RECIPROCITY OF THE MACROPRUDENTIAL MEASURE APPLIED IN LUXEMBOURG

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Analysis

On 18 December 2020, the Comité du risque systémique, as the macroprudential authority in Luxembourg, requested the European Systemic Risk Board (ESRB) for reciprocation by other Member States of non-harmonised macroprudential measure (i.e. not provided for in Union law), with effect from 1 January 2021 and applicable to credit institutions.

Following Recommendation (CRS/2020/005) from the Comité du risque systémique, the Commission de Surveillance du Secteur Financier, acting together with the Banque Centrale du Luxembourg, activated legally binding loan-to-value (LTV) limits for new mortgage loans on residential real estate located in Luxembourg, with different LTV limits applicable to three categories of borrowers:

- LTV limit of 100% for first-time buyers acquiring their primary residence;
- LTV limit of 90% for other buyers i.e. non first-time buyers acquiring their primary residence. This limit is implemented with the following exception: lenders may issue 15% of the portfolio of new mortgages granted to these borrowers with an LTV above 90% but below the maximum LTV of 100%;
- LTV limit of 80% for other mortgage loans (including the buy-to-let segment).

This measure applies to any private borrower taking out a mortgage loan to purchase residential real estate in Luxembourg for non-commercial purposes. "Residential real estate" includes, but is not limited to, construction land, whether the construction work takes place immediately after the purchase or later. The measure also applies if a loan is granted to a borrower for purchasing a property with a long-term lease agreement. The real estate property may be for owner occupation or buy to let. The measure applies to all Luxembourg credit institutions, including insurance corporations and professionals carrying out lending activities.

The measure implemented by the Luxembourg authorities took into account the vulnerabilities identified in the residential real estate market, which are reflected in high levels of house prices combined with high levels of household indebtedness and sustained growth in housing loans combined with a tendency for credit institutions to apply less stringent credit standards. The measure implemented aimed at mitigating credit growth and household indebtedness and tried to ensure the application of more appropriate credit standards.

The imposition of these limits to the LTV ratio also took into account sub-recommendation C of the ESRB Recommendation on medium-term vulnerabilities in the residential real estate sector in Luxembourg (ESRB/2019/6), which recommends Luxembourg to review its policies with the aim of curbing the structural factors that have driven the vulnerabilities identified. The differentiated limits for the LTV ratio are complementary to other macroprudential measures already in place, namely a specific 15% average risk weight floor for exposures of banks using the internal ratings based approach (as announced on 1 July 2016 and in force since 30 August 2016, CRS/2016/004), as well as the increase in the countercyclical buffer rate from 0.25% to 0.5% (as announced on 20 December 2019 and with effect from 1 January 2021).

Within the scope of the application of this macroprudential measure, the Comité du risque systémique, under the terms of Recommendation ESRB/2015/2, requested that the ESRB recommend voluntary reciprocation by other Member States. After analysing the request for reciprocation, the ESRB, through the same Recommendation (as amended by ESRB Recommendation 2021/2), recommended Member States to reciprocate the Luxembourg measure in their jurisdiction if their credit institutions, insurance corporations and professionals carrying out lending activities have relevant material exposures to the risk to be mitigated. Taking into account that exposures granted through branches of other Member States operating in Luxembourg will have to comply with the legislation in force in the country implementing the measure (i.e. there is no need to reciprocate), this reciprocation recommendation mainly applies to institutions with direct exposures collateralised by residential real estate in Luxembourg (i.e. cross-border mortgage loans).

For the purpose of reciprocity, two materiality thresholds have been set to serve as a basis for the potential application of the de minimis principle (provided for in point 15 of Recommendation ESRB/2015/2) by Member States: a country-specific materiality threshold and an institution-specific materiality threshold. The country-specific materiality threshold for the total cross-border mortgage lending is €350 million which, according to the ESRB, corresponds to approximately 1% of the total domestic residential real estate mortgage market in December 2020. The institution-specific materiality threshold for the total cross-border mortgage lending is €35 million which corresponds to approximately 0.1% of the total residential real estate market in Luxembourg in December 2020. Reciprocation is only requested when both thresholds are exceeded.

After assessing the materiality of the exposures of each of the Portuguese credit institutions in question for purposes of reciprocation of this measure, the Banco de Portugal, on the basis of information provided by the institutions, concluded that these exposures are non-material in view of the thresholds mentioned above. Nevertheless, in accordance with point 15 of Recommendation ESRB/2015/2, the Banco de Portugal has decided to reciprocate this macroprudential measure as a matter of principle.

Although the limit applied by the Luxembourg authorities differs from the LTV ratio applied in Portugal by means of the macroprudential Recommendation in force, particularly as regards the method of calculation, limits and exceptions, the Banco de Portugal is of the opinion that the institutions operating in Portugal to which the Luxembourg measure may be applied have the necessary data to apply the measure as implemented by that authority.

This reciprocation decision will remain in force for as long as the relevant macroprudential measure is in place, including any revisions thereof.