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Discussion Paper

Simplification and assessment of the credit risk framework

Contents

Responding to this Discussion Paper

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions stated in the boxes below (and in the Annex 1 of this paper). Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the view expressed;
- describe any alternatives the EBA should consider; and
- provide where possible data for a cost and benefit analysis.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 10 May 2026. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

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1. Reviewing simplicity in Credit Risk

1. The EBA published in October 2025 its *'Report on the efficiency of the regulatory and supervisory framework'*,[1] which provides a set of principles to assess and strengthen the simplicity and efficiency of the regulatory and supervisory framework.[2] The report lists 21 actions to implement these principles; one of these actions is to launch a **comprehensive review** of both the new flow of mandates (i.e. those not yet issued for consultation) as well as to the existing stock (current products from the Single Rulebook). This discussion paper (DP) assesses how this review should be executed in the credit risk framework, where EBA received most mandates as part of the EU Banking Package.

2. The report led to the deprioritisation of several mandates, as reflected in the EBA work programme published alongside it. These include Banking Package mandates implementing the Basel framework in the EU, such as those on dilution risk and specialised lending.[3] This discussion paper therefore considers the remaining mandates given to EBA, asking the question of whether EBA can increase the efficiency and simplicity of the credit risk framework in the context of its future work. Hence, it is important to take a step back to review specifically what EBA can do in the context of its own future work.

3. Concretely, the EBA published in December 2023 its EBA roadmap on the implementation of the EU banking package.[4] In the area of credit risk, the flow of mandates given to EBA relates in many cases to the stock of existing regulations issued and implemented upon previous CRD-CRR requirements. Hence, the implementation of the CRR provides an opportunity to streamline, update and bring about increased consistency (see Annex 2 for the list of mandates given to EBA in the area of credit risk). This does not only include regulatory products but also several reports aimed at assessing the adequacy of specific parts of the framework. Hence, completing the EBA roadmap for its credit risk part is an essential opportunity to embed possible efficiency outcomes as well as to sustain the implementation of the Basel III reforms.

4. The main objective of this discussion paper is therefore to support the efficiency and **simplicity in the design of the rules**, related to the calculation of Pillar 1 requirements. In this context, 'simplicity' in the design of the rules is often interpreted in different ways by different stakeholders.[5] Hence, the assessment of the simplicity of the framework, and more generally

[1] Report on the efficiency of the regulatory and supervisory framework.

[2] The report provides the principles: *"i) preserving the resilience of the EU financial system and its international credibility by remaining committed to implementing the Basel standards, ii) enhancing the ability of supervised entities to reap the benefits of the Single Market, iii) preserving and deepening the Single Market and the Banking Union and iv) maintaining a level playing field in the EU, with appropriate proportionality adjustments and no fragmentation of the Rulebook."*

[3] Specifically this relates to RTS on categorisation within the specialised lending exposure class (CRR Article 147(11)), and RTS on dilution risk (CRR Article 157(6)).

[4] EBA roadmap on the implementation of the EU banking package.

[5] For instance, the latest revision of the Basel standards highlights the diverse interpretations of simplicity. It simplifies the framework for regulators, by the means of relying more on 'simple' (i.e. standardised and more *'comparable'*) approaches. However, it can be viewed as adding complexity for banks, as banks using internal models must now run two parallel calculations (due to the output floor), and smaller banks have to implement more complex (i.e. risk-sensitive) standardised approaches.

its *'efficiency'*, is not an easy task, because, as explained by the Basel Committee "*Regulatory standards balance various ideal attributes, such as being risk-sensitive, simple, comparable and comprehensive, while at the same time limiting opportunities for regulatory arbitrage and providing cost-efficient solutions."*[6] In addition, a secondary objective of this comprehensive review is related to **simplicity in the presentation of the rules**, concerning the readability, coherence, and consistency of the framework. Whilst reviewing its mandates, EBA proposes to work on the consolidation of EBA products, and reconciliation of key regulatory definitions, to ease the readability of the Single Rule book.

5. This DP is however not adding to the discussion on **simplicity in the supervision of rules**, as this aspect is already mainly covered via a dedicated project on the streamlining of the supervisory review and evaluation process (SREP), as well as a revision of the framework to supervise internal models (definition of material model changes and assessment methodologies to be performed by the supervisors).

6. Finally, the EBA presents several suggestions for simplification in this DP which aim to foster discussion on elements of the framework where improvements may be possible. However, they are very preliminary and should not be viewed as representing a uniform position of EBA or competent authorities. They serve as a basis for identifying areas of the framework but are neither exhaustive nor final. Through this DP, EBA seeks to engage with the public on potential changes without committing to a specific course at this stage. EBA will carefully consider feedback received and evaluate any potential simplifications against the need to ensure a balanced and robust prudential framework.

[6] See Evaluation of the impact and efficacy of the Basel III reforms, published 14 Dec 2022.

2. Simplification in the Standardised Approach

2.1 Balancing national specificities and supervisory convergence for real estate exposures

7. The full set of real estate exposure provisions encapsulates a significant portion of the complexity inherent in the prudential regulatory architecture, reflecting the nature of the real estate market in the EU that faces national, regional and local specificities. Owing to its systemic materiality and the typically high leverage of counterparties in this segment, real estate exposures have historically been a major source of financial instability, as evidenced by the 2008 global financial crisis. Simultaneously, the sector remains politically and socially sensitive, with different financing approaches chosen across EU countries which have structured housing markets for decades. As a result, the prudential requirements for real estate must strike a delicate balance between the goal of harmonising the framework and the need to handle national particularities.

8. CRR3 has introduced amendments to enhance risk sensitivity and consistency in the area of real estate. In short, the framework primarily relies on a distinction between residential and commercial real estate properties, with the latter generally associated with higher risk profiles. A further key categorisation is the identification of Income Producing Real Estate (IPRE) exposures, where repayment capacity is primarily dependent on the cash flows generated by the underlying property, rather than the obligor's broader income sources.[7] The principal risk driver is the loan-to-value (LTV) ratio, which reflects the relationship between the loan amount and the appraised value of the property collateral.

9. The CRR3 also mandates the EBA to assess the treatment of real estate exposures.[8] A first challenge in assessing the framework lies in determining how EBA can deliver on its mandates in the real estate area in an efficient and proportionate manner. On the one hand, the EBA faces structural constraints in accessing granular data compared to national competent authorities, primarily due to the need for harmonised and standardised data collection processes across jurisdictions. On the other hand, the EBA benefits from a higher perspective, and can use some elements of comparison between jurisdictions (benchmarking).

10. A second challenge is that the mandates, which require an assessment of the riskiness of the exposures and the appropriateness of the corresponding risk weights, interact with several discretions, derogations reflecting local market structures and EU specificities reflected in the CRR3 framework on real estate exposures (see Annex 3).

[7] CRR Article 4(1)(75b).

[8] CRR Article 126(4) on commercial real estate (both IPRE and non-IPRE) and CRR Article 465(11) (in the context of the transitional arrangement for the output floor calculation).

11. The number of possible derogations, spread out across different parts of the framework, triggers the question of whether further streamlining is not possible, with a view to aggregating some measures that were initially thought to be addressing specific purposes, but whose value added as an independent measure may be perceived as limited. This would be in particular true if, in the context of the review of the so-called "stacking order", the treatment of the systemic risk buffer would change and no longer offer the possibility to act specifically on the real-estate sector. It is the EBA's understanding that the Commission is working on an assessment of the competitiveness of the EU banking sector, with potential implications in the micro-prudential and macro-prudential frameworks for banks.[9]

12. The loss data collected via CRR Article 430a may have limited predictive power and might add minimal value in terms of harmonising the framework. It is questionable that this single metric in its current form could contain all the necessary information to take several actions (e.g., allowing a preferential treatment for IPRE). This loss data collected triggers a significant number of interpretative questions, that do not ease the reporting task from the institution's point of view (see technical box).

