07.05.2026

EBF Response to the EBA Discussion Paper on the simplification of credit risk framework

I. Introduction

The European Banking Federation, on behalf of its member associations, welcomes the opportunity to comment on the EBA's Discussion Paper on the simplification and assessment of the credit risk framework. European institutions strongly support the objective of creating a supervisory and regulatory environment that is robust, coherent and stable, while remaining responsive to evolving challenges such as ESG integration, IRB framework refinements and enhancements to the Standardised Approach.

As the "simplification" agenda advances, our members underline that meaningful simplification must **strengthen usability without undermining risk sensitivity or introducing unintended conservatism**. Many of the measures explored by the EBA could contribute to a more coherent framework; however, others risk generating **additional operational burden, de facto floors, or constraints not envisaged in CRR3**, thereby conflicting with the stated aim of simplification. In this context, several cross-cutting priorities clearly emerge across the industry:

- **Simplification must remain genuinely optional** and should not become a supervisory default or create implicit conservatism through fallback calibrations or prescriptive data requirements.
- **Operational complexity should be reduced only where prudential value is limited**, including in valuation processes, recovery-cost data, downturn identification, representativeness requirements and segmentation tests, where current proposals may introduce new complexity rather than remove it.
- **Supervisory coherence is essential**, particularly between EBA products and the ECB Guide to Internal Models, as diverging interpretations continue to create repeated validation cycles and delays in model approvals.
- **Highly technical modelling specifications should not be embedded in Level 1**, as this reduces flexibility and risks locking in methodological rigidity inconsistent with the DP's objectives.
- **Pillar 1 evolution should be evidence-based**, with ESG risks primarily addressed through Pillar 2 and stress testing until empirical effects on risk parameters become observable.
- **A shift towards principles-based regulation should be a core objective**, as the continued expansion of detailed rules, sub-options and technical specifications that will follow from this DP risks increasing complexity and the size of the rulebook, without

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EU Transparency Register / ID number: 4722660838-23

necessarily improving consistency or legal certainty. This approach would align with the EU simplification agenda, drawing on the Draghi report's call for less prescriptive and more outcome-oriented regulation.

Beyond these cross-cutting principles, the Discussion Paper raises specific concerns for IRB institutions. Members emphasise that **low-default portfolios, specialised lending and structurally data-scarce segments require proportionate expectations**; several of the EBA's proposals—particularly on representativeness, downturn estimation and back-testing—could unintentionally increase conservatism or operational burden without improving risk capture. Importantly, **fallback approaches must be calibrated prudently but not punitively**, as excessively conservative reference values would render them unusable and turn optional simplifications into de facto floors. Members also do not support imposing a **uniform facility definition across PD, LGD and CCF**, which would conflict with the economic logic and operational architecture of existing IRB models.

In the Standardised Approach, the proposed treatment of real-estate exposures—particularly regarding **valuation requirements and Article 430a loss-rate reporting**—would introduce disproportionate operational burden for retail portfolios and create obstacles for recognising robust third-country loss metrics. A more flexible and proportionate approach is necessary to preserve usability and consistency across CRR provisions.

Members also highlight that several measures in the Discussion Paper may entail **substantial one-off implementation costs**, including significant adjustments to rating systems, methodologies and internal processes, while offering limited ongoing simplification benefits. The effectiveness of any simplification will therefore depend on the **supervisory treatment of IRB model changes** and on ensuring that implementation timelines and expectations remain realistic.

Finally, clarity on the **planning and sequencing** of future EBA work remains essential. Simplification will only be effective if supported by realistic implementation timelines, consistent supervisory expectations, and a clear and coherent interaction between Level 1, Level 2 and Level 3 measures. In this context, we encourage the EBA to maintain close engagement with industry and to provide sufficient consultation opportunities—particularly for detailed technical specifications—given their material supervisory and capital implications.

The EBF hopes that these reflections will support the next steps of the EBA's work and help ensure a prudential framework that is **robust, harmonised and operationally workable**, while continuing to safeguard risk sensitivity and support the stable financing of the European economy.

II. Responses to the Annex 1 Questions (Q1–Q17)

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

Based on the descriptions provided in the *technical challenge* of the Discussion Paper, we consider **both definitions of losses** (i.e., **"estimated losses"** and **"observed losses"**) **to be admissible for the purposes of CRR Article 430a**, as they lead to **similar conclusions regarding the stability of national immovable property markets**. Regardless of the definition applied, consistency with the loss rates provided by each jurisdiction should be ensured:

- **For Member States** – covered by the EBA benchmarking exercise – we propose continuing the use of **estimated losses**, aligned with the methodology applied in the Loss Rate calculation in the EBA Benchmarking. This approach offers several advantages:
    - It is familiar to IRB institutions participating in the EBA Benchmarking exercise, allowing for continuity in existing reporting processes.
    - It can be calculated using input data available to all institutions, whether under the IRB or Standardized Approach (SA).
    - It avoids the time-lag inherent in definitions based solely on observed annual losses, particularly relevant for mortgage portfolios where recovery processes can be lengthy.
    - It maintains the cohort-based approach while providing a sufficiently robust and harmonized estimate of losses.
- **For equivalent third countries**, both definitions, **estimated losses** and **observed losses**, should be deemed valid subject to the rates published by the relevant competent authorities. Observed losses refer to losses actually recognized during the reporting period across all exposures outstanding in that period (defaulted and non-defaulted), irrespective of when the default event occurred. To face the time-lag issue, larger period 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:
    - It enhances 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).

We therefore request that the **EBA explicitly recognize loss rates calculated based on observed losses and published by competent authorities**, or allow them to serve as inputs for establishing a mapping to "corresponding loss rates", provided that: these metrics are accompanied by transparent metadata of portfolio perimeter, loss recognition rules, denominator definition, and statistical data is available and representative.

Q2. Should the loss data (CRR Article 430a) be used for the assessment of RWs of real estate exposures?

