Consultation Response

EBA DP 2026/01: Simplification and assessment of the credit risk framework

May 8, 2026

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **the EBA Discussion Paper 2026/01 – Simplification and assessment of the credit risk framework.** AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.
We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

AFME welcomes the EBA's discussion paper on the simplification of the credit risk framework as part of an overall EU agenda to increase regulatory efficiency and EU bank competitiveness. **The industry strongly supports the EBA's simplification agenda, but sees its success resting on consolidation, proportionality, regulatory stability, and a clear focus on observed risk—rather than new requirements or premature quantification.**

Simplification is essential to reduce operational burden, improve consistency and support European competitiveness but it should not come at the expense of risk sensitivity or disrupting regulatory stability or reducing flexibility where it is warranted.

We support consolidation of the EBA's supervisory products, with a principles focused outcome and would emphasise this should be done in a way that minimizes new modelling obligations, additional layers of interpretation and expanded supervisory expectations. A key component of consolidation should also factor for alignment between EBA and ECB guidance.

We would urge the EBA in its ongoing work to simplify to reflect on direct and indirect costs such as model redevelopment, extended approval times and unnecessary RWA volatility. We therefore urge the EBA to provide transparency on sequencing, timelines, and transitional arrangements, as well as consultations that accompany any of the proposals taken up from this discussion paper.

This consultation also gives us the opportunity to highlight ongoing regulatory uncertainty in terms of the use of ratings without implicit government support. With very limited availability of compliant ex-government support ratings and long onboarding timelines, banks face acute execution risk ahead of the 1 January 2027 application date with material, undue RWA increases (due to the adverse impact of unrated exposures generally defaulting to application of the Grade C RW (150%)). **We would request that the EBA, working with the ECB, provides necessary legal clarity to firms as an urgent priority with respect to the policy implications given insufficient rating coverage will be in place by January 2027.**

Association for Financial Markets in Europe
London Office: Level 10, 20 Churchill Place, London E14 5HJ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540
Frankfurt Office: c/o SPACES – Regus, First Floor Reception, Große Gallusstraße 16-18, 60312, Frankfurt am Main, Germany T:+ 49 (0)69 710 456 660
www.afme.eu

In terms of environment and social risk, we believe the priority should be on the consistent application of Pillar 2 processes (for those accelerating and long-horizon risks) while ensuring that Pillar 1 monitoring frameworks remain robust enough to detect if these risks become sufficiently evidenced in the data.

We have also taken the opportunity to raise ongoing concerns with the lack of clarity on the regulatory treatment of Low Default Portfolios, where statistical requirements more suited to high default portfolios drive excessive conservatism. We therefore support more proportional testing which allows greater flexibility for institutions to rely on expert judgment and alternative evidence of model performance.

Regarding optional fallback approaches, at a high level we support these as long as they are unconditionally optional, without requiring additional justification for use and do not become supervisory benchmark or de facto approach due to unduly complex regulation. Further, calibration is key and excessive conservatism could undermine practical uptake and disincentivise risk sensitivity overall – as an industry we would welcome consultation on detailed fallback approaches to be taken forward.

Finally, beyond the issues explicitly addressed in this Discussion Paper, AFME has identified additional areas where modelling and data requirements are not commensurate with prudential benefit. These include downturn identification mechanics, recovery-period modelling, the treatment of data from acquired entities, physical collateral eligibility conditions, and legal clarity regarding the interaction with broader EU legislation such as the AI Act. Addressing these areas through a proportionate and coordinated approach would further support the EBA's objectives of simplification, stability, and competitiveness.

Overall, as a guiding principle for future changes, we would urge the EBA to reflect across all areas - modelling data, governance and supervision – that requirements should be commensurate with risk, structural data scarcity should not be equated with model weakness, and simplification should increase efficiency without eroding prudential soundness.

Questions

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

The definition of loss could be aligned to the one used for Loss Rate calculation in the EBA Benchmarking. Indeed, this is a concept familiar to IRB Banks involved in the EBA Benchmarking exercise, thus allowing firms to capitalize on a reporting approach already up and running, but at the same time can be calculated with input information available to all banks (either IRB or Standardised Approach (SA)).

Annex IV of RTS&ITS on EBA benchmarking:

210 – Loss rate last year:

The loss ratio is computed using as numerator the sum of credit risk adjustments and write-offs for those exposures which were classified as "defaulted exposures" in the last year …".

This would avoid the time-lag issue of a definition of losses based on observed annual losses – recovery processes may be particularly long for mortgage loans for instance – and ensure maintaining the current cohort approach with a sufficiently robust and universal estimate of losses. Indeed, stage 3 provisions are commonly assimilated to "incurred losses" impacting own funds, and they are usually calibrated to represent a stressed recovery on the immovable property. This would mean that a consistent method with the level of losses and across approaches would be to use an exposure value gross of provisions.

We also support the EBA considering a more flexible approach for equivalent third countries, which should allow both definitions of estimated losses and observed losses to be deemed valid subject to the rates published by the relevant competent authorities given they lead to similar conclusions regarding the stability of national immovable property markets. Observed losses refer to losses actually recognised during the reporting period across all exposures outstanding in that period (defaulted and non-defaulted), irrespective of when the default event occurred. To address the time-lag issue, larger periods could be observed. These losses are anchored in accounting recognition events rather than model-based estimations, which may vary materially across institutions and jurisdictions. This approach offers several advantages in enhancing objectivity, comparability and auditability across institutions and approaches (SA/IRB).

In practice, equivalent third countries typically report loss rates based on observed losses. In addition to differences in the definition of losses, other differences in the calculation methodology may arise between loss rates published by different competent authorities (e.g., overall losses vs losses up to the secured value of the property). Although these methodologies may differ slightly from EU-defined loss

rate measures, they often produce valid conclusions (e.g. US net charge-off rates).

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)?

The use of loss data for the purposes of CRR Article 126(4) and 465(11) should be considered carefully and reflect on comments raised in Q1. Indeed, the loss data based on accounting view can be impacted by one-off maneuvers or overlays. In addition, for SA the calculation of the RWA is done on the exposure net of specific credit risk adjustments. Therefore, the more the exposure has been already covered with LLP the lower the exposure at risk will be and the higher the portion of risk is that has been already covered (the LLP reduces the organic generation of capital, thus operating as a direct capital deduction). Hence, using evidence of higher loss rates (that are a consequence of higher provisions) to increase the RW would lead to double counting the effect. That, said, pursuant to what is reported in par. 124(9), the evidence of loss shall be complemented with a deep analysis on forward-looking immovable property market developments, thus not letting the pure evidence of loss drive the adoption of the RW%.

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

Although we understand the necessity to ensure legal certainty and prudent valuation for the purpose of collateral recognition in a sound manner, the real estate framework strongly lacks proportionality regarding the operational requirements to be met, requiring highly complex processes to be implemented by institutions.

