notification, sharp inflation and interest rate increases, combined with falling commercial real estate prices, could lead to problems in the real estate sector and losses higher than what is observed in historical data. The recent period characterized by favorable conditions and low impairment charge ratios may lead to an underestimation of the actual risks and insufficient loan-loss provisions. Before the Global Financial Crisis, strong credit growth to real estate companies led to large losses and this

[4] NACE Rev.2 Statistical classification of economic activities in the European Community KS-RA-07-015-EN.PDF (europa.eu) .

experience shows that negative shocks to the real estate sector may lead to a sudden increase in impairment charges and losses.

9. According to the notification, the measure is deemed effective as it targets the type of economic activity posing the largest systemic risk and it provides credit institutions with greater capacity to absorb unexpected losses. At the same time, the buffer is deemed proportionate. The buffer rate balances the need to conserve capital due to the increased uncertainty and to build up capital rapidly before risks materialise. Thus, the timing and phase-in of the capital requirement is also based on the amount that credit institutions can withhold from their 2023 earnings. The buffer is proportionate as it will more heavily affect the credit institutions with riskier portfolios which command higher risk weights.

10. The sectoral SyRB rate calibration has considered the results of a quantitative sensitivity analysis of individual real estate companies' debt servicing capacity using accounting data. The analysis estimated potential losses to credit institutions in a scenario which features increases in interest rates, falls in commercial real estate and residential real estate prices, and ultimately lower income for real estate companies. The potential losses in the analysis are balanced against the existing capacity of credit institutions to absorb losses, considering impairments, management buffers and the Countercyclical Capital Buffers, and their capacity to accumulate capital without a contraction in credit supply.

11. According to the notification, the impact on the internal market is expected to be positive, as the measure reduces risks arising from lending to real estate companies.

Combination with other buffers

12. The targeted exposures are held by credit institutions that are subject to O-SII buffer requirements according to Article 131 of Directive 2013/36/EU. The SyRB rate applicable in Denmark to the total risk exposure amounts of institutions is currently 0%.

13. The notified sectoral SyRB will result in a combined buffer rate, as calculated for the purposes of Article 133(10), (11) or (12) of Directive 2013/36/EU, of 7% for the targeted subset of exposures of the targeted credit institutions. The notified sectoral SyRB will result in a combined O-SII and SyRB buffer rate for the targeted subset of exposures held by O-SII credit institutions ranging between 8% to 10%. The sectoral SyRB will amount to about 0.5% of total risk exposure amount of the credit institutions impacted.

Assessment and conclusions

14. The EBA acknowledges the macroprudential risk concerns raised by the Ministry of Business, Industry and Financial Affairs in the notification received on 10 October 2023. Based on the information provided, the EBA does not object to the introduction of the described measure. This assessment is supported by the ESRB recommendation on vulnerabilities in the commercial real estate sector in the European Economic Area, the size of the targeted exposures on credit institutions balance sheets, and the uncertainty surrounding the outlook of the real estate markets in Denmark.[5]

15. The EBA welcomes that the notified measure identifies the subset of exposures considering the applicable EBA "Guidelines on the appropriate subsets of sectoral exposures in the application of a systemic risk buffer".[6] Further, the EBA assesses that the measure is proportionate to the risks identified by the Ministry of Business, Industry and Financial Affairs. The EBA highlights however that the identification of exposures based on NACE Rev.2 codes is beyond the first level of economic activity as stipulated in paragraph 24 of the said Guidelines. This increases the risk that the identified subsets lead to a SyRB application with greater granularity and complexity. According to the same Guidelines, excessive granularity could hinder monitoring of compliance, harmonisation among jurisdictions, and limit the reciprocation of the sectoral SyRB measures between Member States.

16. The EBA welcomes the calibration of the buffer based on sufficiently conservative assumptions about the debt servicing capacity of real estate companies. The EBA notes that the timing and phase-in of the buffer rate are also affected by the ability of banks to build capital via retaining earnings. This is to ensure a fast build-up of buffers and to avoid adverse effects in credit supply satisfying thus, that the buffer does not entail disproportionate adverse effects on the whole or parts of the financial system. The EBA would like to note that, at the same, the SyRB should be clearly linked to the systemic risk identified to ensure that macroprudential measures are effective and proportionate to mitigate risks.

17. The parent of one credit institution is established in another Member State and it is subject to a SyRB on all exposures, including the targeted exposures in Denmark.[7] The requirement applies at the highest level of consolidation for the parent. The newly introduced requirement for the subsidiary and the identified subset of exposures located in Denmark may overlap with the requirements imposed to the parent institution if the measure is reciprocated. If this is the case, reciprocating authorities should give due consideration to the interaction with existing

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[5] Recommendation of the European Systemic Risk Board of 1 December 2022 on vulnerabilities in the commercial real estate sector in the European Economic Area (ESRB/2022/9) 2023/C 39/01 (OJ C 39, 1.2.2023, p. 1–14).

[6] EBA Guidelines of 30 September 2020 on the appropriate subsets of sectoral exposures to which competent or designated authorities may apply a systemic risk buffer in accordance with Article 133(5)(f) of Directive 2013/36/EU (EBA/GL/2020/13).

[7] Notification by Finnish Financial Supervisory Authority (Finland) on Systemic Risk Buffer (SyRB) Notification by Finnish Financial Supervisory Authority (Finland) on Systemic Risk Buffer (SyRB) (europa.eu)

requirements to avoid double counting of risks as they will have negative consequences on the functioning of the internal market.

This Opinion will be published on the EBA's website.

Done at Paris, 21 November 2023

[signed]

José Manuel Campa

Chairperson

For the Board of Supervisors