Our members consider that, while the intention to introduce stronger empirical grounding in the calibration of real estate risk weights is understandable, relying mechanically on observed loss data may introduce significant pro-cyclical effects. Losses in real estate markets often exhibit strong temporal clustering, and a framework directly linked to short-term loss observations could reinforce credit tightening during downturns. We would instead support an approach that makes use of supervisory loss datasets in a manner that smooths volatility and avoids mechanically amplifying market cycles.

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

Our members agree that the real-estate framework would benefit from further simplification, particularly in areas where operational complexity is high while prudential value is limited. We see three main priorities for simplification: **valuation requirements**, **loss measurement and Article 430a reporting**, and **proportionality in operational obligations**.

1. Simplification and proportionality of valuation requirements

Across Member States, institutions face significant operational burdens arising from real-estate valuation rules — especially the systematic requirement to rely on independent valuers under Article 229 CRR and the limited flexibility to use Automated Valuation Models (AVMs) in the EBA LOM Guidelines.

While ensuring prudent and independent collateral valuation remains essential, the current framework lacks proportionality for **highly granular, low-risk, standardised mortgage portfolios**, particularly in mature and data-rich markets. This results in costly and complex processes that do not always improve risk capture.

We therefore believe the framework should be adapted to the **risk profile and materiality** of exposures. This could include:

- allowing **broader use of transaction-based or price-index data** where these are produced by public bodies or sworn officers responsible for official statistics;
- enabling **wider reliance on advanced statistical models/AVMs**, subject to appropriate quality criteria;
- adapting revaluation and independence requirements for low-risk retail portfolios.

Such adjustments would preserve prudence while significantly reducing operational complexity.

We also note that some operational obligations — for example, the requirement under Article 208(5) CRR for banks to verify that properties are adequately insured — may be redundant in jurisdictions where national frameworks already mandate near-universal insurance coverage. Allowing reliance on national insurance schemes or observable insured-rate data would improve proportionality without weakening risk management.

In addition, we would invite the EBA to acknowledge the practical challenges associated with the "sustainable value" requirement in Article 229(1)(b)(ii) CRR, which obliges institutions to adjust the property value *"to take into account the potential for the current market value to be significantly above the value that would be sustainable over the life of the loan."* This concept stems from the Basel framework and was intended to ensure prudence in collateral valuation. However, it has proven extremely difficult to operationalize in a consistent and harmonized manner across Member States, given the absence of a clear methodology for determining long-term "sustainable" values and the lack of alignment with national valuation standards.

We fully recognize that this requirement sits in Level 1 legislation and cannot be amended through the present Guidelines. Nonetheless, its practical limitations are directly relevant to the broader aim of simplifying the real-estate framework and ensuring consistent supervisory outcomes. The challenges associated with this requirement have also been acknowledged outside the EU. The UK Prudential Regulation Authority decided **not** to implement the "sustainable value" adjustment in its Basel 3.1 package on the grounds that it is complex to apply and risks generating inconsistent approaches among institutions.[1] This demonstrates

[1] Quote: "*The PRA agrees with respondents that the proposed requirement to adjust a valuation to reflect the value of the property that would be sustainable over the life of the loan could be complex for firms to operationalise and may lead to inconsistent approaches. Having considered the responses, the PRA has amended its draft rules* ***to remove this requirement***."
Source: PS9/24 – Implementation of the Basel 3.1 standards near-final part 2 | Bank of England

that the EU would not be alone in reconsidering the usability and proportionality of this provision.

Given these implementation constraints, we encourage the EBA to reflect these issues in its assessment and to signal the need for a review of Article 229(1)(b)(ii) CRR in future legislative revisions to support a more harmonized and operationally workable approach.

Furthermore, we would urge the EBA to clarify the intended scope of application of Article 229 CRR, in particular whether its valuation rules apply exclusively to the Standardized Approach (SA) and the Foundation IRB (F-IRB) approach, or whether they also extend to institutions using the Advanced IRB (A-IRB) approach. We note that the EBA's CRM Guidelines for A-IRB institutions (EBA/GL/2020/05) take the position that Article 229 should apply in the A-IRB context; however, this interpretation is not supported by the Level 1 legislative framework. The Basel standards clearly place the property valuation concept relevant for LTV and collateral treatment in CRE 20.75(2), which forms part of the Standardized Approach. In the CRR, Article 108(1) explicitly states that Chapter 4 (Articles 192–239 CRR), which contains Article 229, applies to SA and F-IRB only. As Level 3 texts cannot extend or override Level 1 provisions, Article 229 should therefore be understood as applying solely to SA exposures and to F-IRB LGD calculations. A-IRB institutions estimate their own LGDs based on the requirements in Articles 161 and 164, together with the LGD input floor under Article 230. For A-IRB, prudent valuation of collateral values are embedded in Article 181(1)(e), and in the EBA Guidelines 2017/16 on PD and LGD estimation. These provisions provide a dedicated, fit-for-purpose framework for ensuring prudence in A-IRB LGD estimation, rendering the application of Article 229 to A-IRB unnecessary and not aligned with the structure of the CRR. We therefore encourage the EBA to clarify in the final Guidelines that Article 229 applies only to SA and F-IRB, in line with the Level 1 text.

2. Streamlining the loss measurement framework (Article 430a CRR)

The Discussion Paper highlights that Article 430a loss data plays a key role in multiple parts of the framework — including:

- preferential treatment for IPRE exposures under the Standardised Approach, and
- the eligibility of residential property collateral for IRB LGD calculations.

A key 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 should **explicitly allow the use of loss rates published by 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 fit for purpose, a more flexible and proportionate approach could be considered to facilitate 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.

We would encourage the EBA to further clarify (e.g. RTS, Guidelines), the treatment of IPRE exposures that meet the conditions set out in Article 124(2)(a)(ii) CRR.