For instance, CRR Art. 229 systematically requires banks to liaise with an independent valuer with due expertise for the purpose of valuation and revaluation, and the GL EBA on LOM only offer a few derogations to be able to rely on Automated Valuation Model in specific circumstances. This does not seem appropriately proportionate when it comes to highly granular, low risk portfolios in well-developed and mature markets, especially in the context of extensive reliance on digital solutions in the economy. We would be supportive of a simplification of the valuation framework adapted to the risk profile of the exposure and to the materiality of the transaction while ensuring a reliable, independent, and prudent assessment of collateral values. This framework may include:

i) the use of transaction based or price data for low risk, standardised loans, where such data are of sufficient quality, granularity and frequency to ensure prudent valuation - for this risk category, prices validated by sworn officers acting in the context of a mission comparable to a public service, or used to build official statistics on real estate prices, shall be deemed as fulfilling the requirement of a reliable, independent and prudent assessment of collateral values; and

ii) less constrained reliance on advanced statistical models.

Another example is the requirement imposed on banks to monitor that the property is adequately insured against damages (CRR Article 208(5)). According to jurisdiction, national rules on insurance schemes coverage and/or observable insured rates should be sufficient to consider that these requirements are met.

An additional simplification could be to streamline the specific EU legal and reporting prerequisites for recognising the loss rates used to support the derogations under Articles 125(3), 126(3), and 199(4a).

While CRR3 has introduced amendments to enhance risk sensitivity and consistency in the area of real estate, the hard-test aims to valid low loss rates risk, but the current requirements remain heavily driven by EU-specific reporting definitions which can be impossible to replicate in equivalent third countries and limit usability for exposures secured by properties outside member states. As a result, the outcome can be driven by data comparability constraints rather than by actual credit performance or local market characteristics.

It is also reasonable to assume that third-country competent authorities which applies supervisory and regulatory arrangements at least equivalent to those applied in the Union as determined in the Decision of the Commission in accordance with Article 107 (2) segment and publish real-estate loss data in a way that reflects the specificities of their markets and supervisory frameworks. This should not, in itself, justify disregarding robust and widely used loss-rate metrics.

For these reasons, we believe the EBA[1] should **explicitly allow the use of loss rates published by**

[1] Article 126.3 CRR3 states "Where a competent authority of a third country does not publish corresponding loss rates for exposures secured by commercial immovable property situated within the territory of that third country, EBA may publish such information for a third country, provided that valid statistical data, that are statistically representative of the corresponding commercial immovable property market, are available."

equivalent third-country jurisdictions (e.g. US net charge-off rates), provided that:

- the rates are accompanied by transparent documentation of portfolio perimeter, methodology rules,
- statistical data is available and representative,
- the jurisdiction can evidence to have a well-developed and long-established real estate market.

Therefore, where statistically representative and publicly available data from the competent authority exists, and where alternative loss ratios are fit for purpose, a more flexible and proportionate approach could be considered to allow the use of the already available information. However, if published ratios were ultimately considered not to be fully fit for purpose, but the underlying data nevertheless meet the above-mentioned requirements, it may be appropriate to activate and streamline the option foreseen under paragraph 2 of Articles 125(3) and 126(3) CRR. Under these provisions, the EBA may review and publish the relevant loss rates for the corresponding jurisdiction, rather than directly propose to not apply the preferential treatment.

Finally, the reporting requirements for real estate exposures under CRR3 introduced a new layer of "sub-exposure classes", which have created additional complexity for the CR-SA and CR-GB templates, as well as for CA2. The EBA has an opportunity to simplify this by carving out real estate exposures to a new reporting template, similarly to the Securitisation exposure class. This approach would preserve the previous level of integrity of CR-SA, CR-GB and CA2 templates, without sacrificing the granularity of data collected. In addition, the reporting related to par. 8 (d) of Article 465 could be simplified by reducing the time period required (8 years) to a shorter time series (e.g. 3 or 5 years).

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

AFME welcomes the pragmatic approach EBA has proposed with respect to the application of Article 138(g) of CRR meaning 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. Nonetheless, this is **a proposed approach,** and firms need formal confirmation (e.g. in the form of an EBA opinion) as soon as possible in order to provide the certainty of the EBA's view going forward in order to go ahead with their internal processes for obtaining the necessary licence for such ratings if required.

Furthermore, as noted by the EBA, only one major rating agency has developed an XGS rating, and while we understand S&P is also developing an additional rating, we do not think this will necessarily meet the timeline for implementation of the Art 138(g) set out by the ECB as part of their O&D guide as banks will still need 6 months at least to license it and to implement it once it is finalised. Hence, even if the EBA does in effect provide sufficient clarity for firms to licence the Fitch and S&P ratings, industry still has strong concerns linked to the time it takes to onboard such ratings including: the need to internally harmonise ratings from different ECAIs despite differences in methodologies and coverage (e.g. public/policy bank definitions and issuer- versus issue-level ratings); the market coverage and concentration risk that comes with such limited provision of necessary ratings; and the overarching policy intention to reduce over-reliance on ratings.

Indeed, AFME has conducted a quantitative impact study (QIS) with GARP[2] and, based on those results, banks will face a material increase of around a 249% in RWA, and under a fully standardised approach which is used for the output floor the increase is around 306%, assuming that the Fitch XGS rating is not approved and that banks must assign all exposures to institutions to Grade C. Further, the exercise has demonstrated the complexity of mapping the exposures which are not covered by the Fitch XGS rating to the respective rating scale which would only increase costs and additional resource burden for banks until such XGS ratings are approved. Such sunk costs – especially if ratings do become more readily viable – run counter to the current simplification and competitiveness agenda.

In terms of impact, when the requirement to only use such ratings applies from 1 January 2027 (as per the ECB O&D guide) it will affect direct lending, derivative exposures, SFTs and collateral recognition. Collateral eligibility for instance will be impacted, as debt securities issued by institutions will no longer be rated and satisfy Article 197(1)(c). Institutions will be required to derecognise this collateral unless the conditions under Article 197(4) can be proven (complex to implement on large scale). Capital forecasting and stress testing will also be impacted, due to the uncertainty of the expected treatment of the currently rated institutions over the coming years.

Therefore, while and EBA opinion will provide certainty for firms to licence and onboard XGS ratings, we would emphasise this alone does not sufficiently resolve the lack of ratings coverage, which relies on the ECB extension of the 495e transitional. Hence, aside from the EBA providing more regulatory

[2] The study was based on input from 8 EU and EU subsidiaries of non-EU headquartered GSIBs.

clarity on the use of ratings without implicit government support, we also strongly recommend the ECB extends the transitional within the O&D guide to the full extent allowed under Article 495e and Basel 3 finalisation (5 years) as soon as possible to give firms sufficient time to obtain the necessary licences and onboard the ratings internally, but also to increase the number of possible rating agencies since 2 XGS ratings will not be sufficient. This will also allow for harmonisation of the EU approach for SI and non-SIs (where some non-SIs have longer to implement because of the approach of their NCA). We also suggest that the Commission addresses the issue within the level 1 text to provide legal certainty and a consistent EU timeline for implementation. Additionally, extending the transitional to the fullest extent possible would also allow for alternatives to be explored such as considering the approach taken in the APRA's Basel III implementation[3]. Alongside this AFME is willing to support and facilitate workshops to promote consistent XGS rating development and regulatory certainty given the multiple stakeholders involved.