Box 1: Technical challenges when using loss data reported under CRR Article 430a

On the **numerator**, *"losses shall be reported as soon as provisions are to be booked in accordance with accounting rules."*[10]. However, no precise definition of "losses" is provided.

On the **denominator**, CRR Article 430a sets out that the exposure value of all outstanding exposures shall be reported. However, the exposure value is defined differently under the Standardised Approach and under the IRB Approach (*net or gross of specific / any credit risk adjustments*). This creates a discrepancy between institutions using the SA or the IRB Approach.

Regarding the **nature of the calculation**, two implementations are possible:

- A definition of losses close to the prudential LGD framework, being similar with annual LGDs calculated based on cohorts of defaults in a given year, including incomplete recoveries through estimation (with however a key difference that LGD is calculated relative to the exposure at default, while the loss rate in CRR Article 430a reporting is based on all outstanding exposures, not just those that defaulted). In particular, losses shall be reported only for exposures having defaulted during the reporting period, and where the recovery has not been completed within the reporting period, loss estimates shall be used. This has been the historical approach taken in the reporting, which however has as drawback to rely on non-fully observable data (i.e. loss estimates).
- A definition of losses based on observed annual losses, i.e. the losses that have actually occurred during the reporting period across all defaulted and non-defaulted exposures outstanding during the reporting period, independently of whether or how long ago the default events has occurred. This implementation would reflect the situation of the national property market during the reporting period, as the loss depends more on the market value

[9] Commission report on on the macroprudential review for credit institutions and systemic risks for NBFIs.

[10] Annex VII of Commission Implementing Regulation 2021/451, paragraph 12 and 13.

when the immovable property is finally sold than on the market value that the immovable property would have had when the default event occurred. While this approach is based on observed data, it carries the risk of failing to capture risk sufficiently early, particularly if institutions postpone selling immovable properties during downturn years.

Last, regarding the **scope of the calculation**, it is noted that some actions are applicable to the entire real estate market, while others are related to the application of the preferential treatments to IPRE exposures only. Currently, the loss data is not restricted to IPRE exposures (which are expected to be riskier) but covers all non-ADC real estate exposures.

Discussion box 1

It is considered by EBA, in order to acknowledge national specificities while enhancing supervisory convergence for real estate exposures:

C1. To harmonize the definition of the loss for the purpose of reporting under CRR Article 430a.

C2. To revise the use of the loss data for the preferential treatment of IPRE exposures.

Questions:

Q1. For the purpose of reporting under CRR Article 430a, which definition of loss should be used?

Q2. Should the loss data (CRR Article 430a) be used for the assessment of RWs of real estate exposures under CRR Article 126(4) and CRR Article 465(11)?

Q3. Which elements of the real estate framework should be further simplified?

2.2 Rely on existing ECAI mappings when possible

13. According to CRR Article 138(g), "for exposures to institutions, an institution shall not use an ECAI credit assessment that incorporates assumptions of implicit government support, unless the respective ECAI credit assessment refers to an institution owned by or set up and sponsored by central governments, regional governments or local authorities".

14. These provisions, directly derived from the final Basel III framework,[11] trigger the question of whether the mapping process should be adjusted. Rating agency methodologies typically incorporate government support by "notching-up" an intrinsic rating which reflects the credit worthiness excluding any external support. Nevertheless, in order to qualify as an ECAI credit assessment, these ratings shall be issued by CRAs as stand-alone products aligned with the requirements of the CRA regulation (and not be '*derived*' directly by institutions).To date, only

[11] See CRE 20.18 and related footnotes 12 and 13.

Fitch developed an 'ex government support rating' product,[12] and the new rating produced can easily be mapped to existing rating scales (even if a 'suffix' is added to each scale).[13]

15. Until now, the mapping conducted by the ESAs is done by rating scale (i.e. different rating methodologies mapped to a single rating scale require a single mapping). In other words, in the case where a new type of product or obligor is rated, no new mapping is deemed necessary as long as the final (new) ratings are provided in the previously mapped rating scale. This pragmatic 'shortcut approach' (i.e. compared to the supervision of internal models, no bank specific supervisory review of the rating methodology is performed) was justified by analyses in subsequent mapping exercises (to some extent, the EBA review of the mapping allows to identify potential deficiencies of the newly developed rating methodology).

16. Therefore, from a risk perspective, a new mapping exercise based on quantitative data could be performed, in order to assess the adequacy of the new ratings produced without government support. However, this assessment brings significant challenges, notably because the current mapping methodology should be significantly revised to digest more granular information and because it is not clear at this stage how "default" observations could be collected, given that they may not be issued by CRAs under the existing definitions of default (i.e. a "hypothetical" default in case of bail-out measures may not be covered). This implies that, in the short term, no analysis can be performed to "back-test" this new rating method.

17. In terms of materiality, most of the institution's exposures (SA and IRB Approach) are towards EU institutions (68%)[14] (with potentially limited further adjustment of the rating needed), with the rest of the exposures being mainly toward UK and US institutions (8% for both countries). Additionally, as shown in the EBA report on reliance on external ratings, only half of the exposures to institutions are risk weighted using an external rating.[15]

18. Therefore, from a risk perspective, a new mapping based on quantitative data should be envisaged when sufficient data is available. Until this new mapping is performed, it is the EBA opinion that ratings without government support can be temporarily used, as long as they use rating scales that are compatible with the rating scales assessed in previous mapping exercises.

Discussion box 2

It is considered by EBA, to facilitate a pragmatic use of ratings, at least in the short term,

C3. That ratings without government support can be temporarily used until sufficient new data is available to perform a new mapping exercise, if their rating scales for such ratings are fully compatible with those assessed by the EBA in previous mapping exercises.

Questions:

Q4. Which other clarifications do you consider necessary to apply the new ECAI framework?

[12] Fitch Ratings Publishes Final Bank Ex-Government Support Ratings Criteria.

[13] In practice, for EU and US banks' support, Fitch does not see the need for any adjustment, arguing that the current ratings are already without implicit government support. Back in May 2015, Fitch took rating actions to remove sovereign support from their ratings. BRRD Review Unlikely to Re-Introduce Sovereign Support.

[14] COREP data extraction. The vast majority is toward institutions of two countries: FR (23%) and DE (20%) – percentage in relation to the total exposures (EU + non-EU).

[15] EBA report on reliance on external ratings. See Table 1 in the report (numbers are for exposures under the SA only).

3. Simplification in the IRB Approach

19. The Basel I framework introduced in 1988 was a one-size-fits-all framework, with no internal modelling of credit risk allowed. In 2004, Basel II introduced risk-sensitive approaches to better align capital requirements with actual risk and the institutions' internal risk management. Two IRB approaches were introduced, the Foundation Internal Ratings-Based Approach (F-IRB) and the Advanced Internal Ratings-Based Approach (A-IRB). The difference between the two approaches refers to the use of LGD, CCF, and Maturity (M) parameters, where regulatory values should be used under the F-IRB, while own estimates can be applied under the A-IRB.