Additional guidance on the recognition and treatment of real estate collateral for such exposures under the IRB framework would support a more consistent and risk-sensitive treatment across approaches. This could include clarifying the conditions under which residential or commercial immovable property (including offices and other commercial premises) may be recognized as eligible collateral for IRB purposes, where the exposures meet the criteria set out in Article 124(2)(a)(ii).

This could also contribute to greater consistency between the standardized and IRB approaches in the treatment of real estate exposures, while remaining fully aligned with the underlying principles of the IRB framework.

3. Ensuring Coherence with Existing CRR Concepts and Rules

Finally, any simplification or redefinition of the Article 430a loss metric should be assessed not only in relation to the preferential IPRE treatment, but also against **other CRR provisions that reference the same metric**. This is important because:

- the CRR already contains a definition of "loss" for specific purposes;
- Article 430a reporting is referenced in **multiple** parts of the real-estate framework;
- inconsistent adjustments could create interpretational uncertainty or unintended inconsistencies.

Therefore, simplification efforts should ensure that changes to Article 430a remain coherent with the broader structure of the CRR and do not inadvertently affect related rules.

Q4. Which clarifications are necessary to apply the new ECAI framework?

Our members appreciate the EBA's willingness to facilitate the transition toward the new ECAI framework, yet express concern that very few rating agencies currently produce the "intrinsic" ratings required under the new rules. Overall, the current limited number of rating agencies producing an explicit rating without government support is not sufficient to cover the institution's portfolio. We note that the EBA statement: "*only half of the exposures to institutions are risk weighted using an external rating* » is incorrect since this proportion is calculated on the RWEA and not the exposure amount. We think that EBA proposal could be helpful only once the main rating agencies produce the new ratings but, in the meantime, the **competent authorities should make use of CRR article 495e up to the period ending in December 2029, irrespective of the conflict with the ECB - amended earlier date of *January 2027***[2] as the transition end date.

One important area that requires further clarification and especially simplification is the risk weighting corporate exposures under the Standardized Approach. The complex situation arises when corporate exposures, either i) are not externally rated or ii) are rated by agencies incorporated in jurisdictions other than the EU. It results in excessive level of risk weights (e.g. 100%) for companies that are the backbone of EU businesses. Specifically for pension funds,

[2] Article 24a in Regulation - EU - 2025/1520 - EN - EUR-Lex

this is an aspect that is particularly relevant in certain EU jurisdictions where private providers (insurance entities, investment funds, credit institutions, etc.) comprise most of the pensionable income. In this context, considering that most of pension funds (but also insurance entities) are either i) unrated or ii) privately rated, pervasive situations can emerge where an exposure is 100% risk weighted compared to a 20% RW for an exposure towards a regional government or local authority (RGLA), in case the pension is managed by an entity sponsored by the central government, which is common in some jurisdictions across the EU. In this regard, it is important to maintain the level playing field between such (similar) exposures. Hence, we urge the EBA to explore policy alternatives to recognise the low-risk nature of exposures towards EU/EEA entities that traditionally do not have public external ratings.

Q5. Should the consolidation of regulatory products for credit risk be a priority, or is stability preferable?

Members favour a stability-first approach at this stage, given the extensive and resource-intensive CRR3 implementation already underway and the long supervisory approval cycles associated with IRB model changes. As highlighted by several institutions, any consolidation that materially alters existing expectations could trigger re-segmentation of portfolios, redevelopment of approved models, or the reopening of complex supervisory validation processes — outcomes that would undermine regulatory certainty at a moment when stability is particularly valuable. The process for supervisory validation of changes regulation in institutions IRB models is unduly burdensome for institutions and supervisors alike and exacerbates the difficulty in absorption of changes in IRB models.

Banks also note that simplification should only be pursued where it clearly reduces burden without reopening established modelling choices, introducing new calibration requirements, or inadvertently creating implicit conservatism, especially in areas where fallback options may otherwise turn into de facto floors. For these reasons, members stress that consolidation should not proceed in a way that forces premature changes before institutions have fully absorbed CRR3 mandates — including the new RTS and Guidelines on CCF, and other forthcoming items.

At the same time, members recognise that some degree of consolidation is likely unavoidable in the longer term. Yet it is essential to ensure consolidation avoids re-discussing long-accepted concepts and without changing substance of existing guidance. As new CRR-related mandates and supervisory expectations emerge over the coming decade, institutions will eventually need to integrate these updates into a coherent regulatory framework. Several members therefore cautioned that simply postponing consolidation indefinitely may not preserve stability, given that multiple EBA products will have to be revised regardless as part of CRR3 and future Level-1 changes. From this perspective, a forward-looking and strategically timed approach is needed: stability should remain the priority *now*, but a well-planned

consolidation — undertaken once current implementation pressures ease with clear transitional arrangements — could help avoid more frequent, piecemeal adjustments later.

In this balanced view, the key is sequencing. The immediate priority is to avoid overwhelming institutions during CRR3 rollout and long model-approval cycles, while acknowledging that consolidation may ultimately be preferable if coordinated, transparent, and introduced at a moment when the regulatory landscape has stabilised. This timing-sensitive approach allows the sector to safeguard stability today while preparing for the inevitability of a more unified framework when conditions permit.

Q6. Could the integration of environmental and social risks into the credit risk framework be further enhanced without undermining simplicity?

We support a **gradual, proportionate and evidence-based** integration of environmental and social (E&S/ESG) risks into the credit-risk framework. Given current **data limitations**, the **forward-looking nature of ESG risks**, and the need to **avoid double counting** between Pillar 1, Pillar 2 and stress testing, we believe that accelerating E&S risks should continue to be primarily addressed through Pillar 2 processes for the time being, while Pillar 1 evolves only once material impacts become observable in empirical data. The prime concern is data: it is often unavailable, inconsistent across countries, and thus hard to standardize to ensure a level playing field. Even with a well-defined integration proposal, the incorporation of E&S factors in risk drivers would remain highly complex and thus be at odds with the aim of simplification.

