

In case of discrepancies between the French and the English text, the French text shall prevail

Luxembourg, 30 August 2016

To all credit institutions

**CIRCULAR CSSF 16/643**

**Re: Opinion and recommendation of the Systemic Risk Board with respect to the risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg**

Ladies and Gentlemen,

We are pleased to inform you that on 1 July 2016 the Systemic Risk Board (*Comité du Risque Systémique*, hereinafter "SRB") adopted an opinion and a recommendation concerning the risk weight applied by the banks using internal ratings based systems for retail exposures (non-SME) which are secured by residential property in Luxembourg ([CRS/2016/004](#)).

In its opinion ([CRS/2016/004](#)), the SRB informs the banks and the CSSF that the Board considers that the use of rating systems as part of the Internal Ratings Based Approach ("IRB Approach") for the calculation of risk-weighted exposure amounts for credit risk should not result in an average risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg below 15%. A 15% weight is considered as being a floor.

The SRB's recommendation ([CRS/2016/004](#)) invites the CSSF to take any appropriate measure to ensure that the necessary measures be taken by the credit institutions in response to the Board's opinion and to submit a written report on the practices of Luxembourg credit institutions in this regard to the Board by 31 October 2016 at the latest.

The purpose of this circular is to inform banks on the CSSF's follow-up on the opinion of the SRB, and in particular on its expectations regarding the banks' responses in this respect, as far as both the integration of the opinion in the banks' in-house Internal Capital Adequacy Assessment Process (ICAAP) and the transmission of information to the CSSF are concerned.

The banks which are active in the local residential property sector and using the IRB Approach for the calculation of risk-weighted exposure amounts for credit risk are invited to inform the CSSF by 30 September 2016 at the latest whether they comply with the Board's opinion. If not, they should state the measures taken, if any, to comply. To this end, they are invited to fill in the form attached to this circular.

Moreover, the banks concerned are requested to document, on an annual basis, that they take into account the Board's opinion and its implementation in their ICAAP as defined in Article 18 of Regulation CSSF N° 15-02, including in the ICAAP report that they submit, on a regular basis, to the competent authorities within the meaning of Article 4 of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR).

For further information, please contact Ms Vania TINOCO PEREIRA or Mr Louay KHEDER (tel.: 26 25 1 – 1; e-mail: [macropru@cssf.lu](mailto:macropru@cssf.lu))

Yours sincerely,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Françoise  
KAUTHEN  
Director

Claude  
SIMON  
Director

Simone  
DELCOURT  
Director

Claude  
MARX  
Director General

## **Reply form - Circular CSSF 16/643**

The banks referred to in the SRB's opinion (CRS/2016/004) appended to this compliance statement are invited to send the latter to the CSSF by 30 September 2016 at the latest.

### **Question 1. Do you currently comply with Part 1 of the SRB's opinion?**

The opinion specifies that *the use of rating systems as part of the Internal Ratings Based Approach for the calculation of risk-weighted exposure amounts for credit risk in accordance with Section 2 of Chapter 3 of Title II of Part Three of the CRR should not result in an average risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg below 15%.*

Yes/No

### **Question 2. If the answer to question 1 is in the negative, please specify if and as from what date you intend to comply with this opinion.**

Date:

### **Question 3. If the average risk weight is currently below 15%, please indicate the measures implemented in response to the SRB's opinion.**

Explanation:

**ANNEX**

OPINION AND RECOMMENDATION OF THE SYSTEMIC RISK BOARD

# Systemic Risk Board

## OPINION AND RECOMMENDATION OF THE SYSTEMIC RISK BOARD

of 1 July 2016

on the risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg

(CRS/2016/004)

THE SYSTEMIC RISK BOARD,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 ("CRR"), and in particular Articles 4 and 92, as well as Section 2 of Chapter 3 of Title II of Part Three;

Having regard to the Law of 1 April 2015 establishing a Systemic Risk Board and amending the Law of 23 December 1998 concerning the monetary status and the Central Bank of Luxembourg ("Banque centrale du Luxembourg"), as amended, and in particular Article 2(c) and (e) thereof ("SRB Law");

Whereas:

- (1) The small number of defaults observed for years for credits secured by residential property in Luxembourg weighs down on estimates of probability of default.
- (2) These estimates determine the risk weights and thus the own funds requirements of the banks that use the internal ratings based approach.
- (3) In the absence of a floor for risk weights of claims secured by real estate, the corresponding own funds may no longer represent sufficient credit risk mitigation through all economic cycles in all cases.

ADOPTED THIS OPINION AND RECOMMENDATION:

**Part 1: Opinion for the attention of credit institutions and the CSSF with respect to the risk weight applied to all retail exposures (non-SME) secured by residential property in Luxembourg**

The Systemic Risk Board is of the opinion that the use of rating systems as part of the Internal Ratings Based Approach ("IRB Approach") for the calculation of risk-weighted exposure amounts for credit risk in accordance with Section 2 of Chapter 3 of Title II of Part Three of the CRR should not result in an average risk weight applied to all retail exposures

(non-SME) secured by residential property in Luxembourg below 15%.

## **Part 2: Recommendation to the CSSF**

1. The Systemic Risk Board recommends that the CSSF:
  - (a) transmit a copy of this opinion to the Luxembourg credit institutions that use an IRB Approach for the calculation of their risk-weighted exposure amounts for credit risk in accordance with Section 2 of Chapter 3 of Title II of Part Three of the CRR, as well as to the European Central Bank and to the European Systemic Risk Board; and
  - (b) take any action it deems appropriate to ensure that the necessary measures are taken in response to the Board's opinion and that the credit institutions referred to in Part I apply an average risk weight of not less than 15% to all retail exposures (non SME) secured by residential property in Luxembourg.
2. The CSSF should send a written report to the Systemic Risk Board by 31 October 2016 at the latest, detailing the practices of the Luxembourg credit institutions in this regard, including the adaptations made by the credit institutions to their rating systems following the publication of this opinion. The report should, where appropriate, state the measures to be taken by credit institutions to fully comply with this opinion.

## **Part 3: Follow-up on the opinion and the recommendation**

### 1. Interpretation

The terms used in this opinion and recommendation have the same meaning as in the law of 5 April 1993, i.e. in the CRR.

### 2. Publication

The Systemic Risk Board invites the secretariat of the Board to publish this recommendation and opinion on the website of the Systemic Risk Board<sup>1</sup>.

### 3. Monitoring and assessment

- (1) The secretariat of the Systemic Risk Board:
  - (a) assists the CSSF in order to facilitate the implementation of the opinion and of the recommendation;
  - (b) prepares a report on the CSSF's follow-up on this opinion and recommendation and informs the Systemic Risk Board thereof.

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<sup>1</sup> As the website of the Systemic Risk Board is currently under construction, the opinion and recommendation will be published on the website of the BCL.

(2) The Systemic Risk Board assesses and follows up on the responses of the CSSF to this opinion and recommendation.

Done in Luxembourg, 1 July 2016.

For the Systemic Risk Board

Pierre Gramegna  
Chairman