20. The F-IRB was designed for institutions that had the ability to estimate PD but lacked the data or systems to estimate LGD and CCF. The A-IRB was intended for more sophisticated institutions with advanced risk management systems and sufficient historical data to estimate all risk components internally. Hence, this tiered approach allowed a wider range of institutions to adopt internal models, promoting broader adoption of risk-sensitive capital requirements. It was justified by both dynamic and static considerations:

    a) It acknowledged modelling issues caused by data scarcity due to typically small portfolio sizes and in some cases a low number of defaults.

    b) It allowed institutions to gradually build their modelling capabilities without being overwhelmed by the complexity of full model development from the outset. The F-IRB was originally intended to serve as a transitional step for institutions aiming to eventually adopt the A-IRB.

21. Retail exposures were as such not seen as subject to these issues and hence would not benefit from the possibility to use the F-IRB. On the other hand, for specialised lending exposures (SLE) where data scarcity can be higher, the IRB Approach provides for an additional modelling optionality in the form of a supervisory slotting criteria approach, which assigns risk weights and expected loss values based on predefined assignment criteria.

22. More than 20 years later, the modelling landscape has significantly evolved. Many institutions have now developed the capacity to model LGD and CCF also for non-retail exposures. In addition, for many exposure classes, only one approach remains, either because the A-IRB has always been mandatory (retail exposures), or because the final Basel 3 Standard removed the possibility to use it (exposures to institutions, financial sector entities, and large corporate obligors).

23. The EBA considers that overall, this configuration between A-IRB, F-IRB, and SA seems to strike the right balance between risk sensitivity and simplicity, but that there are several detailed aspects, as highlighted in the following sections, where further simplification could be pursued.

3.1 Consolidating and increasing consistency in the IRB rules

3.1.1 Aggregating the IRB rules

24. The requirements applying to IRB models are spread out across several regulatory products, in addition to specific guidance provided by each individual competent authority:

    a) The RTS on assessment methodology indirectly clarifies some requirements that apply to institutions, by requesting the competent authorities to assess their compliance with such requirements;

    b) The IRB repair program launched in 2015/2016 progressively clarified some of these requirements in several guidelines (Guidelines on PD and LGD estimation, Guidelines on downturn LGD, Guidelines on CRM and the CP guidelines on CCF estimation) and RTS (RTS on economic downturn and the RTS on slotting approach)

    c) Finally, the EBA published the validation handbook and various Q&As.

25. The readability of the regulatory package could be simplified by aggregating the products of same legal nature (i.e. combine guidelines and separately combining the RTS mandates). With regard to guidelines, this work could be conducted during the finalisation of the guidelines on CCF estimation. The intention would not be to introduce significant change in the regulation, but rather to ensure a comprehensible package of modelling guidance. In another step also level 2 texts can be streamlined and aggregated. In this process any duplications on clarifications of the requirements would be removed, acknowledging that some products have been designed at a different point in time.

26. At the same time, the EBA is examining how E&S risks could be more systematically integrated into existing risk differentiation and quantification steps. This could involve clarifying the incorporation of new risk drivers, ensuring the conservative use of overrides, and encouraging the use of stress testing to capture environmental risks, as foreseen in the report on the role of environmental and social risks in the prudential framework.[16] Over time, as more data becomes available, institutions may need to reflect environmental risk drivers in the estimation of PD and LGD parameters. At the same time, the EBA acknowledges that introducing new risk drivers may increase modelling complexity, and such trade-offs need to be carefully assessed. Further, in the review of the RTS on the supervisory slotting criteria approach, the EBA is also assessing the possible incorporation of BCBS FAQ 8. The EBA has also considered to integrate the ESG requirements on the IRB stress test (i.e. stress tests mentioned in CRR Article 177) in its Guidelines on ESG Scenario Analysis.[17]

Discussion box 3

It is considered by EBA, in order to simplify the readability of the IRB regulation,

C4. To aggregate IRB products of the same legal nature (L2 and separately L3).

C5. To remove duplications across IRB products.

[16] Report on the role of environmental and social risks in the prudential framework.

[17] See consultation paper on Draft Guidelines on ESG Scenario Analysis published in January 2025.

C6. To integrate guidance on how to incorporate environmental and social risks into risk differentiation and quantification steps.

Questions:

Q5. Should the consolidation of regulatory products for credit risk be a priority or should the regulatory stability be preferable instead? Have you identified any redundancies in IRB products?

Q6. Do you consider that the integration of environmental and social risks into the credit risk framework could be further enhanced without undermining its simplicity? Which areas, if any, would you prioritise for further work or clarification?

3.1.2 Harmonise testing requirements for continuous and discrete models

27. The IRB Approach is based on the notion of grades and pools, which are used to derive estimates of PD, LGD and CCF, and evaluate the performance of the model subsequently (i.e. back-testing). The grade scales can be based on the obligor characteristic, as defined in CRR Article 142(1)(6), or on the facility characteristics, as defined in CRR Article 142(1)(7).

28. CRR Article 169(3), which sets general principles for rating systems and is therefore applicable to all risk parameters, introduces the possibility to use direct estimates of risk parameters for individual obligors or exposures, by considering them as estimates assigned to grades on a "continuous rating scale".[18] The CRR therefore allows for the computation of own funds requirements as well as the main steps of the validation and risk quantification on a continuous basis. Currently, such continuous rating scales represent less than 10% of the overall number of PD models.[19]

29. It should be noted that such "continuous rating scales" are different from "continuous ranking models". The latter are very common, where the models are continuous in the risk differentiation part (e.g. a continuous scoring function) and then only discretised in a second step within the risk quantification.

30. The Basel framework does not mention the possibility to model continuous rating scales, and as such, the EU framework is more flexible, but also more complex than foreseen in international standards. The EBA answer to the call for Advice on the implementation of Basel 3 already discusses the CRR provision and formulate a recommendation (recommendation CR-IR-46)[20] to *develop guidelines with further clarifications on the application of CRR requirements with regard to model development, risk quantification, application and validation of risk parameters based on continuous or very granular rating scales*. This recommendation has been followed by the co-legislators, who have introduced a mandate in Article 169(9) of the CRR.[21]

31. There are several estimation and application challenges arising from using continuous rating scales (as described in the technical box below), which limits the comparability of RWA

[18] The discussion on CRR Article 169(3) is not related to the use of so-called "master scales", as institutions which do not make use of this provision are not required to use a master scale.

[19] See table 8 in the EBA chart pack on the credit risk 2020 benchmarking exercise.

[20] EBA Policy Advice on Basel III.

[21] Since then, it is noteworthy that the UK near final rules of Basel 3.1 published in September 2024 proposed to remove the use of continuous PD estimates (and maintain this possibility only for LGD and CCF modelling).

requirements. It could therefore be considered to develop under the mandate in CRR Article 169(9) a requirement or method to discretise the result of continuous models for the purpose of certain IRB testing requirements (e.g., on discriminatory power and homogeneity), which would allow for a simplification of the IRB framework and increase comparability of estimates. Introducing a discretisation requirement for continuous models for the purpose of testing these models would reduce significantly the complexity of the framework, allowing for the harmonised application of modelling requirements and limiting unwarranted RWEA variability.

32. A consideration would be for institutions using continuous ranking scales to build homogeneous grades or pools. These buckets are already used for regular back-testing, hence for high performing models, the costs would be limited. For models with weak model performance where the construction of homogenous grades or pools is harder to reach, the re-development costs could be more substantial.