1. Pillar 1 constraints limit the ability to capture long-horizon ESG risks

There is an inherent methodological tension between the requirement in Pillar 1 to include all material risks in IRB models and the design of those models, which rely on historical data and a 12-month risk horizon. This challenge is even more pronounced for climate-related factors, which are inherently forward-looking and scenario-based rather than backward-looking, and therefore do not align well with traditional risk data approaches. That is, E&S risks are in most cases irrelevant when tested against historical realization of losses and defaults, due to their low frequency (acute physical risks, e.g. floods) or their increasing trend (e.g. transition risks). This makes historical data non-representative for future E&S risk materialization. Inclusion of any risk drivers, including E&S risk drivers, currently needs to be motivated by their past performance over the development dataset, and this should remain the case. Incorporating such risks prematurely into IRB parameters would jeopardise the best-estimate principle, distort risk differentiation and undermine comparability.

Supervisors should therefore explicitly acknowledge that **accelerating integration of ESG risks is not expected to be quantified in Pillar 1 at this stage**, and that Pillar 1 integration should occur naturally only once the effects become evident in monitored credit performance data.

2. ESG risks are better captured through Pillar 2 and stress testing for now

In the spirit of simplicity, add-ons and overlays (for pillar 2 purposes, where these add-ons and overlays are inferred from tools such as scenario analysis) should be considered as a long-term solution to appropriately capture the impact of ER on capital, given that the add-ons are based on a solid quantification methodology. In addition, Pillar II models may capture the forward-looking impact of E&S risks, while avoiding inclusion of risk drivers in IRB models based on forward-looking expectations. Another effort to simplification is making sure that banks focus solely on material E&S risks (see point 5 below). The credit risk framework should not be required to be adjusted for immaterial E&S risks. This allows for focus and a proportionate approach.

Existing ESA and EBA guidance already provides robust tools for incorporating ESG risks into forward-looking Pillar 2 processes, especially through scenario analysis and stress testing. These frameworks are better suited to modelling non-linear, long-horizon risks. Stress tests can therefore serve as an appropriate channel to assess ESG vulnerabilities, provided they **do not lead to additional Pillar 2 capital outcomes** on top of existing requirements and guidance, in order to avoid overlap and double counting.

3. Need for clearer articulation of existing supervisory expectations

The EBF recognises that the EBA has already issued extensive guidance on the consideration of environmental and social risks within the prudential framework (e.g. EBA/REP/2021/18 and EBA/REP/2023/34). The intention here is therefore not to request additional supervisory guidance, but to set out members' current interpretation of the existing publications and to ensure a common and consistent understanding across institutions. This supports the objective of promoting harmonised implementation while avoiding unintended inconsistencies or double counting across Pillar 1, Pillar 2 and stress testing.

Further clarification of interpretation – rather than additional requirements – would assist institutions in understanding how environmental and social risk factors may interact with existing PD, LGD and CCF modelling practices, including the relevant transmission channels, treatment of risk drivers and the appropriate use of overrides, while ensuring continued adherence to the best-estimate principle. At the same time, it remains important that interpretative clarity does not create expectations for a separate or quantifiable environmental and social risk impact on PD estimates where such effects cannot be robustly identified or reliably evidenced in the available data.

For reference, based on existing EBA publications and the design principles of Pillar 1 – our interpretation is that institutions should consider the following aspects to comply with supervisory expectations regarding the inclusion of environmental and social risks into Pillar 1:

- Financial ratios as transmission channels: Continue to include financial ratios (among other drivers) in IRB risk-parameter models, because these represent potential

transmission channels for environmental and social risk-related impacts, consistent with EBA/REP/2021/18 and EBA/REP/2023/34.

- Model segmentation: Assess whether segmentation by physical location and/or industry sector is appropriate in cases where environmental and social risks vary materially across regions or sectors.
- Manual overrides: While the classic transmission-channel approach may show limited materiality at the overall portfolio level, this does not imply that environmental and social risks are irrelevant. Certain obligors may still be materially exposed, particularly within broad model segments. For these cases, manual overrides should be applied during model use.
- Explicit use of environmental and social risk drivers: Where such drivers are found to be material, institutions should assess and integrate them through the same processes used for traditional financial risk drivers. In principle, this integration should not be more complex than the inclusion of any other risk driver. However, **in practice this remains the least feasible area**, as members report significant data limitations and a lack of observed defaults attributable to environmental and social risks. These constraints currently limit robust statistical analysis and the reliable inclusion of explicit environmental and social risk drivers in IRB models.
- Targeted use of margins of conservatism (MoCs): Our current interpretation is that MoCs related to environmental and social risks may be relevant in the following situations:
    - Category A MoC (data limitations): When environmental or social drivers are included in the model, but the historical data for these drivers contain gaps or cover incomplete periods.
    - Category B MoC (representativeness): When the current application portfolio exhibits observable impacts of environmental or social risks that were not present in the estimation dataset, reducing representativeness. Importantly, only *current* observed impacts (in the application portfolio) should be considered under this category. Long-term forward-looking scenarios should *not* be incorporated, as this would conflict with the Pillar 1 focus on observed impacts and risk double counting with scenario-based assessments carried out under Pillar 2.

Given the above, we kindly request the EBA's confirmation – or correction – of our interpretation to ensure consistent implementation across institutions.

4. Gradual evolution supported by monitoring and prioritisation

While Pillar 1 integration is not yet feasible, IRB model monitoring already allows institutions to detect emerging ESG-related patterns. As these risks materialise and become statistically meaningful, they can progressively be incorporated into IRB models in line with the framework's design. In the meantime, institutions should focus on financial-related risk drivers that act as transmission channels for ESG risks.

5. Material and quantifiable ESG components to be prioritized

Supervisory expectations should also prioritise the evidence based material and quantifiable ESG components to ensure convergence and avoid fragmented modelling practices. We propose that the initial priority must be *environmental transition and physical risks* where risk measurement practices are more mature. This prioritisation is consistent with the 2026 ESA Joint Guidance on stress testing (JC 2025 78) and will help to align supervisory expectations regarding the scope of ESG risks across Pillar 1 and Pillar 2.