In addition, the CRR3 introduced a new requirement to benchmark external ratings against an internal credit risk assessment (Article 113(1)). For this purpose, we therefore recommend the EBA officially endorses the usage of IRB PD models or internal scoring (not used for RWA computation). The CRR3 also introduced a specific Standardized Approach for exposure to unrated Institutions (Article 121). Along the same lines as for the benchmarking requirements, we propose that EBA issues guidance providing additional flexibility to leverage on internal IRB ratings when institutions do not have compliant ECAI assessments. This could also be considered for CVA and introducing unrated methodology here.

Please also refer to question 52 of our response to the EC consultation on the competitiveness of the EU banking sector.

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?

Our view is that this consolidation can be achieved without causing regulatory instability, therefore the consolidation of regulatory products and regulatory stability are not necessarily mutually exclusive (as implied with this question). For example, as a minimum the EBA should aim to consolidate existing regulatory guidance without changing the substance of existing guidance. Any rationalisation exercise should also avoid introducing new requirements or additional interpretative layers, as the objective should be simplification of the existing framework rather than regulatory expansion. By design, this would not cause regulatory instability.

In our view the consolidation of regulatory products must be a focus because the current product landscape is complex to navigate. This results in differing interpretations of the same requirements, which can cause delays in model development, model validation, supervisory review cycles, and model implementation.

Since the beginning of IRB repair program, publications on IRB modelling were spread over time, with sometimes several years between publications. For instance, EBA GL on PD-LGD estimation were published in 2017 while draft EBA GL on CCF estimation were consulted on in 2025. However, the draft GL on CCF estimation it proposed changes to modelling assumptions also impacting LGD modelling (e.g. additional drawings, extrapolations) which would incur model redevelopment, when banks had mostly "IRB-repaired" their LGD models. We would like to stress that avoiding RWA volatility should be targeted by the EBA when reflecting on simplification.

In any event, a consolidated landscape is a necessity because it will provide the appropriate foundation to use for further refinements, additions, simplifications, and - if appropriate - "fallbacks" as proposed in the DP, among others.

In our view the introduction of fallback methods, in combination with a consolidation of products, is a proportionate way to limit the impact on existing approved internal models, whilst introducing a range of fallback methods to consider by institutions for their future internal models redevelopment programmes. However, given the conservatism embedded in fall back approaches they should not become a de facto solution to unnecessary, overly complex regulation. The effectiveness of such fallback methods will also depend on their calibration. They should remain optional, operationally usable, and sufficiently risk-sensitive, and should not be calibrated at a level of prudence that would neutralise the intended simplification benefit. Otherwise, institutions may face a formally simpler route that is not a credible alternative in practice.

Further, as highlighted in our recent feedback to EBA concerning the CCF estimation consultation

[3] APRA's practical guidance APG 112, which allows for banks: *"to make appropriate adjustments to external ratings such that they do not reflect implicit government support in the credit rating used. To make these adjustments, an ADI may use information on rating methodologies provided by ECAIs".*

(EBA/CP/2025/10), alignment between the EBA products and ECB products is also crucial to reduce contradictions and improve regulatory certainty (also refer to our response to Q17). This alignment should explicitly extend to all supervisory reference documents, including the Supervisory Handbook, to ensure full consistency between EBA products, ECB supervisory expectations.

The consolidation of similar guidelines could make sense to ensure a comprehensive and integrated view of similar regulatory products.

Finally, regarding the possibility of having a unique EBA GL for PD-LGD and CCF, this could certainly support the re-organization and streamlining of regulatory products. Nevertheless, the timing implications should be considered. Indeed, as per the CRR3 Mandate, the EBA is mandated to finalise the GL on CCF in the course of 2026, thus already posing critical operative implications for the IRB banks in adhering to these new requirements. In this regard, considering the points of contact between CCF and LGD parameters, the need to organically review the EBA GL, requires urgent clarification of the timeline for doing so – taking account of the industry input to the consultation on CCF GL of the need to provide an extended period for the compliance (e.g. 3 years from final EBA GL publication).

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?

In our view, the existing supervisory guidance provides sufficient direction for incorporating accelerating risks—such as environmental and social risks—within **Pillar 2 processes**, particularly through stress testing. Recent publications, including the ESA joint guidance JC 2025 78, already outline how these risks can be integrated into forward-looking stress-testing frameworks and the activities of NCAs as well as how the impact of ESG risks can be measured under adverse scenarios in a complementary assessment.

However, when considering the integration of such accelerating risks into **Pillar 1** specifically within IRB models used to estimate minimum capital requirements, it requires more consideration and ongoing dialogue between supervisors, regulators and banks (e.g. working group or taskforce) where longer and ongoing discussions could take place to find relevant solutions (e.g. concrete incorporation of ESG risk drivers in IRB models). This need arises because institutions are required to include all *material* risks in IRB models, yet IRB models are based on *observed data* and are designed generally with a **12-month risk horizon, whereas ESG risks can materialise within longer horizons**.

With respect to the 12-month horizon used in model estimation, it is noted that the rating-assignment process should also adequately anticipate and reflect risk over time horizons *longer* than 12 months (refer to BCBS FAQ 10 in BCBS d543 and EGIM paragraph 213). However, this is limited to the consideration of highly plausible outcomes and does *not* extend to long-term forward-looking scenarios. Specifically, the requirement in BCBS FAQ 10 that "*banks should use a time horizon longer than one year in assigning ratings*" is therefore not interpreted as requiring the inclusion of long-term ESG scenarios in ratings. This view – that long-term horizons are not appropriate for Pillar 1 – is further supported by EGIM paragraph 213(b), which states that "*a horizon of two to three years is considered to be appropriate for most portfolios*." This interpretation ensures that back-testing and the reflection in ratings of actual changes in economic conditions are not compromised.

By design, these constraints limit the ability of IRB models to adequately capture fast-moving and uncertain risks such as environmental and social risks that evolve on time horizons much longer than 12 months and may not yet be observable in historical data making it challenging to reliably quantify these risks within the Pillar 1 framework.

That said, IRB model-monitoring processes already play an important role in identifying emerging patterns or early signals that may eventually reflect the impact of environmental and social risks. Over time, as these risks materialise in observed default behaviour and become statistically meaningful, IRB models can naturally begin to capture them within the Pillar 1 framework. For this reason, we believe the priority should be on the consistent application of Pillar 2 processes (for these risks) while ensuring that Pillar 1 monitoring frameworks remain robust enough to detect if these risks become sufficiently evidenced in the data. Regarding the incorporation of new ESG risk drivers, concerns remain on the data availability in sufficient historical length of these risk drivers. If the EBA objective is to ensure conservative use of overrides to incorporate ESG risks, we would like to underline that the conservative approach does not favour a best estimate approach.

The EBA should therefore acknowledge the ongoing challenge of integrating such risks into Pillar 1, the evident lack of materiality of such risks at present, and the work that has been done to already reflect these risks in Pillar 2. We would also emphasise that no additional Pillar 2 outcome should be expected on top of existing Pillar 2 requirements/guidance.

Improved standardisation of definitions

At an industry level, alignment is needed on environmental- and social-risk taxonomies, including harmonised definitions of physical-risk categories (e.g., flood, drought, wildfire) and transition-policy-related risks. Today, ESG-related data lack standard definitions, verification standards, and consistent granularity, resulting in inconsistent risk identification across institutions. As a result, the same risk – such as flooding or drought – may represent very different underlying conditions across banks, undermining comparability of modelling practices and results.