Box 2: Use of continuous estimates

A number of requirements *de facto* cannot be applied directly to continuous models, due to the fact that each grade is technically populated by a single exposure:

- **Validation of the requirements applicable at grade level:** homogeneity and heterogeneity[22], concentration[23], minimum number of observations.[24]
- **Application of the model**, in particular for overrides, where the usual practice of "*notching*" cannot be applied directly to continuous scales.
- **Review of the estimates and back-testing:** The back-testing of final risk parameter estimates required in CRR Article 185(b) is defined at grade level.[25] For PD, validation at the grade level is practically at odds with continuous rating scales, since a single obligor's PD (a value *between* zero *and* one) must be compared to a binary default outcome (zero *or* one), resulting in "default rates" of either 0% or 100% per grade. This issue is less pronounced for LGD and CCF, where individual realised values can be directly compared to estimates.

In practice, institutions may build certain buckets to test the above requirements. However, even if it is done, these buckets may not meet all requirements relevant for grades.

To note, because of the concave shape of the RW function with respect to PD, RWEA variability could occur between continuous and discrete rating scales. Because the RW function is steep at low PD values, using a continuous rating scale can result in lower RWEA compared to discrete scales. However, neither smoothing estimates nor increasing granularity inherently improves accuracy.

[22] As specified in CRR Article 170, and Article 38 of the final draft RTS on IRB assessment methodology and further clarified in paragraphs 69 and 130 of the Guidelines on PD and LGD estimation.

[23] As specified in the CRR in Article 170(d), CRR Article 170(f), and in CRR Article 170(3)(c).

[24] As specified in CRR Article 170(3)(b).

[25] It should be noted that the back-testing of final LGD/CCF estimates required in CRR Article 185(b) is phrased in a slightly different manner than for the PD: "*Institutions using own estimates of LGD and conversion factors shall also perform **analogous** analysis for these estimates".*

Discussion box 4

It is considered by EBA, in order to accommodate a level playing field between continuous and discrete modelling practices, and limiting unwarranted RWA variability,

C7. To develop under the mandate in Article 169(9) a method to discretize the use of continuous models for the purpose of certain IRB testing requirements.

Questions:

Q7. Which requirements should apply in relation to the measurement of the performance of continuous models (e.g. Back-testing)? How could testing requirements be facilitated and enhanced for continuous models that are compliant with CRR, Part three, Title II, Chapter 3, Section 6 (Requirements for the IRB approach)?

Q8. Which requirements should apply in the application phase of continuous models (e.g. overrides)?

3.1.3 Clarify and harmonise the definition of facility

33. The CRR3 introduces a new definition of facility.[26] This definition allows for a degree of flexibility for the institution, namely whether a facility is a credit exposure arising from a (single) contract, or a set of contracts. In other words, CRR3 enables to some degree aggregation across contracts to allow institutions to align their modelling with business practices. This level of aggregation referenced in the definition of facility in the CRR impacts a wide range of areas in the framework, such as the definition of default (which can be applied at facility level for retail exposures), the estimation of PD (counting of number of defaulted and non-defaulted facilities in the risk quantification), and in the estimation and application of the LGD and CCF parameters. On this last aspect, the consultation paper (CP) on CCF estimation proposes a number of clarifications, in particular in relation to the so-called "*change in consumer product mix*".[27]

34. On the one hand, a consistent facility definition (i.e. a single level of aggregation) for all risk parameters would simplify the application of the framework. This would avoid possible arbitrage risk in the calculation of different risk parameters, for example via a more granular definition of facility for PD (to circumvent contagion) and a more aggregate level of facility for CCF (to circumvent the flooring of a negative CCF during risk quantification).

35. On the other hand, using a consistent definition of facility constrains the level at which the PD (for retail), LGD and CCF risk parameters are estimated (calculation of realised values) and applied. However, no unintended consequences in the case where the risk management policy of off-balance sheet exposures (e.g. management of limits) is not aligned with the recovery policies (e.g. due to collateral and contracts) were identified.

36. Additional guidance on the definition of facility might introduce the need for institutions to redevelop models that would need to be approved by CAs, increasing the burden for both

[26] As specified in CRR Article 5(6): *"'facility' or 'credit facility' means a credit exposure arising from a contract or a set of contracts between an obligor and an institution"*.

[27] Consultation Paper on CCF Guidelines.

supervisors and institutions. However, it is questionable whether this additional guidance on the level of facility would introduce many standalone changes, given also the regulatory updates in the CRR3 (e.g. the requirement that the LGD is calculated for the single facility) and other regulatory products.

Discussion box 5

It is considered by EBA, in order to facilitate supervisory convergence,

C8. To develop additional guidance on the definition of facility, for example by requiring a consistent facility definition (i.e. a single level of aggregation) across all risk parameters.

Questions:

Q9. Which challenges have you encountered in implementing the new CRR definition of facility?

Q10. Should a consistent and single facility definition be applied across all risk parameters?

3.1.4 Clarify and harmonise representativeness requirements

37. The CRR requires the data used to build the model to be representative of the population of the institution's actual obligors or exposures. This is to ensure that the model is designed in such a way that it functions appropriately for the scope of obligors or facilities for which the model is used. The PD and LGD Guidelines provide a section with more detailed guidance on how to assess representativeness.

38. The representativeness framework has been reviewed in the context of the recently consulted CCF Guidelines, aiming at simplification and clarification of the regulation, and at the same time addressing the relevant risks attached to non-representativeness of data. The three main clarifications are:

    a) The implications of a lack of representativeness may differ across data samples, with a distinction introduced between data used for developing the model and data used for testing the model. More flexibility is introduced in the development of a model, but for the testing of model performance, representativeness remains essential, as a lack of representativeness may imply biased test results. The consequence of a lack of representativeness of data used for risk quantification is not changed vis-à-vis the Guidelines on PD and LGD estimation;

    b) The dimensions along which to analyse representativeness have been simplified;

    c) Several situations of a lack of historical data for CCF modelling are addressed under this framework as well.

39. This updated representativeness framework could also be applied to PD and LGD estimation, albeit with targeted amendments to accommodate PD and LGD specificities (e.g., likely range of variability of one-year default rates). As part of future work, it could be investigated whether the treatment of external and pooled data has been sufficiently clarified. In any case, the EBA is assessing the interaction between these representativeness concepts, and the current use of portfolio level calibration, and particularly the use of calibration samples (for PD estimation) that are shorter than the historical observation period used for the long run averages.

Discussion box 6

It is considered by EBA, in order to facilitate supervisory convergence and accommodate more efficient modelling practices,

C9. To apply the guidance on representativeness for the CCF parameter also for PD and LGD estimation with targeted amendments to accommodate PD and LGD specificities.

Questions:

Q11. Are adjustments proposed in the representativeness requirement for the CCF parameter also suited for PD and LGD risk parameters? Which amendments would be needed to accommodate PD and LGD specificities?

Q12: Do you consider further simplification of the representativeness requirement, as proposed for the CCF parameter, as necessary for PD and LGD and if so, what kind of simplification?

3.2 Simplified approaches in IRB estimation

40. The Guidelines on PD and LGD estimation have been published end 2017. These guidelines were one of the initiatives to reduce unjustified variability of risk parameters and own funds requirements in order to restore trust in models without impeding the risk sensitivity of the framework. Subsequently, the EBA published in March 2019 its final Guidelines on downturn LGDs, specifying how institutions should quantify the estimation of loss given default appropriate for conditions of an economic downturn.

41. Following almost 10 years of experience with these guidelines and the application of the Basel 3 accords restrictions in modelling (scope, input and output floor), the EBA suggests reviewing certain elements of these GL that could warrant an (optional) simpler approach. The suggestions developed in this section are based on the following principles:

    a) The gained risk sensitivity is limited (either in relation to the criticality of the exposures, or the materiality of the risk),

    b) The burden on modelling and the related supervisory review process is high,

    c) Any new approach proposed would be an opt-in approach and should be simple to apply, in order to keep the transition costs relatively low in comparison to the actual relief of model maintenance (and the development of new models),

    d) The simpler approaches are to a reasonable extent conservative, and do not lead to a material deviation in relation to the Basel framework.