Q7. Which requirements should apply in relation to the performance measurement of continuous models (back-testing)?

EBF members consider that testing requirements for continuous models should remain **fully aligned with the principles already established in the CRR** and with existing supervisory expectations — in particular, those set out in the **ECB Guide to Internal Models (EGIM)** for institutions under the SSM (for example, par. 250, 285 & 321 of the Credit Risk Section). Our request for alignment is therefore not a call for new requirements, but a call to **avoid introducing additional layers** or diverging expectations that would increase complexity.

Within this existing framework, however, **a degree of flexibility is necessary**, particularly for portfolios characterised by structural data scarcity (e.g., low-default portfolios). In these cases, the direct application of performance tests originally designed for high-default environments may lead to excessive aggregation, reduced discriminatory power and unnecessary conservatism. The purpose of this flexibility is therefore to ensure **proportionate application** of already established principles, not to deviate from them.

In this context, the framework should explicitly acknowledge that institutions may, where justified, **discretise continuous model outputs into appropriate buckets solely for testing purposes** (e.g., back-testing, homogeneity assessment), while maintaining more granular continuous scales for risk management and internal use. This does not introduce a new requirement but clarifies how existing expectations can be applied in a proportionate, operationally feasible way.

Where performance thresholds are defined, they should remain **risk-sensitive and feasible**, taking into account the inherent statistical constraints of portfolios with limited default observations. Expectations that implicitly assume large datasets are not compatible with the design logic of the IRB framework.

Lastly, we underline that in situations where institutions need to adjust calibration or discretisation approaches, this may constitute a model change and should therefore be treated under the **existing model-change materiality and approval framework**, without adding new procedural requirements.

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

We believe overrides to be a necessary and appropriate component of both discrete and continuous IRB models. Overrides enable institutions to incorporate **expert judgement and qualitative information** in cases where model outputs do not fully capture the specific circumstances of an exposure, and they are explicitly recognised in the CRR (Article 172(3)) and further detailed in the EBA Guidelines on PD and LGD estimation (EBA/GL/2017/16).

In our view, the existing regulatory framework already provides a **sufficiently robust and comprehensive** set of requirements governing the justification, documentation, governance and monitoring of overrides. Introducing additional or model-specific requirements for overrides in the context of continuous rating scales would not enhance consistency or reduce unwarranted RWA variability. Overrides are, by nature, an exercise of expert judgement that cannot realistically be standardised in a way that would be operationally meaningful across institutions and portfolios.

We therefore see no need for further prescriptive rules. Instead, harmonisation efforts should focus on **clarity and coherence**, ensuring that override expectations remain aligned with the CRR and existing EBA guidance, as well as with supervisory expectations already established in the ECB Guide to Internal Models for SSM institutions.

It is also important that references to a "conservative use of overrides" are interpreted **carefully**, so as not to introduce implicit Pillar 1 add-ons or to undermine the best-estimate principle underpinning IRB models. Overrides should continue to be applied in a **proportionate, transparent, and risk-sensitive manner**, without creating additional layers of conservatism beyond what is already embedded in the CRR.

Finally, we note that institutions using continuous rating scales can—and in practice do—form **homogeneous buckets or grades** for back-testing and override purposes. These discretised pools allow the application of overrides even where "notching" concepts from discrete systems cannot be directly applied, demonstrating that the existing framework can accommodate both rating philosophies without the need for new requirements.

Nevertheless, for portfolios characterised by structural data scarcity, including low-default portfolios, the framework should explicitly acknowledge 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;"

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 behaviours and also 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;
- managing migration of exposures between facilities over time (e.g., product switches); and
- reflecting structural changes to facilities through their lifecycle; and
- allocating collateral to a facility when the collateral relates to multiple facilities

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. Despite the flexibility, the ECB's guide on Internal Models previously mentioned aggregation criteria, such as similar risk management practices and cross-collateralisation. Alignment between the supervisory guidance and regulatory text is welcomed. The alignment shouldn't be limited to previous EBA GL (e.g. on CCF), but also include the more principle-based approach under the accounting framework. In this way the approach preserves simplicity, flexibility and consistency.

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

We do not support imposing a single, uniform facility definition across all IRB risk parameters. While consistency is desirable where it improves clarity or reduces unwarranted variability, a strict application of the same aggregation level for PD, LGD and CCF would neither enhance risk sensitivity nor reflect how institutions' data, systems and risk processes are structured in practice.

From an operational perspective, existing IRB model architectures were not designed around a uniform facility concept. Introducing a single definition would require **extensive remapping of portfolios, redevelopment of model segmentation, and re-evaluation of historical datasets**, with significant implications for internal systems, collateral management processes, and limit-granting frameworks. Such changes would create major operational burden without delivering meaningful prudential benefits.

More fundamentally, the three risk parameters rely on **different economic and empirical foundations**, which naturally lead to **different relevant levels of aggregation**:

- **LGD estimation** is aligned with **recovery processes and collateral realisation**, which often operate at a higher aggregation level than contractual facility limits.
- **CCF estimation** depends on **limit management and utilisation behaviour**, which can occur at a more granular level and may require disaggregation, especially where facilities combine revolving and non-revolving components.
- Other bespoke facility structures used in practice also do not fit naturally into a single definition.

Forcing a uniform facility definition across parameters would therefore risk **disconnecting LGD and CCF models from their underlying economic logic**, leading to sub-optimal risk differentiation and potentially less accurate estimates. In some cases, it could even reduce the representativeness and reliability of model outcomes.

In addition, default risk and loss risk are often driven by different underlying factors, which may be most appropriately captured at different levels (e.g. obligor versus transaction level). A fully harmonised definition of "facility" may therefore not necessarily lead to simplification.