A common taxonomy, coupled with standardised severity levels and risk drivers, is essential. Standardisation should focus on a common set of *key* risk event types to ensure industry-wide comparability. This does not prevent banks from defining more granular, institution-specific event types, provided these can be clearly mapped to the harmonised baseline taxonomy. Having a common taxonomy is also broadly consistent with the proposals set out in the EBF report *Climate & Environmental Credit Risk Data and Modelling* (October 2025). The climate stress testing foreseen for 2027 could be a way to drive such harmonised taxonomies and build them up over time.

We also welcome and will be responding to the recently launched consultation of the EBA on the reporting framework which is seeking to incorporate the ECB/EBA Joint Bank Reporting Committee advice on ESG definitions, aimed at improving semantic alignment as part of the broader move towards integrated reporting.

Reducing the ESG scope

Finally, according to the Executive Summary of EBA/REP/2023/34 the ultimate objective is to ensure that the full suite of ESG risks is eventually captured in Pillar 1. That implies a broader scope than the environmental and social risks addressed in this Discussion Paper. In our view, achieving this ultimate objective is not realistic at present, given the low maturity of risk-measurement practices across many ESG dimensions.

We therefore recommend narrowing the initial focus of EBA guidelines and RTS to *environmental* risks only. This viewpoint also aligns with the prioritisation approach outlined in the ESA Joint Guidance (JC 2025 78)), to which EBA also contributed published in January 2026. Importantly, given that the ESA Joint Guidance relates to stress testing under Pillar 2, it would be inconsistent to have a broader scope for Pillar 1 practices (as implied in this DP which considers environmental *and social* risks). Given the breadth and heterogeneity of ESG factors, focusing first on the most material and most quantifiable components (i.e. specific environmental transition or physical-risk drivers) would foster greater consistency across institutions, provide clearer supervisory expectations, and reduce the risk of fragmented modelling practices. Consistently with this pragmatic and gradual approach, it is recommended that the EBA clarifies ESG drivers should be included in Pillar 1 models only as long as they would make it possible to achieve a degree of statistical robustness that is suitable for the very strict requirements for these models.

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)?

We note that supervisory expectations for the use and performance assessment of *continuous* models (also referred to as *direct estimates*) are already comprehensively outlined in the ECB Guide to Internal Models (EGIM) (par. 250, Credit Risk section). We would favour that EBA products align with that expectation. However, we have concerns regarding the application of these expectations to low default portfolios (LDPs) as set out below.

For LGD and CCF models, individual realized values can be compared with related individual estimates. Therefore, the testing by calibration segments could be complemented with calibration metrics checking the number of cases with individual realized LGD higher or lower compared to individual estimates. In addition, analyses at the level of individual observations (representing continuous grade) could be used to identify patterns deserving further investigation (e.g. appropriate calibration at segment level driven by few observations with very high estimates, alongside larger number of cases with structural underestimation).

In general, introducing additional or more granular requirements at this stage may lead to unnecessary complexity for both model development and back-testing. Moreover, doing so risks further dispersing the requirements across multiple regulatory sources, which could reduce coherence and make the overall supervisory framework more difficult to interpret and operationalise.

Nonetheless, whilst additional horizontal requirements for continuous models in general should be

avoided, a targeted and proportionate clarification would be beneficial for PD models in low-default portfolios. In such portfolios, the direct application of testing frameworks originally designed for high-default environments may lead to undue conservatism, excessive aggregation and reduced discriminatory capacity, without necessarily improving prudential soundness.

In particular, the framework should explicitly allow institutions to preserve granular internal master scales for risk management, pricing, and steering purposes, while discretising continuous outputs into appropriately calibrated and well-justified buckets for selected IRB testing purposes, including back-testing, discriminatory power and homogeneity assessment.

Such clarification would not create a new overarching layer of requirements, but would instead improve proportionality, supervisory consistency, and operational feasibility in those use cases where structural scarcity of defaults limits the applicability of standard statistical testing approaches.

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

Overrides are, by definition, an exercise of expert judgement – whether applied via a discrete rating adjustment or a proportional adjustment in continuous models. Because this judgement cannot realistically be standardised across institutions, introducing model-specific override requirements for continuous models would not improve consistency nor reduce unwarranted RWA variability.

Indeed, in the application phase, the continuous parameter can be applied consistently with the estimation. Given the possibility to ensure calibration testing by grade, once it's ensured that the model is properly calibrated, there is no specific issue to adopt the precise estimated parameter for RW calculation. Regarding situation where a grade PD is needed, as in the case of an override, the sub-range PD adopted in the context of continuous PD calibration aligned with par. 250 of the EGIM can be adopted. Alternatively, in case of mapping to a separate masterscale the same expectations set out by EGIM in par. 251 can be adopted.

Consequently, in terms of the existing supervisory expectations on the governance, the justification and monitoring of overrides already provide an adequate framework for both discrete and continuous models. We therefore see no need for additional requirements for overrides.

Nevertheless, as highlighted in Q7 for portfolios characterised by structural data scarcity, including low-default portfolios, it would be helpful if the framework explicitly acknowledged that the use of expert judgement, supported by benchmarking and evidence at an appropriately aggregated level, is an inherent component of sound model application and governance rather than an exception to an otherwise statistically complete evidentiary framework.

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

In general, our facility definitions already aligned with the high-level definition introduced in CRR3 Article 5(6), namely:

> *"'facility' or 'credit facility' means a credit exposure arising from a contract or a set of contracts between an obligor and an institution;"*

Therefore, the overall criteria for facility identification look generally understandable and highlight the linkage with the risk management practices (which is in this sense reasonable). However, while the CRR3 definition is conceptually understandable, practical implementation challenges remain where the same legal or contractual relationship contains instruments with different drawdown dynamics, repayment patterns, collateral structures, or lifecycle behaviour. Practical challenges can also arise when:

- determining appropriate facility aggregation for different risk parameters;
- handling facilities that include both revolving and non-revolving components;
- handling facilities combining amortising and non-amortising components;
- allocating collateral to facilities where the collateral management is at an aggregated facility level;
- managing migration of exposures between facilities over time (e.g., product switches); and
- reflecting structural changes to facilities through their lifecycle.

Given these operational complexities, we consider it important that institutions retain a degree of flexibility in the application of facility definitions, provided that the chosen approach supports the accurate estimation of risk parameter. We do not see additional areas of clarifications/simplifications a regarding the facility definition.

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

In our view, applying a single facility definition across all risk parameters is not feasible. Accordingly, simplification should focus on a common conceptual basis and clearer implementation principles, rather than on forcing a single operational unit of analysis across all parameters. This would preserve the simplification objective while avoiding unintended distortions in parameter estimation and disproportionate implementation costs. The primary reasons are that different aggregation/granularity levels are relevant for LGD (recovery based) and CCF (limit based) estimation, and that facility setup can be complex and that data availability is different: Overall, LGD may have more historical data for some portfolios, requiring different segmentation than the often scarcer data availability for CCF. More practical challenges are listed in Q9.