Discussion box 7

It is considered by EBA, in order to reduce the modelling burden and streamline the supervisory review process,

C10. For Margin of Conservatism (MoC) categories A and B, to add an optional fallback approach for cases where quantifying subcomponents is complex or risks double counting, and to standardise MoC C.

C11. In order to account for direct and indirect costs, to add an optional fallback approach to use a [relative] increase of [realised] LGD of [X%].

C12. For downturn LGD and CCF estimation, to add an optional fallback approach with a calibration structure more similar to the reference value or similar to the fixed add-on approach provided in para. 7 of the GL on downturn, for example by allowing institutions to use these approaches as a basis for estimation if they have sufficient years of observation capturing also downturn conditions.

C13. For in-default LGD estimation, to add an optional fallback approach, e.g. using an SA-like approach as a basis to estimating own fund requirements for in-default exposures, subject to (back-testing) requirements.

C14. For CCF estimation, to add an optional fallback approach by allowing the use of a fixed CCF for entire types of exposures, subject to back-testing requirements.

C15. For CCF estimation, to allow more flexibility in the use of the 12-month fixed horizon approach, e.g., to incorporate elements of the cohort approach while requiring institutions to explain significant deviations from long-run average realised CCFs calculated under the 12-month fixed horizon approach.

Questions:

Q13. Should these simplifications be pursued? Do you have any preferred approaches with respect to these simplifications?

Q14. Do you have any comments and suggestions with reference to the calibration of the fall back approaches?

Q15. Do you see other potential simplification areas where the modelling burden is not commensurate to the gain in risk sensitivity?

Q16. What do you perceive as challenges in your capacity to collect appropriate data, in particular in relation to indirect costs?

3.2.1 Simplified approach for Margin of Conservatism

42. CRR states that to overcome biases, an institution shall include appropriate adjustments in its estimates to the extent possible; after having included an appropriate adjustment, it shall add to its estimates a sufficient margin of conservatism that is related to the expected range of estimation errors; where methods and data are considered to be less satisfactory, the expected range of errors is larger, and the margin of conservatism shall be larger. Finally, the less data an institution has, the more conservative it shall be in its estimation.

43. The Guidelines on PD and LGD estimation clarified how to set up a framework to quantify the margin of conservatism.

a) When estimating risk parameters, institutions should identify any deficiencies that may lead to a bias in the quantification of risk parameters, or to increased uncertainty that is not fully captured by the general estimation error. These deficiencies may be related to data and methodology issues (defined in the GL as category A), or to the changes in relevant processes or in the external environment which may lead to additional uncertainty in the quantification of risk parameters (specified as category B). Categories A and B are expected to be non-overlapping, i.e. each identified deficiency should be classified in only one of the categories.

b) Institutions are required to address the identified deficiencies via appropriate adjustments and a MoC (of category A or B). A MoC should be quantified for all deficiencies that could not be rectified by an appropriate adjustment, and the MoC should also cover the additional uncertainty stemming from the adjustments. The quantification of MoC A and B should reflect the additional uncertainty resulting either from the application of the adjustments or, where no adjustments are possible, from the uncertainty driven by the deficiencies in the relevant category.

c) Institutions should quantify a general estimation error and present it in a separate category (category C). The quantification of the MoC for the general estimation error should reflect the dispersion of the distribution of the statistical estimator.

d) The MoC should be applied on top of the best estimate of the risk parameter (i.e. a parameter after applying all appropriate adjustments).

44. The EBA is considering simplifications and standardisation in the MoC categories.

a) For MoC categories A and B, the Guidelines offer a structured process for identifying deficiencies and quantifying the margin of conservatism. However, the resulting modelling effort may not always be proportional to the related risk (uncertainty). To address this, an optional fallback approach could be proposed for cases where quantifying subcomponents is complex or risks double counting. This reduces the modelling burden while preserving the required level of conservatism.

b) For MoC category C, there is a high degree of heterogeneity in the approaches used by institutions. This leads to significant variability in outcomes and makes comparability across institutions difficult. Next to that, for low-default portfolios in particular, the methods may yield counterintuitive or overly conservative results. Further standardisation could help address these issues but should not restrict viable modelling options.

3.2.2 Simplified approach for Direct and Indirect costs

45. The Guidelines on PD and LGD estimation require institutions to store and collect data on their direct and indirect costs incurred in recovering the exposure for defaulted exposures, and include them in the realised loss. For allocating indirect costs, institutions may apply exposure-weighted averages or use statistical methods based on a representative sample of defaulted obligors or facilities. Although the EBA considers that these costs can be a significant contribution to the final LGD estimate, they may also be an appropriate candidate for

standardization. For instance, it could be considered as a fallback (i.e. optional) approach to allow the use of a [relative / absolute] increase of [realised / estimate] LGD of [X%] .

3.2.3 Simplified approach for Downturn estimation

46. The CRR requires institutions to apply an LGD and CCF that are appropriate for a Downturn (DT) period. For this purpose, the EBA has previously published several products:

    a) The RTS on the specification of the nature, severity and duration of an economic downturn (*RTS on DT periods*). This RTS specifies the requirements on how to identify and determine the characteristics of downturn periods.

    b) The Guidelines for the estimation of LGD appropriate for an economic downturn (*GL LGD DT*). These GL specify the different estimation steps that institutions should follow after having identified the DT periods.

    c) The consultation paper on the CCF Guidelines (*CP GL CCF*). The CP includes guidance on the CCF DT estimation, which is largely similar to the guidance for LGD in the GL LGD DT.

47. More specifically, for the estimation of downturn LGD, institutions have the choice between three methodologies, and need to compare the outcome of the analysis with both the long run average (which is a floor required by the CRR) and a "reference value" (non-binding metric introduced in the guidelines), calculated as the simple average of the average realised LGDs from the two individual years with the highest observed losses.

48. The EBA understands that the process can be in some cases complex to apply in practice, with limited gain in terms of adequacy of own funds requirements. As such, it could be considered to give more prominence to the reference value mentioned above, for instance by allowing institutions to use this as a basis for a simpler estimation method if they have sufficient years of observation. Similarly, a more relevant role could be given to the fixed downturn add-on provided by section 7 of the downturn guidelines.

3.2.4 Simplified approach for estimation of LGD for defaulted assets

49. The CP on Guidelines for CCF estimation introduces a simplified approach for in-default exposures, designed to ensure proportionality to the materiality of the affected exposures. A similar rationale could apply to in-default LGD estimates. With minimum provisioning requirements under the NPL backstop in the CRR, the risk of undercapitalisation for these exposures is significantly reduced. Hence, EBA is considering the introduction of a simplified approach for these estimates where materiality and the risk of underestimation are low.

50. A key distinction between CCF and LGD is that post-default drawings can be more effectively managed through institutional risk controls. Implementing and adhering to strict post-default drawing policies significantly reduces the risk of high conversion factors for in-default exposures. Therefore, for CCF, institutions may apply non-default grade-level estimates to facilities based on their most recent grade assignment prior to default, provided that internal policies restrict additional drawings and historical data shows a low proportion of post-default drawings relative to undrawn amounts at the time of default.

51. Implementing a comparable approach for LGD is more challenging, as collateral recoveries are often outside the institution's direct control, unlike drawing policies. The EBA is therefore seeking input on criteria that could support a simplified method for estimating the LGD in-default parameter while maintaining an appropriate level of conservatism. One possible option could be to permit the use of an SA-like approach as a basis to estimating own fund requirements for in-default exposures, without the need to model risk parameters for defaulted exposures (possibly subject to back-testing requirements).

