Consultation on EBA Guidelines on proportionate retail diversification methods EBA/CP/2024/22

FINANCE DENMARK

Memo

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Question 2: Do you identify any implementation issue in implementing the diversification method?

For small financial institutions, the proposed guidelines are not fully appropriate. Implementing the diversification methods will result in extra administrative burdens and increased costs. EBA's proposed Method 1 is particularly complicated and unnecessarily burdensome, requiring significant IT-development.

Also, the draft Guidelines increase the capital requirements for the smallest financial institutions. Albeit important for the local communities, these institutions have typically a simple business model, with minimal risk for overall financial stability.

Question 5: What is the impact of the proposed diversification assessment set out in these Guidelines compared to the diversification assessment that you currently perform on your retail portfolio?

The Basel III standards are minimum requirements which apply to internationally active banks, which ensure a global level playing field on financial regulation[1]. However, these rules are proposed to be applied to small, local institution.
For the small institutions, EBA's Guidelines on the diversification of the retail portfolio will lead to a significant increase in the capital requirement for the retail portfolio. A survey among 29 of small Danish institutions, shows that the method proposed by the EBA, results in the capital impact of the two diversification methods being inversely correlated with the size of the retail portfolio, thereby having a relatively higher impact on smaller institutions. Furthermore, the feedback shows that the iterative 10 pct. approach significantly affects the smallest institutions, leading the entire retail exposure portfolio for 8 institutions from a risk weight of 75 pct. to a risk weight of 100 pct. Approach 2 also has a considerable impact on the smallest institutions.

It will also be more difficult for smaller institutions to price products for retail customers, as changes in the composition or volume of the retail exposures of the institution can lead to increase in risk weights for a given exposure. In such cases,

[1] [1] https://www.eba.europa.eu/activities/basel-framework-global-regulatory-standards-banks

institutions would theoretically have to renegotiate prices with customers to achieve the required return on the extra allocated capital.

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