As such, enforcing a uniform facility definition across all IRB risk parameters could lead to sub-optimal risk differentiation and estimation. Therefore, we consider it important that institutions retain a degree of flexibility in the application of facility definitions to be able to identify, on case-by-case basis, the most suitable one. Specifically, we strongly believe that EBA be more explicit that LGD and CCF can be calculated at distinct granularities. Please also refer to our response in Q9.

The proposed EBA changes could have substantial repercussions on existing LGD and CCF models, likely necessitating material changes and triggering all the well-known implications associated with supervisory review. We are not convinced that this proposal would lead to simplification.

A misalignment between LGD and CCF calculation granularity does exist by design (LGD granularity aligned with recovery process, CCF granularity aligned with limit granting process). If for instance, LGD calculation granularity is not in line with the recovery process, there is a strong risk that the modelling and quantification of LGD calculation would be disconnected from economic sense.

In addition, from a PD perspective, when the definition of default is at obligor level, it is not possible to ensure the same level of aggregation with both LGD and CCF. Besides, the restriction of IRB-CCF models to revolving commitments only makes it all the more difficult to align with LGD calculation granularity (as LGD models would cover both revolving and non-revolving products) with the CCF calculation granularity.

Furthermore, (and in further support of not needing a *single* facility definition) if the facility definition used in model estimation and application is inconsistent with the aggregation level required for a specific reporting requirement (such as accounting or capital reporting), this misalignment is *not* problematic. The results for each modelled facility can always be *aggregated* to a higher level – or *allocated* to a lower level – depending on the reporting objective.

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?

The EBA stance is not sufficiently detailed at this stage to understand the implications of the concrete proposals of the EBA for PD and LGD, and we would welcome more clarity on these points.

In our view, in principle, the simplifications proposed in EBA/CP/2025/10 for assessing representativeness in the context of the CCF risk parameter may be relevant for the PD and LGD parameters. (It is our interpretation that the main simplifications proposed in EBA/CP/2025/10 relate to the addition of specific tests for various representativeness dimensions and replacing the assessment of the representativeness risk characteristics with an analysis of material sub ranges.)

In general, more flexibility in the representativeness requirements is welcome as long as the MoC is not automatically applied whenever representativeness imperfect. MoC should only be used where there is genuine, residual uncertainty that cannot be addressed in other ways. If this is the case, extension of any flexibility to PD and LGD are welcome. Finally, we would like more flexibility in meeting the requirements related to likely range of variability of one-year default rates.

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?

As stated in Q11, if the flexibility is maintained, then the requirement envisaged only for the aspects related to representativeness on the GLs on CCFs could be applicable also for PD and LGD.

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

We would welcome further engagement on the detailed proposals before implementation, nonetheless, subject to the comments below, we support the introduction of **optional** simplifications and fallback approaches in principle. We think that the conditions of application of such approaches should be flexible, simple, and feasible enough in order to provide simplification for the bank.

In our view, offering these simplifications on an optional basis which firms can implemented over time if relevant to the firm, is an ideal way to update supervisory expectations *without* immediately affecting existing approved internal models or becoming hardwired supervisory expectations. For instance, if appropriate, institutions can adopt the simplified approaches over time when revising models, thereby ensuring smooth and non-disruptive implementation.

Furthermore, the optionality granted to institutions should be *unconditional*. Institutions should not be required to perform an extended analysis to justify that a fallback approach is appropriate, because such a prerequisite would undermine the intended simplification goal, nor should they lead to supervisors mandating them as supervisory expectations. This is based on the understanding that the fallback approaches will be conservatively calibrated and therefore not susceptible to arbitrage. The only precondition should be the availability of sufficient data in cases where the fallback method relies on data inputs.

In addition, the decision to adopt a fallback approach should remain a methodological choice of the institution, based on clear internal criteria and embedded in model governance. The burden of proof should not fall on the institution, including control functions, to demonstrate the appropriateness of the fallback through extensive analysis against the traditional methodology, as this would undermine the intended simplification objective. Likewise, fallback approaches should not become a benchmark against which traditional methodologies are expected to be justified or reassessed.

Although calibrated in a prudential way, fallbacks should be designed in such a way that they do not generate scenarios that are not consistent with the level of risk. By way of an example, a fallback on CCF=100% plus MOC creates an undesirable situation where the risk weighting of a *drawn non-revolving* facility is *less* than the risk weighting of an *undrawn revolving* facility (with limit equal to the drawn amount of the non-revolving facility). In this case risk sensitivity is negatively impacted by the fallback approach.

We also support allowing institutions to apply a fallback method to a specific modelling aspect *independently* of whether fallback approaches are used for other modelling components.

Although we see some hints at Low Default Portfolios in the paragraphs dedicated to Margins of Conservatism, we would welcome further EBA intention to provide more adapted requirements to low default portfolios for which simplification and flexibility would be both welcome.

In general, the calendar and planning of the EBA work, and specifically how these simplifications may impact it is still unclear at this stage. When proposals are incorporated in Guidelines or RTS, we understand that the changes will be subject to a consultation process as it is usually the case when updated mandates are published. Indeed, detailed requirements are not provided in this DP consultation. However, we think that every nuance in the written paragraphs of future EBA mandates (the devil is on the details) could be subject to strict reading by supervisory missions and we would like to emphasize our focused attention of such aspects. We would highly recommend allowing for an industry feedback process on the detailed requirements.

In addition, for some of the EBA proposals, it remains unclear if amendments to the level 1 text is needed (e.g. comparison with cohort approach for CCF). We would welcome further clarification on this point.

We have the following comments on the specific fallback approaches proposed:

C10: Simplified approach for Margin of Conservatism

The EBA's proposal is not sufficiently detailed, therefore we can only opine on the principles without having evidence that the outcomes will practically simplify the calibration of the different MoCs.

Standardisation of MoC C:

In general, we support the EBA's view on MoC C as outlined in paragraph 44(b) of the Discussion Paper, *provided* that any standardisation is an optional fall back and any changes do "not restrict viable modelling options". As recognised by EBA, we note for low-default portfolios, the MoC may be counterintuitive and overly conservative - where flexibility and adaptation are necessary (e.g. allow institutions to lower percentile to draw confidence intervals). For this reason, we recommend that the EBA

continues to maintain flexibility in the choice of MoC C quantification methods.

We note that any standardization of MoC C should also consider potential misalignment with the additional interpretation related to MoC provided in the EGIM (e.g. Section 19 of the Credit Risk section).

We support the proposed fallback options for MoC A and MoC B, and recognize that, in some cases, the modelling effort may not be proportionate to the underlying risks.

C12: Simplified approach for Downturn estimation

Downturn quantification:

In our view, the existing guidance on downturn identification and quantification—such as EBA/RTS/2018/04, CDR(EU)2021/930, EBA/GL/2019/03—is extensive, but at the same time challenging to apply and comply with in a fully unambiguous manner.

However, we understand that the spirit of the EBA texts is to allow to use an observed impact when data is available, thus, to provide more accurate downturn estimation when banks invest in retrieving the data and investing the downturn analysis. However, using the reference value approach may lead to overly conservative results for portfolios prone to idiosyncratic events, especially LDPs.