3.2.5 Apply the fixed IRB-CCF derogation to a larger scope

52. The EBA published in July 2025 the CP on Guidelines for CCF estimation, as mandated under CRR Article 182(5). Within the boundaries of the Level 1 text, the CP proposes requirements that align as closely as possible with supervisory expectations for other risk parameters, particularly LGD estimation. Some requirements, however, are specific to CCF (e.g., calculation of realised CCFs), and several '*simplified approaches*' are suggested where the cost of modelling would not be commensurate with the underlying risk.

53. One such approach concerns the standardisation of CCF through a fixed CCF. The CP introduces the concept of a fixed CCF while continuing to apply own LGD estimates. Own estimates of LGD and CCF are considered a 'package deal,' meaning institutions should apply either both LGD and CCF or neither (i.e., revert to F-IRB). The CP therefore allows the application of a fixed CCF to certain exposure segments where institutions cannot reasonably meet the requirements of CRR Part Three, Title II, Chapter 3, Section 6.[28] The corresponding SA-CCF value may not be appropriate, as LGD may be calibrated using realised CCFs significantly higher than the SA-CCF value.

54. In general, CCF models exhibit low discriminatory power, raising questions about their validity. Beyond the inherent difficulty of identifying risk drivers to predict future drawings, additional complexity arises from the interaction between facility-level modelling requirements and behavioural patterns observed at obligor level.[29] Another commonly cited challenge is the 'region of instability' where a facility is close to being fully drawn at the reference date. Furthermore, CCF estimates for individual facilities are floored at 50% of the SA-CCF value, offering limited gains in risk sensitivity.

55. IRB-CCF modelling is also restricted to revolving exposures where the A-IRB approach is applicable. As such, the burden of CCF modelling may not be proportional to the benefits of applying own CCF estimates. It could therefore be considered to broaden the scope of the fixed

[28] See background and rationale section 3.4.1.b of the CP on CCF GL: *"According to Article 143 of the CRR3, 'prior permission to use the IRB Approach, including own estimates of LGD and IRB-CCF, shall be required for each exposure class and for each rating system and for each approach to estimating LGDs and CCFs used'. Therefore, for facilities that include commitments in scope of the IRB-CCF, but to which institutions are not able to assign an IRB-CCF because they cannot meet the minimum requirements for calculating the IRB-CCF as specified in CRR, PART Three, Title II, Chapter 3, Section 6, institutions should assign the LGD values of Article 161(1) of the CRR ("Foundation IRB LGD") instead of own estimates of LGDs. Since there are situations in which institutions would not be able to reliably estimate an IRB-CCF even though they would be able to estimate robust LGD estimates, these CCF GL introduce the notion of a minimum fixed value for the IRB CCF that would allow institutions to meet the requirements in CRR, PART Three, Title II, Chapter 3, Section 6."*

[29] E.g. a revolving credit may be used to pay interest and redeem principal on a connected term loan, or in the other way, a revolving loan may be restructured into term loan just before default.

CCF derogation, allowing optional use of a fixed CCF for entire types of exposures, subject to the other requirements set out in the CP on CCF Guidelines.[30]

56. The upcoming CCF Guidelines and new CRR provisions will likely require some degree of model redevelopment.[31] The EBA therefore does not expect institutions to incur significant transition costs, as applying a fixed CCF may even result in cost savings. In any case, LGD models may need to be redeveloped or recalibrated to ensure consistency between LGD and CCF models.

3.2.6 Introduce more flexibility around the CCF 12-month fixed horizon approach

57. For IRB-CCFs, it may also be appropriate to allow greater flexibility in applying the 12-month fixed horizon approach.[32] While this requirement aims to standardise the calculation of realised CCF and the selection of risk drivers, technical challenges arise from the mismatch between the modelling and application phases, as outlined in the box below. As a result of these technical challenges, the 12-month fixed horizon approach is likely to introduce bias into the estimates. This introduces modelling complexities and has led to the inclusion of additional guidance in the CP CCF Guidelines.

58. It could therefore be considered to allow greater modelling flexibility around this requirement, for example by relying to some extent on a cohort approach while requiring institutions to explain any significant deviations from long-run average realised CCFs calculated under the 12-month fixed horizon approach. A cohort approach could help ensure consistency between the estimation and application phase. Since a cohort approach is also applicable to the LGD parameter, extending it to CCF would promote consistent treatment across both parameters.

59. Although this could represent a partial deviation from Basel standards, it is unlikely to reduce own funds requirements and would primarily serve to reduce modelling complexity. In addition, the input floor for IRB-CCF (set at a minimum of 50% of the corresponding SA-CCF) provides an additional safeguard. The EBA has further strengthened the framework in this area through the publication of its RTS on off-balance-sheet items in August 2025.[33]

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[30] Under the fixed CCF, institutions should apply a sufficient MoC in their CCF estimates such that these final CCF estimates have a minimum value of 100%. Institutions should define a MoC that is sufficiently conservative. As such, it is possible that the final CCF estimate for the related facilities is higher than 100%. Next to that, the fixed CCF approach is subject to back-testing requirements to ensure sufficient conservatism in the estimate.

[31] As published in a statement in July 2024, "*The EBA considers that, with respect to the CRR 3 changes on credit conversion factor estimates (IRB-CCF), institutions shall implement the changes impacting the scope of application of the IRB-CCF (limitation to revolving commitments as per Article 166(8b) of CRR 3) and the final IRB-CCF (CCF input floors) at the application date of CRR 3. The implementation of other CRR 3 changes on IRB-CCF which may impact the performance of the rating system (e.g. 12 months fixed horizon reference date) may not need to be prioritised until the finalisation of the EBA guidelines specifying the methodology that institutions are to apply in order to estimate IRB-CCF, as mandated by Article 182(5) of CRR 3. For these other CRR 3 changes, institutions should assess the materiality of the temporary non-compliance to CRR 3 and discuss with the Competent Authority about the application of adequate mitigation measures to their IRB-CCF until the changes are implemented.*"

[32] CRR Article 182(1)(g) prescribes that a "12-month fixed-horizon approach" should be used for the estimation of IRB CCF. This requirement is complemented by CRR Article 182(1), subparagraph 3, which further clarifies that *"each default shall be linked to relevant obligor and facility characteristics at the fixed reference date defined as 12 months prior to the date of default"*. This CRR implementation follows the prescription in the final Basel 3 framework, in which CRE 36.93 requires that *"Banks' EAD estimates must be developed using a 12-month fixed-horizon approach; ie for each observation in the reference data set, default outcomes must be linked to relevant obligor and facility characteristics twelve months prior to default"*.

[33] Final Report on Regulatory Technical Standards on the allocation of off-balance sheet items and UCC considerations.

60. No transition modelling costs are expected, as the EBA published a statement in July 2024 that CRR 3 changes on IRB-CCF such as the 12-month fixed horizon reference date may not need to be prioritised until the finalisation of the EBA CCF guidelines.

Box 3: Technical challenges when applying the 12-month fixed horizon approach.