In further support of not requiring a single facility definition, any inconsistency between the facility definition used for model estimation and the aggregation level required during model application for specific reporting purposes (such as accounting or capital reporting) 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.

For these reasons, the institutions consider it essential to **maintain flexibility** in selecting the appropriate aggregation level for each risk parameter, as long as choices are well-justified, transparent, and aligned with the institution's underlying processes and data. A principles-based approach allows institutions to ensure consistency where appropriate, without imposing operationally disruptive or conceptually unsuitable constraints.

Q11. Are the representativeness adjustments proposed for CCF suited for PD and LGD?

We generally support extending the simplifications proposed in the CCF representativeness framework to the PD and LGD risk parameters, as long as such extensions are **appropriately adapted** to the specificities of each parameter. The underlying principles used to assess representativeness—scope of application, definition of default, risk characteristics, credit-management policies, and market conditions—are indeed common and should be consistent across IRB parameters, and greater flexibility in their application would be welcome. A simplified and harmonized approach would reduce unnecessary complexity and support future model development and model extensions, while preserving risk sensitivity.

In practice, many institutions face persistent challenges in meeting representativeness requirements, particularly in portfolios characterised by **low default incidence or structural scarcity of observations**. For these portfolios, a strict interpretation of representativeness may be neither feasible nor proportionate. In this context, a more **pragmatic and risk-based approach**, placing greater emphasis on **model performance** in calibration and validation rather than on perfect representativeness of development samples, would allow banks to make better use of available data without compromising model quality.

At the same time, we emphasise that any extension of the CCF approach should **not automatically trigger Margin of Conservatism (MoC) requirements**. Flexibility should support efficient and reliable estimation, not introduce an expectation of systematic conservatism. Furthermore, PD and LGD modelling have **parameter-specific considerations**—such as the PD "likely range of variability" analysis and the alignment of LGD modelling with recovery processes—that must be reflected in any adaptation of the CCF framework.

Against this background, we consider the EBA's initial proposals promising but not yet sufficiently detailed to fully assess their operational implications. Additional clarity on the precise nature of the intended simplifications and the role of development, testing, and quantification samples for PD and LGD would help ensure consistent implementation across institutions and supervisors.From a cost-benefit perspective, it should be carefully assessed whether extending representativeness requirements beyond the current framework would provide sufficient additional value, given that existing requirements for PD and LGD are generally considered adequate and robust.

Q12. Is further simplification of the representativeness requirement necessary for PD and LGD?

Yes, we believe that further simplification of representativeness requirements for PD and LGD models would be beneficial, particularly for portfolios where achieving strict statistical representativeness is inherently difficult. This is especially relevant for **low-default portfolios, specialised or granular exposures, and portfolios where historical data is structurally limited**.

In such cases, rigid representativeness expectations can create substantial operational burdens without materially improving model accuracy or discriminatory power. We therefore support a more **proportionate and risk-based approach**, allowing institutions greater flexibility in the modelling sample and enabling the use of **broader tolerance ranges, alternative qualitative assessments, or expert-based judgement** where quantitative representativeness cannot realistically be met.

Any simplification should remain aligned with the **purpose and performance** of the models, ensuring that calibration and validation continue to provide reliable and robust estimates, while avoiding requirements that compromise model stability.

We also note that the EBA may introduce future policy work on the **likely range of variability of one-year default rates**. In this context, additional flexibility will be essential to ensure that representativeness expectations can be met across the wide diversity of IRB portfolios, without imposing unwarranted conservatism or systematic MoC.

Q13. Should these simplifications be pursued?

The EBF supports the introduction of **optional** simplifications and fallback approaches, provided they **genuinely reduce modelling burden**, **preserve risk sensitivity**, and **do not create de facto floors** or implicit Pillar-1 add-ons. Overly conservative fallback options wouldn't be operationalized and thus be ineffective. Calibration is essential and a determining factor in whether to pursue with fallback options. Optionality should be **unconditional in principle**: institutions should be able to adopt a fallback **without first performing extensive justification exercises** that would undermine the purpose of simplification, and they should be free to adopt fallbacks **modularly** (i.e., for specific modelling components) and **at an appropriate time** (e.g., at model refresh), avoiding mandatory widescale model changes.

To ensure proportionality and avoid unintended conservatism, we recommend:

1. **MoC**

- Simplifications should not translate into **systematic MoC** or **implicit floors**, especially for **low-default portfolios (LDPs)** where data scarcity already drives uncertainty.
- A **single MoC-C approach** risks being too blunt; allow **institution-specific adjustments** and **proportionality** to reflect portfolio idiosyncrasies.
- **The effectiveness of the fallback option stands with the level of calibration** of the metric. Any overly conservative calibration would render the metric ineffective and would only add complexity – rather than simplify– the framework.
- We favour harmonization of MoC-C practices. Within the constraints above, a **standard error-based approach may be used**, in which the statistical uncertainty of PD, LGD, and CCF observations forms the basis for conservatism. At the same time, and aligned with par. 44(b) of the DP, institutions should be permitted to **deviate** from the standard-error method to use a portfolio-specific method under *specific circumstances*. Examples include extremely limited observations, structural changes in the portfolio, or data-quality issues that impair the representativeness of the sample.
- Fallback or simplified approaches **should not inadvertently become new benchmarks** against which more advanced models are expected to align, as this would reduce flexibility and undermine the purpose of simplification.
- As a practical simplification, the introduction of **materiality thresholds** could be considered to permit institutions to exercise proportionality in the MoC assessments, for example in cases where data deficiencies affect only a very small share of the development or calibration sample.

For LDPs, highly standardized or quantile-based approaches may produce **unstable or overly conservative** outcomes due to sparse or uneven data. Any fallback should therefore allow proportionality and expert judgement to avoid distortions.