We agree in principle that using the reference-value method for LGD and CCF parameters provides a solid basis for a fallback approach. (As defined in the LGD downturn guidelines EBA/GL/2019/03 (and the forthcoming CCF estimation guidelines following EBA/CP/2025/10), the reference value is calculated as the average of the two years with the highest observed LGD or CCF values.). The reference-value method may produce very conservative results that are not solely due to the economic downturns effects. To mitigate this risk, we propose adjusting the reference-value calculation to use the **average of the three worst years** instead of the two worst years, but more analysis is needed to decide the appropriate calibration.

Practically it means that the reference-value method, which is currently a non-binding challenger for the downturn quantification (as per Section 8 of EBA downturn GL, and par. 304-308, Credit Risk Section of EGIM 2025), is elevated to be the primary calculation method, should the institution select this fallback method for downturn quantification. Therefore, it could be a candidate to replace the approach LRA + 15% of the EBA Guidelines.

The specific advantages of the “optional fallback approach” include eliminating the need to perform downturn period identification and significantly reducing modelling complexity.

Additional considerations include the need for a minimum of seven years of observations for the fallback method to be applied credibly, on the basis that seven years broadly represent the average duration of an economic cycle. Furthermore, for the purpose of annual calculations, calendar years—rather than rolling 12-month periods—should be used to support the overarching simplification objective.

Downturn Estimation GLs:

We support the current GLs being updated to consider clarifying:

- The method for the identification of the downturn periods in presence of macro-economic factors showing adjoint peak or troughs in particular regarding the use of quantitative evidence of correlation coupled with qualitative contribution from expert economists in order to identify period of downturn that are prudent and sound with economic meaning.
- How to consider the lagged effects of downturn, given the general statement reported in the GL on downturn to take them into account but creating also relevant confusion in the interpretation and in the interaction with the Competent Authorities.
- How to integrate the four metrics (realised LGDs, annual recoveries, number of defaults, time in default) foreseen by Section 5, par. 27(a) of EBA/GL/2019/03. In this respect the additional interpretation already provided in EGIM (par. 303,Credit Risk Section), which seems to give preference to the first of the four metrics namely realised LGDs should be confirmed/clarified by EBA.

C15: CCF 12-month reference period:

We welcome the possibility to introduce elements of the cohort approach having understood that it allows the possibility to use year-end modelling snapshots and this flexibility should in turn allow for alternative approaches such as the "variable Horizon" approach from the 2006 CEBS Guidelines. Nonetheless, we think that some elements will deserve further clarity from EBA(see our answer to Q14).

C15 notes in in general that the cohort approach is deemed more consistent with the view of estimation

and application of PD and LGD parameters as well as some other alternative approaches, however it is not at clear how this approach can be used given the 12-months fixed horizon requirement set out in Level 1 regulation and, more particularly, how the explanation of significant deviations from long run average calculated versus 12-months fixed horizon can be considered a simplification, given the fact that review of explanation will be subject to supervisory interpretation.

In addition, considering the EBA statement referred to in par. 60 of the DP:

"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."

We request confirmation that the same prioritisation that applies to the new 12-month fixed horizon also applies to the new IRB-CCF zero flooring, to support consistent expectations from NCAs on these changes introduced through the CRR3 to the IRB-CCF.

As a side comment also expressed during the consultation on GL on CCF estimation, we would like to remind the EBA that level 1 text does impose a specific CCF-in-default approach.

Fixed CCF

We think that the approach to propose a fixed CCF which is at least 100% is a deterrent to use such an optional fallback approach at all. A more relevant approach should be to use SA-CCF, since the calibration of these values is considered sufficiently conservative and this will provide level-playing field between SA banks and IRB banks. An alternative could also be to allow the usage by banks of a combination of fixed SA-CCF and modelled LGD.

LGD direct and indirect costs:

We support the proposal of fixed percentages for these costs as an optional fallback method. Also see our related responses to Q14 and Q16.

Regarding LGD

We welcome a SA-like approach which brings an acceptable cost-effectiveness regarding the framework for defaulted exposures.

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

Avoid excessive conservatism:

It is expected that the calibration of the fallback methods may include some conservatism so that the fallback options are not susceptible to arbitrage. However, it is important to avoid introducing excessive conservatism. This may deter the use of these simplifications thereby undermining the objective of institutions adopting simpler methods. Furthermore, excessive conservatism in these simpler methods will compromise the risk sensitivity. Where relevant, the calibration of fallback approaches should use the institution's historical internal data.

This is particularly important for Margin of Conservatism in low-default portfolios, where statistical uncertainty is structurally higher. In such cases, overly mechanical or standardised MoC calibrations may distort compress meaningful risk differentiation and generate capital impacts that do not necessarily reflect genuine methodological weakness.

A proportionate framework should therefore recognise that data scarcity is not, in itself, evidence of model deficiency, and should permit institutions to combine conservative quantification with expert judgement and portfolio-specific evidence.

Direct and indirect costs:

The calibration of fallback percentages should reflect that these costs typically vary by exposure class, jurisdiction, collateral type, and other portfolio characteristics. An industry-wide survey can serve as a useful benchmarking tool to derive fallback values that are representative across institutions.

At the same time, fallback calibrations should remain genuinely usable in practice and should not embed a degree of conservatism that renders them economically or prudentially unworkable. Otherwise, the intended simplification would not be achieved.

CCF:

When incorporating elements of the cohort approach and making a comparison with long-run average

based on 12-month fixed horizon approach, we would welcome confirmation that the long-run average is performed the same way that under 12-month fixed horizon approach, thus using an arithmetic average of realised CCFs weighted by the number of defaults.

Downturn quantification:

See our proposal under Q13 which is based on the *reference value* approach, but using the average of the *three* worst years instead of the current two worst years to reduce the impact of outliers which may otherwise result is an overly conservative downturn quantification.

The calibration of fall-back approach shall be based, to the maximum extent possible, on historical internal data and should be calibrated, including the use of sensitivities, with respect to the realized evidence of the credit risk parameters. In other terms, overly conservative fall-back approaches (e.g. the 100% CCF estimates considered in the EBA GL) should be avoided where the objective is to achieve simplification.

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

We propose the following potential simplification areas:

Maximum Recovery Period:

The estimation of the maximum recovery period typically requires disproportionate analytical effort while contributing only marginally to overall risk sensitivity. As a simplification, we propose an optional fallback approach whereby the maximum recovery period is set equal to the time-in-default corresponding to the 99th percentile of the cumulative average recovery curve (calculated across all default vintages).

Furthermore, in the case of portfolios collateralised by residential real estate, upon reaching the maximum recovery period, a 0% recovery rate should not be automatically assumed; instead, potential recoveries may still be recognised in cases where the collateral has not yet been enforced, as the asset could still be repossessed and sold, assuming it is enforceable as of the relevant date and it meets all regulatory eligibility criteria. The recovery rate should appropriately incorporate relevant adjustments, including the discounting effect reflecting the time elapsed between the end of the maximum recovery period and the actual disposal of the property, as well as any directly attributable realisation costs.