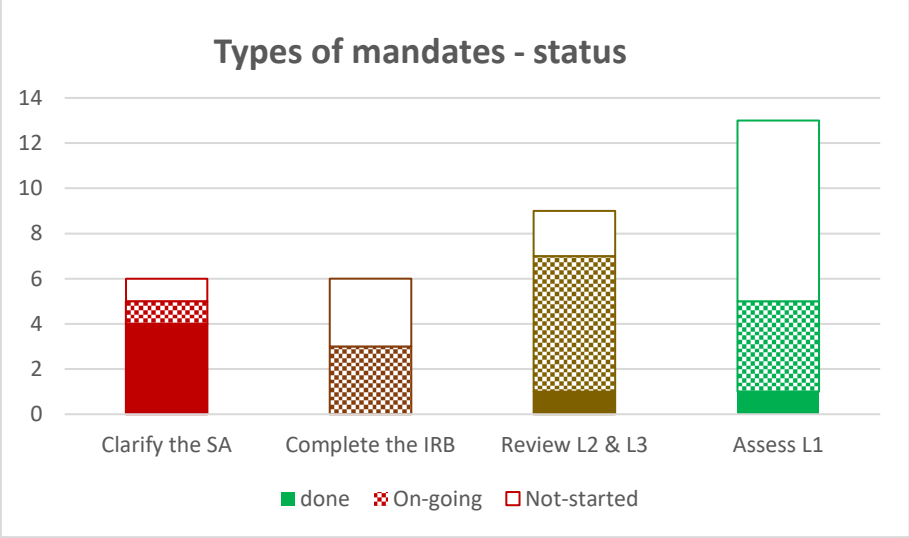
The use of the 12-month fixed horizon approach impacts all phases of the CCF estimation:

- For the definition of the target variable (calculation of the realised CCF), the 12-month fixed-horizon approach implies that the reference date is fixed exactly 12 months before the default date. This can have severe effects, for instance where the defaults are observed at a specific day in the month (the due date being the same for all facilities, e.g. for credit cards).
- For the risk differentiation (definition of the risk drivers), the 12-month fixed-horizon approach implies that the value of the risk drivers used for the construction of the model must be the one observed exactly 12 months before the defaults. This limits the possibility to predict drawings with a shorter time horizon.
- For the risk quantification (calculation of the long run average), the 12-months fixed-horizon approach implies a certain weighting of exposures, which is different from other approaches such as a "cohort approach". In particular, those defaults that occur within 12 months of their origination are either likely overrepresented (if counted in the long-run average) or underrepresented (if excluded).

4. EBA reports to assess L1

61. Beyond L2 and L3 mandates, CRR3 requires EBA to produce several reports assessing the appropriateness of L1 elements. As shown in Figure 1, these assessments now represent a significant share of the remaining credit risk roadmap work. In pursuing simplicity and efficiency, trade-offs between simplicity and risk sensitivity should be considered while analysing the framework and drafting these reports.

Figure 1: overview of the progress on the credit risk roadmap



62. Put at its extreme, the regulatory framework can be endlessly simplified, for example requiring that each euro lent is funded by one euro of equity, thus allowing to remove all requirements in the EU capital rules for institutions. Another example, though less strict, approach, was given by former FDIC chair, Thomas Hoenig, who put forward the proposal of a 10% leverage ratio.[34]

63. However, as these examples show, less risk sensitivity generally comes with higher conservatism. This can lead to an over-capitalisation, where the associated cost, such as hindering the financing of the real economy, may outweigh the potential benefits of enhanced financial stability. In addition, an increased risk sensitivity also ensures a more precise capital allocation, therefore bringing together risk management and regulatory metrics. Conversely, insufficient risk sensitivity can create incentives to invest in higher-risk assets, potentially undermining the intended prudence of the framework. Hence, simplification is not the sole goal for the regulatory framework.

64. On the other hand of the spectrum, there are limits in how risk sensitive a framework can be, as complexity may lead to market entry barriers, misapplication of the rules or more generally increased compliance costs. Therefore, any supervisory framework inherently involves some degree of averaging, which may overstate or understate the risk of some exposures. Each refinement of the framework should therefore be assessed individually.

[34] See for instance Market-Based proposal for regulatory relief and accountability, speech from 13 March 2017.

65. To support the analysis in the reports to review the appropriateness of L1, the EBA proposes an analytical framework (see figure below) based on six measures for assessing changes in credit risk regulation – to be used in the context of these reports only to ensure a consistent analysis of how to increase the efficiency of the framework.[35] These criteria do not aim to reduce or anyway alter the capacity by EBA to fulfil the mandates received from co-legislators. In short, a refinement should be considered only if the benefits in terms of risk sensitivity (material reduction of the miscalibration on a critical set of exposures) outweigh the costs associated with increased complexity and the transition process. This analytical framework should be complemented by two overarching considerations: first, on the intrinsic consistency of the framework (e.g. appropriate ranking of the risk measures), and second on the extrinsic consistency with international standards (i.e. compliance or gold plating vis-a-vis the Basel framework).

Discussion box 8

It is considered by EBA, in order to ensure a balanced approach between risk sensitivity and simplicity,

C16. To apply the aforementioned framework to the mandated reports to review the appropriateness of L1.

Questions:

Q17. Do you agree with the approach proposed by EBA? Do you see further measures as necessary?

[35] These measures are currently intended for use within the credit risk context.

CRITICALITY OF EXPOSURES

How critical are the exposures affected by the refinement? This can be assessed in both quantitative terms (e.g. size or volume of the exposures) or qualitative terms (e.g. relevance to the financing of real economy, sensitivity of the own funds requirements in the pricing, importance for specialised business models).

MATERIALITY OF MISCALIBRATION

How wide is the gap between the regulatory parameters and the actual risk? A central challenge in this assessment lies in determining the underlying risk itself, which can be approached through various methods ranging from pure theoretical assessments to more empirical, data-driven analyses.

SIMPLICITY OF THE RULES

What is the increased complexity of the new set of rules? Such complexity can be, among others, conceptual (e.g. more calculation steps) or operational (e.g. reliance on data not readily available), and incurred by both supervisors or institutions.

TRANSITION COSTS

How costly is it to implement the change? This can be incurred both by institutions (e.g. re-development of internal models) and supervisors (e.g. review of new models). It can be reduced via transitory measures (e.g. grandfathering).

INTRINSIC CONSISTENCY

Is the proposed change consistent with other parts of the framework? The final rules should ensure that riskier exposures are subject to higher own funds requirements and incentivise more refined risk management techniques.

EXTRINSIC CONSISTENCY

Is the proposed change consistent with other international frameworks? Adjustments to international standards should be justified by European specificities.

Annex 1 – List of questions in this DP

Q1. For the purpose of reporting under CRR Article 430a, which definition of loss should be used?

Q2. Should the loss data (CRR Article 430a) be used for the assessment of RWs of real estate exposures under CRR Article 126(4) and CRR Article 465(11)?

Q3. Which elements of the real estate framework should be further simplified?

Q4. Which other clarifications do you consider necessary to apply the new ECAI framework?

Q5. Should the consolidation of regulatory products for credit risk be a priority or should the regulatory stability be preferable instead? Have you identified any redundancies in IRB products?

Q6. Do you consider that the integration of environmental and social risks into the credit risk framework could be further enhanced without undermining its simplicity? Which areas, if any, would you prioritise for further work or clarification?

Q7. Which requirements should apply in relation to the measurement of the performance of continuous models (e.g. back-testing)? How could testing requirements be facilitated and enhanced for continuous models that are compliant with CRR, Part three, Title II, Chapter 3, Section 6 (Requirements for the IRB approach)?

Q8. Which requirements should apply in the application phase of continuous models (e.g. overrides)?

Q9. Which challenges have you encountered in implementing the new CRR definition of facility?

Q10. Should a consistent and single facility definition be applied across all risk parameters?

Q11. Are adjustments proposed in the representativeness requirement for the CCF parameter also suited for PD and LGD risk parameters? Which amendments would be needed to accommodate PD and LGD specificities?