2. **Downturn LGD/CCF estimation**
   - We support the availability of a **reference-value-based fallback approach** for downturn LGD and CCF estimation, **when chosen by the institution**, , with calibrations designed to mitigate bias and avoid undue sensitivity to extreme observations.

- To reduce sensitivity to idiosyncratic outliers, and **as an optional fallback**, we propose allowing institutions to compute the reference value as the **average of the three worst calendar years within a sufficiently representative recent observation window** (e.g. a minimum of seven years where feasible). This approach aims to smooth isolated extreme outcomes while avoiding excessive reliance on distant economic cycles that may no longer be representative of current portfolio characteristics.
- Further analysis may be needed to confirm whether the proposed use of *three* years is indeed appropriate to mitigate the bias due to idiosyncratic outliers across portfolios.
- This fallback approach is **not intended to replace a full downturn identification and quantification process** where such analysis is feasible and appropriate, but rather to reduce operational burden in case where proportionality considerations apply, while maintaining prudent outcomes.
- For simplification measures to be effective in practice, it is important that **competent authorities allow the use of such fallback options where foreseen in the framework**, ensuring a consistent and harmonised application across Member States and avoiding additional national constraints that would undermine the objective of simplification.
- **Finally, the prudential value of requiring a long-run average calculation alongside downturn LGD estimation should be reconsidered.** Where LGD parameters are already estimated under stressed conditions or through a conservative downturn fallback, layering an additional long-run average component risks **double counting conservatism**, increasing operational complexity and blurring the conceptual distinction between downturn and through-the-cycle measures, without clear gains in risk sensitivity.

3. **CCF 12-month fixed horizon**

- We support **additional flexibility** around the 12-month fixed reference, aligning CCF practice with other IRB parameters and reducing modelling/application mismatch.

- Our understanding, for confirmation by EBA, is that this additional flexibility, to remain compliant with the current Level 1 requirement in CRR3 Article 182(1)(g) and the Basel specification in CRE 36.93 includes the (interpreted) option to develop the IRB-CCF risk-*differentiation* model using a cohort approach in which the reference period may deviate from a fixed 12 months. This would allow alignment with a cohort methodology used for other risk parameters, such as the IRB-LGD. However, the risk *quantification* of the IRB-CCF must be tested against the outcome derived using a 12-month fixed reference period, that may result in further changes to the IRB-CCF risk quantification level, to ensure Level-1 compliance.

4. **Direct and indirect LGD costs**

   - We support **fixed percentage** fallbacks to standardise treatment and ease implementation.

   - To enhance proportionality and risk-alignment, consider **differentiated fallback rates by customer type** (e.g., retail individuals, SMEs, large corporates).

5. **LGD for defaulted exposures**

   - We welcome simplifications: current requirements are **overly complex relative to either the marginal risk-sensitivity** achieved or the amount of exposures covered. A simpler, standards-based path here would lower burden without weakening prudential quality.

6. **Fixed IRB-CCF derogation / Fixed CCF fallback approaches**

   - We support optional fallback values for CCFs provided that the AIRB LGD is still supported, i.e. the use of the fixed CCF does not require reversion to the FIRB or SA for the LGD. The use of SA CCF fallback values should be considered an option for AIRB. Furthermore, where feasible, we support allowing institutions to use their own data to calibrate the fixed CCF values in order to avoid fixed CCFs that are demonstrably overly conservative relative to a portfolio's observed credit conversion behaviour.

   - In this context, it may also be useful to further reflect the operational complexity introduced by the draft guidelines on CCF estimation (EBA/CP/2025/10). In particular:

1. the linkage between the application of SA-CCF and the LGD approach could be reconsidered, and

2. the use of 100% CCF floors may raise proportionality concerns.

Safeguards against erosion of risk sensitivity and level-playing-field concerns

- Fallbacks should **remain optional** and **not become supervisory defaults** simply because they are easier to review.
- Calibration should be **prudent but not punitive**; fallbacks should **not mechanically inflate own funds requirements** where banks can demonstrate robust, data-driven estimates.
- Avoid **cross-country inconsistencies** whereby differing supervisory interpretations of downturn evidence create **unwarranted capital disparities**. Optional, well-calibrated fallbacks can be a tool to mitigate—rather than amplify—such disparities.
- Fallback values should be calibrated using the institution's *own data*, where relevant and feasible (e.g. using own data to determine the reference value for downturn quantification, provided that a sufficiently long loss-data history is available).

To conclude, we support pursuing these simplifications on an **optional, modular and proportionate basis**, with calibrations that **preserve risk sensitivity**, provide **clear usability gains**, and **do not introduce de facto floors**. This will improve the **usability and consistency** of the IRB framework without discouraging its adoption.

Q14. Do you have comments on the calibration of fallback approaches?

We agree that the calibration of fallback approaches is crucial to ensuring that the proposed simplifications are genuinely usable. While a certain degree of prudence is reasonable to avoid arbitrage, several of the calibrations currently suggested—particularly the downturn LGD add-ons and some of the fixed CCF fallback values—appear **excessively conservative**. Calibrations that function as **de facto floors** risk discouraging banks from adopting simplified approaches and may even disincentivise the continued use of IRB models, contrary to the objective of enhancing usability.

It is essential that fallback parameters remain **proportionate, risk-sensitive, and operationally workable**. Introducing overly cautious fallback options would only insert additional features - adding rather than reducing the complexity of the framework. Fallbacks that are calibrated too high will not be viable alternatives in practice and could lead to **unwarranted increases in own-funds requirements**, particularly in jurisdictions where

downturn evidence is limited or disputed. This raises **level-playing-field concerns**, as more conservative interpretations would mechanically disadvantage some institutions over others.

For direct and indirect LGD costs, we support the introduction of fixed fallback percentages but note that calibration should account for **differences across customer types, collateral structures, jurisdictions and portfolio characteristics**. An industry-wide benchmarking exercise could help ensure fair and representative calibration.