In our view, the result of this fallback method for the maximum recovery period (applicable to the LGD parameter) is also suitable to use as the value for the *maximum drawing period* (defined in EBA/CP/2025/10) that is applicable to the CCF parameter.

Consideration of historical data of acquired banks in the case of mergers and acquisitions

The current interpretation of regulatory expectations, especially as reflected in supervisory documents such as the ECB's *Guide to Internal Models*, tends to imply that banks must incorporate historical data from acquired entities into IRB model development and updates. In practice, this gives rise to significant operational and conceptual challenges that far exceed any intended supervisory benefits in terms of enhanced risk sensitivity and result in disproportionate costs for institutions.

In the context of a merger or acquisition, pre-integration data often suffers from misalignments in definitions, systems and governance frameworks with respect to those of the acquiring entity, which significantly undermine their representativeness and reliability for IRB modelling. Differences in the definition of default, facility characteristics, credit policies, IT systems and risk classifications mean that such data are generally not comparable with the acquirer's portfolio without extensive, resource-intensive harmonisation efforts. Moreover, traceability of legacy data to original sources may simply no longer be feasible post-integration, leading to weak documentation and an unclear audit trail that cannot credibly support model validity.

From a prudential and risk management perspective, there is a strong argument that forward-looking, post-integration data better reflect the current risk profile and underwriting standards of the combined institution. Pre-acquisition data reflect the risk culture, pricing and portfolio composition of a different legal and economic entity, often under materially different lending and risk control regimes. Including such data may actually dilute the predictive power and calibration quality of IRB models, particularly for parameters such as PD and LGD, which are sensitive to policy, process and portfolio mix changes that are not captured in legacy datasets.

Finally, requiring banks to reconstruct and adjust pre-integration data imposes a disproportionate burden relative to the supervisory insight gained. Historical data rebuilding across different systems and definitions typically demands extensive manual intervention, IT development and governance overhead, without necessarily improving the risk sensitivity or prudential soundness of the models. In the interest of simplicity, proportionality and efficient use of resources, banks should instead be allowed to focus on building credible, representative datasets from the point of integration onwards, subject to

appropriate safeguards and supervisory oversight.

Downturn and likely range of variability periods

Under the current EBA framework, institutions are required to identify downturn periods and determine the likely range of variability based on their own data, risk drivers and portfolio-specific analyses, subject to supervisory review. While this institution-specific approach aims to preserve risk sensitivity, in practice it often results in significant methodological complexity, divergent practices across institutions within the same jurisdiction, and substantial implementation and validation efforts, without necessarily leading to materially different prudential outcomes.

Consequently, in the context of the simplification discussion, **some of our members** would support consideration of an alternative optional fallback approach whereby the National Competent Authority could be responsible for determining the downturn period and the likely range of variability, based on transparent and predefined macroeconomic indicators. These periods and ranges could be applied by all institutions under their jurisdiction that opt in. Such an approach would maintain prudence and macroeconomic risk sensitivity and materially reduce operational burden, duplication of analyses and model risk stemming from heterogeneous methodological interpretations, without undermining supervisory oversight.

Proportional application of homogeneity/heterogeneity requirements for grades or pools in the context of risk differentiation for LDPs

IRB models are subject to requirements ensuring that segmentation (or the risk differentiation process) achieves appropriate homogeneity within grades or pools and sufficient heterogeneity across them in terms of risk. However, an overly prescriptive or statistical-test-driven interpretation of these properties may lead to unintended consequences. Requiring institutions to systematically pass multiple quantitative tests applied in a mechanical or large-scale manner risks turning segmentation assessment (whether conducted by the Internal Validation function or the Supervisor) into a purely technical exercise, detached from its underlying prudential objective. In practice, excessive testing can constrain the ability to design stable and meaningful risk grades, potentially resulting in segmentations that, even if temporarily formally compliant, are operationally unstable or economically unintuitive.

This is particularly relevant for low-default portfolios, where the direct transposition of testing frameworks designed for high-default environments may force excessive aggregation, reduce discriminatory capacity and weaken the usefulness of the model for internal risk management, pricing and steering purposes.

Further clarification would also improve consistency of supervisory assessments across institutions, especially where limitations stem primarily from the structural characteristics of the portfolio rather than from genuine model deficiencies.

In this context, the framework should explicitly allow a proportionate combination of quantitative indicators, expert judgement, benchmarking and stability analysis, rather than relying on the mechanical application of statistical thresholds.

While statistical methods and algorithms are valuable tools to support the design and assessment of segmentations, regulatory and supervisory expectations should remain principles-based and proportionate. Compliance with homogeneity, heterogeneity and absence of undue concentration requirements should be demonstrated through a balanced combination of quantitative evidence, expert judgment, stability analysis and performance metrics, rather than through the mandatory fulfilment of numerous statistical tests along with the corresponding thresholds. An excessively granular or test-intensive approach increases model complexity and development burden, without necessarily improving predictive power or risk sensitivity.

A simplified and proportionate framework would allow institutions to evidence compliance through a limited and well-justified set of core indicators, supported by qualitative rationale and performance monitoring over time. Such an approach would better align with the objectives of the EBA's simplification initiative by preserving prudential soundness while avoiding unnecessary methodological overcomplexity and resource-intensive testing processes, which eventually comes to no meaningful conclusion.

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

The key challenge with recovery-related costs is that they often arise from functions and services operating at a highly aggregated level within the institution. These shared services typically support a broad range of activities, not solely the recovery process. In addition, certain costs that are technically *direct* may also originate within these shared services; however, for operational reasons (e.g. batch-processing of direct costs), these costs are not allocated to the specific recovery case. Furthermore, the

current cost structure of these shared services may no longer be representative of the older costs that are required for older recovery data.

As a result, attributing recovery-specific indirect costs—and unallocated direct costs—to individual portfolios necessarily relies on assumptions, which introduces uncertainty. Given these limitations and practical realities, the use of fallback methods for direct and indirect costs will help to reduce variability across institutions.

For example, the EBA could provide a clarification of the approach looking to a set of more recent years to simplify and clarify the determination of this component. In this vein the adoption of %addendum retrieved from LGD with and without indirect costs would allow firms to better isolate this component.

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

EBA and ECB alignment on modelling guidelines:

In our recent feedback to the EBA on the CCF estimation consultation (EBA/CP/2025/10), we identified several areas where the 2025 EGIM are not fully aligned or are in direct conflict with the EBA guidelines, including the proposals in EBA/CP/2025/10. e.g. calculation formula of LRA CCF, likely range of variability analysis, long run average calculation and intermediate exposure weighted averaging at obligor level.

The consequences of the above are inconsistent interpretation, additional validation and supervisory feedback cycles, and delays in model approval and implementation. These consequences are expensive, and lead to frustration since institutions must repeatedly adjust models to satisfy diverging expectations, often without a clear view of the ultimately binding standard. This undermines planning certainty, consumes significant resources, and detracts from the objective of achieving a stable, predictable, and harmonised regulatory framework.

In our view, although not in the scope of this DP, achieving consistency between EBA and ECB products is a natural and *necessary* extension of the objective to improve regulatory stability and clarity. Ensuring alignment across these supervisory texts would help prevent contradictions and support a more coherent and predictable regulatory framework.

