European Banking Authority

BANKING STAKEHOLDER GROUP

EBA BSG 2025 010

12 February 2025

Banking Stakeholder Group

Banking Stakeholder Group's response to Consultation on Guidelines on proportionate retail diversification methods under Article 123 (1) of Regulation (EU) No 575/2013

Introductory remarks

The draft Guidelines on proportionate retail diversification methods have been developed pursuant to the mandate granted under Article 123(1) of the CRR3, tasking the EBA of defining a proportionate method to ensure diversification of the retail portfolio in the context of the standardised approach for the credit risk.

It is worth reminding that granularity of the exposures is only one of the criteria that retail exposures shall meet, as only certain kinds of exposures to individuals and SMEs are eligible for the retail class, and the maximum exposure to a single counterpart (group of connected clients) cannot exceed an absolute threshold of 1 million euro.

The mandate follows to the choice of the EU legislator to exercise the discretion, provided in the Basel III standards, to apply other methods to achieve satisfactory diversification of the retail portfolio than the one envisaged by the BCBS (whereby only exposures smaller than 0.2% of the overall portfolio are eligible for the regulatory retail treatment).

The need for an alternative approach to assess granularity basically lies in the fact that the 0.2% of the sum of the exposures potentially falling in the scope of the retail portfolio might result in a strict threshold depending on the size of the retail portfolio. Therefore, this mandate is essentially intended to address proportionality concerns, as clearly stated in CRR3 tasking EBA "to specify proportionate diversification methods".

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In light of the above, the BSG would like to highlight some points of attention in order to ensure that the final approach outlined for the diversification test actually represents a proportionate method, having regard to all parties involved.

BSG comments

The BSG acknowledges the importance of ensuring adequate diversification of the retail portfolio in line with the prudential objectives of the risk-sensitive capital framework. At the same time, a key issue that shall be taken into account is the possible impact of the proposed diversification test, given that it can result in disqualifying exposures from the regulatory retail treatment (with consequent application of higher risk weights, thus affecting capital requirements for banks and indirectly the availability or the cost of credit for those clients).

The relevance of this aspect under the proportionality profile is twofold.

First, as mentioned also in the Consultation Paper, the diversification test is expected to be more binding for smaller retail portfolios (also taking into account the existing absolute threshold of 1 million euro per exposure). It would be important to ensure that the application of the proposed method, while remaining effective, does not unduly penalise smaller banks by means of a material impact on their capital requirements. This could affect their ability or willingness to offer credit in cases where the application of the diversification test would affect their portfolio structure and imply a large capital impact.

Not less important, a material impact in terms of increased capital requirements would likely not only affect the banks bound by the diversification test, but it could be passed on to clients. It has to be noted that the scope of the retail portfolio is limited to exposures to individuals and SMEs, hence possible tightening of the prudential treatment might have, in certain circumstances, an adverse impact on the supply or cost of credit for households and SMEs.

Particular attention should be given to the choice of approach – whether iterative or non-iterative - used to determine the portfolio component that, despite not meeting the diversification test, can still be considered as part of the retail portfolio that can benefit from the preferential retail risk weight. As stated in the CP, in the iterative approach, i.e. the one proposed by EBA, “by construction, the resulting granularity is systematically higher” due to the fact that the 0.2% threshold become more binding at each iteration. This effect appears to be more pronounced the smaller the size of the portfolio. Therefore, the choice of the iterative approach might be more penalizing for smaller banks, also depending on the structure/composition of their retail loans portfolio. It should also be noted that the concern regarding the possible construction of “artificially large non-granular retail exposures”, intended to inflate the denominator of the ratio, thus undermining the effectiveness of the non-iterative test, seems unlikely, given that the maximum amount of each retail exposure is capped at 1 mln.

For these reasons, also considering that the stylised example in the Consultation Paper shows that the proposed test might determine a significant impact in terms of exposures eligible for the retail

regulatory treatment, the BSG would argue that an assessment of the actual impact of the diversification test (and the different effects of the two proposed methodologies) is necessary, including careful consideration of the evidence gathered through the consultation, but also of further evidence if needed, to assess the impact on different portfolio sizes and structures, possibly also assessing the sensitivity of the test at different levels of the thresholds. More precisely, the choice of the approach should be driven by methodological and operational considerations (while the issue of the different outcomes of the two options in terms of impact could be addressed via appropriate calibration of the threshold).

Last but not least, it has to be noted that the diversification method outlined by the EBA will potentially be applied by all banks (excluding in principle banks having a business model not covering retail credit). Indeed, as the method pertains to the identification of the retail portfolio under the standardised approach, it has to be assumed that not only banks using the standardised approach for credit risk have to implement it, but also banks using internal models when performing the standardised calculation for the purpose of the output floor calculation.

Ensuring proportionality by means of clarity and simplicity of the calculation to be carried out is therefore relevant to most banks. In this regard, given the lack of a specific regulatory reference within the GL, the EBA should provide a clear definition of the “exposure value”, possibly leveraging on existing practices (for the purpose of the calculation performed under Article 1(b), to reduce the administrative burden.