POSITION PAPER

ESBG response to the European Banking Authority (EBA) consultation on draft guidelines on proportionate retail diversification methods

ESBG (European Savings and Retail Banking Group)

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ESBG

Questions for consultation

Question 1: What is the percentage of exposures within your retail portfolio that are part of a group of connected clients?

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

The EBA proposes a highly disproportionate method where a portfolio of retail exposures of EUR 500mn or more is considered by definition as diversified and therefore can be granted the 75% risk weight whereas a portfolio of retail exposures of less than EUR 500mn is subjected to a diversification test which may result in the entire portfolio or parts of it being assigned a risk weight of 100%. The proposed method effectively means that the smaller a financial institution's retail portfolio is, the larger is the part being assigned a 100% risk weight.

The method proposed by EBA is based on a Basel III standard which stipulates that a retail exposure is considered as diversified if the exposure does not exceed 0.2% of the total portfolio of retail exposures. As both Basel and CRR at the same time set an upper limit for a retail exposure of EUR 1mn, all retail exposures of institutions with a retail portfolio of EUR 500mn or more will by definition meet the threshold of 0.2% (as the individual exposure would otherwise not be considered part of the retail exposure category), and the entire retail portfolio will by definition be considered as diversified (EUR 500mn x 0.2% = EUR 1mn).

Therefore, for smaller institutions, EBA's Guidelines on the diversification of the retail portfolio may lead to a significant increase in the capital requirement for the retail portfolio, despite two alternative methods of calculating the part of the exposures in the retail portfolio that can exceed the 0.2% threshold (an iterative 10% approach and a non-iterative 5% approach).

Furthermore, the quarterly implementation of the granularity test leads to considerable expense. Since the structure of the relevant credit portfolio is not expected to change significantly within a quarter, an annual calculation should also be permitted for banks whose share of loans that exceeded the 0.2% criterion in the CRSA retail business at the last survey is well below the 10% threshold.

A quarterly calculation not only makes planning and price calculation for the retail portfolio more difficult but also adds unnecessary complexity. By reducing the frequency of the test, we can alleviate this burden and streamline operations, making the process more straightforward and less complex for banks.

To further reduce the burden on banks, the test should only be carried out once a year at year-end for banks whose RWA from CRSA retail business accounts for less than 10% of total RWA (de minimis limit 1) or a certain amount (de minimis limit 2).

Banks should also be able to exclude from the granularity test those exposures in the CRSA retail class that receive the guarantor's risk weight due to guarantors providing unfunded credit protection (e.g., guarantees) outside the CRSA retail exposure class.

Question 3: Which methods do you currently use to assess retail diversification? Please elaborate.

Currently, very different methods are used to define the granularity threshold. The majority of banks use the 0.2% criterion, a quantitative measure, while small banks, in particular, mainly use qualitative criteria. This diversity ensures that banks with different business models can define the granularity threshold that suits them, taking into account their specific business requirements and size.

Using qualitative criteria, particularly for small banks, ensures consistent treatment of loans in the retail portfolio. This flexibility is not just a preference, but a necessity to account for the specific requirements of a business area and the different sizes of institutions. It reassures banks that the proposal is adaptable to their unique circumstances.

Question 4: Under the proposed approach, in the first step of the calculation before any exclusion, what is the share in terms of exposure value of the large eligible retail exposures as defined under the proposed approach compared to all the eligible retail exposures?

Question 5: What is the impact of the proposed diversification assessment set out in these Guidelines compared to the diversification assessment that you currently perform on your retail portfolio?
- Please fill in the amounts in the table below using as reference date end-2023 and please report the amounts in EUR millions. To ensure comparability between all the amounts provided, please report all the amounts using the CRR III rules as of 1st January 2025.

The diversification method proposed by EBA is not risk-based and should in our opinion be rethought and rewritten, as the basis for assessing diversification in the current draft Guidelines in the form of the 0.2% threshold results in an inherent disproportionality, which the supplementary thresholds of 5% and 10% cannot correct.

For smaller institutions, EBA's Guidelines on the diversification of the retail portfolio may lead to a significant increase in the capital requirement for the retail portfolio.

As a result, our Danish member (LOPI) has carried out a questionnaire survey among their 29 members with a retail portfolio of less than EUR 500mn, which mirrors EBA's corresponding consultation, in order to gain a clearer picture of the impact of the diversification test on smaller institutions.

The feedback shows that among the included retail portfolios of up to EUR 500mn, the method proposed by EBA results in the capital impact of the two diversification methods being inversely correlated with the size of the retail portfolio, thereby having a relatively higher impact on smaller institutions (we have not included data from our questionnaire survey in this document, but if you would like to receive the data showing the impact of the proposed diversification assessment for each institution, we will of course send it to you in the form being requested by EBA).

Furthermore, the feedback shows that especially the iterative 10% approach has a significant impact on the smallest institutions leading the entire retail exposure portfolio from a risk weight of 75 % to a risk weight of 100% but also approach 2 has a considerable effect on the smallest institutions.

Smaller institutions on the Standardised approach (SA) are already operating under higher risk weights than IRB institutions for otherwise identical exposures. With EBA's draft Guidelines, the risk weights are further increased for the smallest institutions, which face a 33% (25 percentage points) increase in capital charge on the entire or parts of the retail portfolio.

It will also prove more difficult for the smaller institutions to price products for retail customers, as the capital requirement for a given exposure can increase by 33% (25 percentage points) if there are changes in the composition or volume of the retail exposures of the institution.

Thereby, the diversification method proposed by EBA does not ensure a level playing field between the financial institutions and reduces the competitive strength of smaller institutions.

If the EBA absolutely must retain a quantitative measure, then the EBA should raise the 0.2% criterion to 0.3%. Since the 0.2% criteria of the Basel Committee referred to retail portfolios of large banks, such a proposed increase by the EBA would also be justified to consider the specific characteristics of the European

banking market with its small banks. This change would have to be combined with the non-iterative method being increased to at least 10 % to support a fair and equitable regulatory environment for the smaller banks.

Breakdown by risk weight	Amounts applying current diversification methods		Amounts applying diversification methods as proposed in the Consultation Paper		Amounts applying the alternative diversification method as proposed in the explanatory box of the Consultation Paper (non-iterative)	
	EV	RWA	EV	RWA	EV	RWA
Preferential risk weight						
Non-preferential risk						

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping 32 savings and retail banks in 27 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. Advocating for a proportionate approach to banking rules, ESBG unites at EU level some 859 banks, which together employ 619,000 people driven to innovate at 37,000 branches. ESBG members have total assets of € 6,35 trillion, provide € 372 billion in loans to customers, and serve 163 million Europeans seeking retail banking services. ESBG members commit to further unleash the promise of sustainable and responsible 21st century banking.

Our transparency ID is 8765978796-80.

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