It would be helpful to clarify the respective status and interaction of EBA Guidelines and supervisory guidance. In particular, we understand the ECB's Guide to Internal Models (EGIM) to reflect the ECB's interpretation of best practice for demonstrating compliance with the IRB framework, including relevant CRR requirements and EBA Guidelines.

Against this background, we would welcome confirmation that EGIM should considered an important supervisory reference, but that it should not be applied with the same degree of rigidity as the EBA Guidelines themselves. In assessing any deviation, the focus should remain on continued compliance with Level 1/2 requirements and the objectives of the EBA Guidelines.

In this context, we note that other prudential frameworks explicitly recognise "material compliance" as an organising principle for model permissions (e.g., PRA CRR Article 143(1)(a), 143(2B), 143(3)(b), 146(1)(a) and 149(2A), which allows for immaterial non-compliance where there is minimal impact on the quantitative and qualitative aspects of the firm's IRB approach).

Regarding MoC A and B:

Current regulation mandates an appropriate adjustment (AA) to the default rates (DR) to reduce unrepresentativeness-engendered biases and then add MoC to account for uncertainty of AA. In case of a change in lending standards in the case of discontinued activity, this AA is applied as a shift to the risk parameters in line with regulation, which can increase or decrease DR. In the light of the recent discussion paper on IRB simplification, this methodological complication can be further simplified by simply excluding such cases of unrepresentativeness instead of neutralising the impact via appropriate adjustment and MoC.

LR Models and AI Systems:

Although the AI Act is outside the scope of the EBA products covered in the DP, it has a material impact on internal models governed by those products. Members make extensive use of logistic and linear regression (LR) models for IRB parameter estimation and credit scoring, yet the AI Act's broad definition of AI systems has created legal uncertainty as to whether such models fall within scope.

This uncertainty concerns, in particular, the application of grandfathering provisions, the availability of scope exclusions, and the implications of the Use Test, given the link between credit scoring models for natural persons (which are automatically classified as high-risk in terms of the AI Act) and IRB models used for prudential purposes.

LR models are basic data-processing techniques that are transparent, explainable, and implemented in a fixed, non-adaptive manner to comply with IRB requirements. Subjecting such models to the AI Act would therefore be neither proportionate nor appropriate. AFME therefore propose a clear and unambiguous clarification (in the relevant EBA product) that fixed, non-adaptive logistic and linear regression methods – both for IRB purposes and related credit scoring – are excluded from the scope of the AI Act. Such clarification is essential to ensure legal certainty and regulatory consistency and would be fully aligned with ECB Opinion CON/2026/10 (par. 4.2).

Reduce level of technical details in Level 1 text:

For future revisions of the Level 1 text, we have recommended to the EC that Level 1 should avoid prescribing detailed modelling specifications—such as reference-period selection methods and zero-flooring for CCF which constitutes a deviation from Basel in CRR Article 182. Similarly, the possibility to use an SA-CCF while using own LGD estimate should be granted, avoiding burdensome modelling constraints for a limited eligible portfolio (revolving facilities only). These technical elements are more appropriately addressed in Level 2 or Level 3 texts, where they can be updated more efficiently and aligned consistently with other modelling requirements. We therefore propose this article be removed or changed to an EBA mandate.

Article199(6)(d) – conditions for IRB physical collateral eligibility

This is a challenging condition of the Article for members to apply in practice as the eligibility criteria are disconnected from economic reality and from banks' financing practices. This may therefore benefit from additional EBA input to support consistent implementation as intended, if not a level 1 clarification. Under the provisions of this article firms subject to CRR3 can no longer consider the value of their financed movable transport assets such as ships, thereby facing higher costs of capital. As a result, traditional collateral-backed structures economically do no longer offer advantages compared to unsecured structures which may offer higher margins. This will impact on firms' competitiveness if banks in other jurisdictions are able to offer lower loan pricings based on such collateral recognition.

We would highlight that cases of repossession or forced sale remain exceptional. Banks prioritise restructurings that are more favourable to both the bank and the client whenever possible (e.g. restructuring without enforcing collateral, encouraging refinancing of voluntary sale of collateral by the borrower). The required statistical test is therefore difficult, if not impossible, to perform. An overly strict interpretation of the regulation could compel banks to treat as unsecured exposures those that are low risk because they benefit from valuable collateral.

A historic-data-based test applied without grandfathering protection effectively penalizes past strategic decisions that cannot now be remedied. In addition, banks with sound risk management and prudent financing structures which have a limited and/or aged liquidation history should not be disadvantaged compared to banks with continued liquidation incidents (which gives them a chance to improve their historic data and pass the testing criteria).

We note there is an existing Q&A 669 on the topic. It is our view this could be supplemented to clarify that firms do not only need to rely on internal observations of liquidations for collateral – market observations could also be used. Any additional clarification could also reflect the following:

- not all defaults involve liquidation (which could skew the outcome) and that also other restructuring solutions should be eligible – the important factor is whether the transaction is secured.
- To acknowledge and incentivise de-risking strategies of banks, the cut-off of historic data could be allowed (e.g. change of business model, focus on conservative recourse structures)

More generally we would support a broader review of the FCP framework under the FIRB approach. This should include both the scope of eligible collateral types and the valuation principles underpinning their recognition.

Low Default Portfolios (specifically SLE):

We support a review of the effect of modelling rules for Low Default Portfolios given the tendency to limit credit risk models to purely statistical models under level 2 measures. These are commonly used for high-default portfolios but are not well suited to low-default portfolios. For such portfolios, purely statistical internal models are less discriminatory and imply overly conservative Margins of Conservatism. In extreme cases, banks may be incentivized or constrained to revert to less sophisticated approaches (F-IRB or the Standardized Approach), which are also less risk-sensitive. This may for instance result in banks no longer being able to undertake certain types of financing notably within specialized lending, in particular low risk transactions which cannot otherwise get financing. We think it

should be possible and made more feasible to grant banks greater flexibility in their choice and development of models without undermining model quality.

The review should take account of the following solutions to support both competitiveness and simplification:

- Models could be developed not only on the banks' own data but using external data more extensively, provided by recognized pooled data providers such as Global Credit Data and subject to representativeness of these data with the bank portfolio.
- Models other than purely statistical ones could be recognized, provided their quality is ensured by relying more extensively on backtesting. This would be compliant with article 174 of CRR3 which specifies that banks can use "statistical or other mathematical methods (("models") to assign exposures to obligor or facility grades or pools". Article 174 requests a satisfactory back-testing : "(a) the model shall have good predictive power". Such predictive power can be measured by the back-testing in particular considering distributions of potential LGDs and their realization (observed LGDs). Such observed LGDs would not be used for "calibration" of the model output but for its back-testing, i.e. good predictive power. Any kind of model would be allowed, like mathematical ones, also incorporating expert judgment. LDP models would be exempted from all the modeling rules and instead would be subject to a robust and risk sensitive back testing approach.

Please also see comments under Q60 of our response to the European Commission's consultation on the competitiveness of the EU banking sector for additional recommendations on improvements to the credit risk framework.

Contact:

Constance Usherwood
Managing Director, Capital and Risk Management

Constance.usherwood@afme.eu

+44 (020) 3828 2719