Q12: Do you consider further simplification of the representativeness requirement, as proposed for the CCF parameter, as necessary for PD and LGD and if so, what kind of simplification?

Q13. Should these simplifications be pursued? Do you have any preferred approaches with respect to these simplifications?

Q14. Do you have comments and suggestions with reference to the calibration of the fall-back approaches?

Q15. Do you see other potential simplification areas where the modelling burden is not commensurate to the gain in risk sensitivity?

Q16. What do you perceive as challenges in your capacity to collect appropriate data, in particular in relation to indirect costs?

Q17. Do you agree with the approach proposed by EBA? Do you see further measures as necessary?

Annex 2 – Categorisation of mandates

"Stock" of regulatory texts published by the EBA

Mandate	CRR ref.	SA/IRB	CRR 3 Mandate
RTS - CRA	110(4)	SA&IRB	Yes (report)
RTS - factors to change RW for RE exposures	124(9)	SA	Yes
RTS - CIU	132a(4)	SA	No
ITS – ECAI mapping	136(1)	SA	Yes (regular)
RTS - Model change	143 (5)	IRB	Yes
RTS - assessment methodology (3)	144 (2), 173 (3), 180 (3)	IRB	Yes
RTS - slotting approach	153 (9)	IRB	Yes
RTS - slotting approach	153 (9)	IRB	Yes
RTS - materiality threshold (DoD)	178 (6)	SA&IRB	No
Guidelines - DoD	178 (7)	SA&IRB	Yes
RTS economic downturn	181(3) / 182 (4)	IRB	No
Guidelines LGD downturn	/	IRB	No
Guidelines CRM	/	IRB	Yes
Guidelines PD-LGD estimation	/	IRB	Yes

"Flow" of mandates (L2 and L3)

Mandate	CRR ref.	SA/IRB
Phase 1		
ITS - Joint decision process for IRB approval	20 (8)	IRB
RTS - Annex 1 CRR	111 (8)	SA
GL - diversification methods (Retail def)	123 (1)(b)	SA
RTS - equivalent legal mechanism	124 (14)	SA
GL - definitions for ADC	126a (3)	SA
GL - DoD - diminished financial info	178 (7)	SA&IRB
Phase 2		
RTS - high quality project finance	122a (4)	SA
RTS - factors to change RW for RE exposures	124(9)	SA
RTS - Model change	143 (5)	IRB

RTS - assessment methodology (3)	144 (2), 173 (3), 180 (3)	IRB
RTS - exposure classes - SLE	147 (11)	IRB
RTS - slotting approach	153 (9)	IRB
GL - ESG stress test for IRB	177 (2)	IRB
GL - Artificial CF LGD and discount rate	181 (5)	IRB
Phase 3		
RTS - Exposure classes	147 (12)	IRB
RTS - purchased receivables	157 (6)	IRB
GL - CCF	182 (5)	IRB
RTS - comparable property (EC)	229 (4)	SA
Phase 4		
GL - Continous models	169 (3)	IRB
GL - PPU / Roll Out	150 (2)	IRB
GL - CRM	181 (4)	IRB

"Flow" of mandates (reports)

Mandated report	**CRR ref.**	**SA/IRB**
Report - policy insurance as CRM (published)	506	IRB
Report – Debt restructurer	36(5)	SA&IRB
Report – mortgages	126(4)	SA
Report – Output floor (unrated Corporates)	465 (3)	SA
Report – Output floor (Real Estate)	465 (11)	SA
Report – Specialised lending assessment	495b (2)	IRB
Report – high quality object finance	495b(4)	SA
Report – Appropriateness leasing	495c	SA&IRB
Report – UCC	495d(2)	SA
Report – agricultural financing (2)	505	SA&IRB
Report – Consistency of own fund deductions	506c	SA&IRB
Report – SFT	506f	SA
Report – portfolio guarantee	506e	SA

Annex 3 – Deviations from the general framework for real estate exposures

As part of the "macro-prudential tools", CRR Article 124(9) allows the (national) "designated authority" to add criteria in the list of general conditions provided in CRR Article 124(3) to qualify for the real estate treatment. ESRB and EBA shall publish their opinions on such decisions, and shall publish these new criteria.

The risk weights for non-ADC exposures[36] can be increased under CRR Article 124(9) after an analysis from the "*designated authority*. This analysis is based both on the loss experience of exposures secured by immovable property, reported according to Article 430a, as well as forward-looking immovable property market developments. To note, contrary to the other cases where the loss rates are used, no specific thresholds are provided in the CRR. Similarly to the RW in the SA, the LGD input floors can be increased for retail exposures after an analysis from a "designated authority" designated in each Member State as per Article 164(6). The EBA published under CRR Articles 124(11) and 164(8) an RTS to specify the types of factors and conditions to be considered in the analysis (update of the existing RTS).[37] The ESRB may, by means of recommendations, and in close cooperation with EBA, give guidance to designated authorities on how to perform their analysis (factors to be considered and indicative benchmarks). The EBA and the ESRB shall publish the list of amended RW (CRR Article 124(9)) and LGD input floors (CRR Article 164(6)).

CRR Articles 125(2) and 126(2) allows for IPRE exposures to be treated as non-IPRE exposures if general "*market conditions*" are met, for both exposures secured by residential or commercial property respectively. These market conditions are related to loss rates observed on the different real estate markets, as reported to competent authorities under CRR Article 430a(1) and published by competent authorities under CRR Article 430a(2). These losses are subject to hard thresholds: 0,3% for exposure with exposure-to-value below 55%, and 0,5% for exposure with exposure-to-value below 100%.

CRR Article 458 allows an authority designated by the member state (either the CA or the "designated authority") to amend the framework (in general, not only for real-estate exposures) if it identifies changes in the intensity of macroprudential or systemic risk. The power to adopt an implementing act to reject the draft national measures is conferred on the Council (CRR Article 458(4)), acting by qualified majority, on a proposal from the Commission, following the receipt of the EBA and ESRB opinions on the measure. Since 2020 (arbitrary date), Several Member States

[36] Non-ADC exposure' means any exposure secured by one or more residential properties or commercial immovable properties that is not an ADC exposure, where 'land acquisition, development and construction exposures', or 'ADC exposures', means exposures to corporates or special purpose entities financing any land acquisition for development and construction purposes, or financing the development and construction of any residential property or commercial immovable property.

[37] The EBA publishes final draft amending technical standards on factors assessing the appropriateness of real estate risk weights | European Banking Authority.

have put in place a measure related to real estate exposures, and one Member State used the article for exposures not related to real estates.[38]

CRR Article 465 of CRR 3 provides a transitional arrangement with lower RW for the application of the output floor for exposures secured by residential properties, treated as non-IPRE exposures. i.e. non-IPRE exposures as well as IPRE exposures that meet fall in the four specific cases or in a market with low losses. This transitional arrangement is subject to a decision by member state (i.e. the low risk weight applies on the exposures with the residential property in this Member State), and subject to low loss rates observed on the data collected via CRR Article 430a. Where Member States exercise the discretion, they shall notify EBA and substantiate their decision. These notifications should be the basis of a report to expose the finding of the monitoring of such transitional treatment, as per CRR Article 465(10).

CRR Article 133 of the CRD introduces the possibility to set a systemic risk buffer for some specific exposures. Many Member States are using specific buffers for real estate exposures.[39]

[38] See https://www.eba.europa.eu/risk-and-data-analysis/risk-analysis/risk-monitoring/macroprudential.

[39] See ESRB overview of the Systemic risk buffer.