Dir Sirs,

This is a response to Consultation Paper from EBA titled “Guidelines on Proportionate Retail Diversification Methods under Article 123(1) of Regulation (EU) No 575/2013,” published on November 12, 2024.

In this paper, the EBA is consulting on an approach where institutions that do not hold a sufficiently granular portfolio, as per the Basel 0.2% criterion for retail exposures, would still be eligible to use preferential risk weights. One of the EBA’s suggestions is that institutions with less diversified retail portfolios (exposures above the 0.2% criterion) would still be considered sufficiently diversified, provided that no more than 10% (iterative approach) of their retail portfolio exceeds the 0.2% threshold. Another proposed approach in his paper is that no more than 5% (one-step approach) of their retail portfolio exceeds the 0.2% threshold.

In paragraph 3.1 point 6 it is emphasized that smaller institutions tend to have more concentrated retail portfolios than larger institutions and that the diversification methods proposed in this consultation paper allow for institutions whose retail portfolio are not granular enough to still be eligible for preferential risk weight.

We agree with the notion that smaller institutions tend to have more concentrated portfolios, but we believe that diversification criteria of no more that 10% of the retail portfolio exceeding 0.2% is still hardly achievable for smaller institutions and start-ups.

One of the conditions to identify retail exposures according to CRR3 Article 123 (1) (b) is: “the total amount owed to the institution, its parent undertakings and its subsidiaries, by the obligor or group of connected clients, including any exposure in default but excluding exposures secured by residential property, up to the property value shall not, to the knowledge of the institution, which shall take reasonable steps to confirm the situation, exceed EUR 1 million;”

So, let’s assume that all the other points in Article 123 (1) are met, and we have a portfolio of retail exposures with values equal to EUR 500 ,000, which is half of the 1 million defined in Article 123 (1) (b).

**Exposure size = EUR 500 ,000**

Each exposure must represent at most 0,2% of portfolio size:

**0,2% \* Portfolio size >= 500 ,000**

Let’s calculate the size of the portfolio:

**500, 000 / 0.002 = 250, 000 ,000**

Now let’s calculate the minimum number of exposures needed to reach the total portfolio size:

**250 ,000, 000 / 500, 000 = 500**

In this hypothetical scenario, at least 500 different retail exposures of EUR 500 ,000 would be needed for the portfolio to be eligible for 0.2% criteria.

If we apply the proposed approach from the EBA, where no more than 5% (one-step approach) of the retail portfolio exceeds the 0.2% threshold to be considered as diversified, for our hypothetical scenario:

Let’s assume in this case that the total value of our retail portfolio is the same, EUR 250, 000 ,000, and all the exposures in our portfolio are not equal to EUR 500, 000, but their average is still EUR 500 ,000.**Which part of the portfolio is allowed to exceed EUR 500, 000:**

**5% \* 250 ,000, 000 = 12, 500 ,000**

**How many exposures can fit into the EUR 12 ,500, 000 cap:**

**12, 500, 000 / 500, 000 = 25**

So, after applying the EBA’s proposed approach of 5% to our hypothetical scenario, we find that in a portfolio where an average amount of exposures is EUR 500 ,000, the minimal number of exposures that exceed 0.2% threshold would be 25, and the remaining number of exposures not exceeding 0.2% threshold would be 475.

A similar scenario is observed when using 10% (iterative approach). The number of exposures that would exceed the 0.2% threshold is different, but the minimum overall number of exposures would still be 500.

In these scenarios we can observe that the minimum number of exposures in a portfolio to be considered sufficiently diversified under the EBA proposed approaches is 500.

For larger institutions that have been operating for a longer period, 500 different retail exposures might not seem like a significant number. However, for smaller institutions and start-ups, this number is harder to achieve due to limited resources, administrative costs, and a lack of automated processes.

At the start of operations, most new credit institutions do not have fully incorporated automated systems and must determine if the client corresponds to their risk profile on an individual basis. This process takes a lot of time, resources, and incurs higher administrative costs. Additionally, institutions consider clients with exposure classes other than retail. Credit institutions that started their operations under CRR2 (Regulation (EU) 2019/876) used 75% risk weight for retail exposures. An increase to a 100% risk weight would be substantial and negatively effect an institution’s ability to adequately forecast its capital needs.

As a result of the increase in the risk weight for retail exposures to 100% from 75%, the risk weighted amount of an institution would increase, negatively affecting its available capital. Due to these reasons, this diversification approach proposed by the EBA is more favorable for older and larger institutions and hurts the chances for smaller institutions to achieve sustainable growth and compete in the market.

Based on these arguments, our proposal would be to allow smaller credit institutions and start-ups to use the 75% risk weight for retail exposures, as was the case under CRR2 (Regulation (EU) 2019/876), or at least provide an adequate transitional period during which institutions would have the opportunity to diversify their retail portfolios over time and not incur increased capital costs without having time to properly prepare and hedge the additional risks.

Best regards,

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