On CCF fallbacks, we emphasise that any simplified methodology must remain **fully aligned with the CRR**. In this context, **SA-CCF values may represent a feasible fallback option for those exposure classes that remain eligible for IRB-CCF estimation under the CRR**, provided their use does not entail a change of approach and remains strictly optional.

At the same time, the CRR clearly distinguishes between exposures eligible for IRB-CCF estimation and those to which SA-CCF values must apply by design. **Fallback approaches should therefore not extend SA-CCF values to exposure types beyond those permitted under the CRR**, nor blur the delineation between IRB and SA methodologies. Introducing fixed CCFs in a way that effectively applies across entire exposure categories would risk creating regulatory ambiguity and undermining clarity around method selection. Any CCF fallback should therefore respect both the **scope and boundaries of IRB eligibility under the CRR**, while remaining operationally workable and proportionate.

Regarding downturn quantification, we refer back to our response to Question 13, where we propose optional adjustments (e.g. using the average of the three worst calendar years – subject to further analysis –, with a minimum observation period) to ensure that fallback calibrations are prudent yet not overly sensitive to idiosyncratic outliers.

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

Several areas of the IRB framework generate a **high modelling burden with limited marginal gains in risk sensitivity** and should therefore be prioritised for simplification. This is especially true for **low-default portfolios (LDPs), specialised lending, and long-dated corporate exposures**, where data scarcity and structural complexity often limit the incremental value of highly granular modelling requirements.

A first area where simplification would be beneficial is the **maximum recovery period**. The current approach requires significant analytical effort while contributing only modestly to overall LGD accuracy. We support introducing a fallback based on the **time in default corresponding to the 99th percentile of the cumulative average recovery curve**, calculated across all vintages. Consistent with this, the same 99th-percentile-based fallback could also be adopted as the **maximum drawing period** for CCF estimation to further support cross-parameter simplification.

Simplification is also warranted in the **identification of downturn periods and likely ranges of variability**, which currently involves institution-specific modelling that is often operationally demanding and results in significant methodological complexity, prone to divergent practices within the same jurisdiction, and not always proportionate to the prudential benefit. We support exploring a more standardised approach whereby **Competent Authorities define downturn periods and variability ranges at national level within the maximum period of 20 years**, based on transparent and predefined macroeconomic indicators. At the same time, when banks can demonstrate that a **severe observed event** is already clearly reflected in their empirical LGD outcomes, no additional effort should be required to back-cast weaker downturns identified solely through macro indicators. This would reduce unnecessary burden while enhancing consistency, comparability and level playing field across firms and preserving risk sensitivity.

Further simplification would also be appropriate in the **treatment of historical data following mergers and acquisitions**. Requiring institutions to integrate legacy datasets from acquired entities—often defined under different systems, default definitions and credit policies—introduces disproportionate complexity while offering limited predictive value. In such cases, allowing institutions to rely on **post-integration, forward-looking data** would better align modelling with the actual risk profile of the combined institution.

Likewise, we support a more **proportionate application of homogeneity and heterogeneity requirements** in segmentation. Excessive reliance on numerous statistical tests can lead to unstable or economically unintuitive grade structures. A simplified framework that focuses on a **limited set of core indicators**, supported by expert judgment and qualitative justification, would maintain prudence while reducing unnecessary methodological complexity. 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.

Finally, for institutions with material low-default portfolios, the treatment of PD models in such portfolios should be recognised as a high-priority simplification area. This area should be prioritised not only because of its implementation burden, but also because it is a recurrent source of supervisory findings, remediation cycles and model redesign efforts, often with limited additional prudential benefit relative to the operational and governance costs created.

Q16. What challenges do you perceive in collecting appropriate data, especially indirect costs?

Indirect cost data remain difficult to use due to limited granularity, limitations in representativeness, weak links to default events, and high operational complexity in collection and allocation. Therefore, collecting and allocating indirect recovery-related costs remains one of the most challenging aspects of LGD modelling. In practice, these costs are often dispersed across multiple systems, shared services and organisational units, many of which have evolved or been replaced over time. As a result, historical datasets rarely provide the granularity or traceability needed to attribute indirect costs reliably to specific recoveries or calibration segments.

Moreover, where indirect costs are recorded within centralised or batch-processing functions, distinguishing between recovery-specific costs (i.e., direct costs) and broader operational expenses (i.e., indirect costs) is inherently difficult. Institutions must therefore rely on estimation techniques and expert judgment, which, while pragmatic, are hard to back test and may face supervisory scrutiny due to limited empirical evidence.

Given these structural constraints, we support the introduction of **simplified or standardised fallback approaches** for indirect (and unallocated direct) costs, provided they remain empirically grounded and proportionate. Such approaches would reduce unwarranted variability across institutions while recognising the practical limitations of historical data reconstruction—particularly for legacy portfolios and low data-granularity environments.

In our view, although we propose fallback approaches for both direct and indirect costs, institutions should be able to opt in to the fallback for indirect costs, direct costs, or both, depending on the specific data availability of the portfolio under consideration.

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

1. **Support for Overall Objectives, and Need for Principle-Based Regulation**

We support the EBA's objective to develop a more streamlined, coherent and proportionate credit-risk framework. The analytical criteria proposed in the Discussion Paper can serve as a useful basis for assessing potential changes, provided they are applied in a way that safeguards **proportionality**, avoids **unintended capital impacts**, and preserves **genuine optionality** where simplifications are introduced.

However, although the EBF welcomes the EBA's work to simplify the prudential framework, we are concerned that the current approach of adding further detailed rules, sub-options and technical specifications to the already rules-based system risks eventually **increasing** complexity rather than reducing it. EBF members also observe divergent interpretations of

identical provisions by NCAs. This demonstrates that adding more detailed rules does *not* necessarily deliver greater legal certainty or more consistent supervision.

For these reasons, the EBF proposes, as a long-term and sustainable solution, that the current **rule-based** prudential framework should progressively evolve toward a **principles-based** framework.

A principles-based system is aligned with the **2024 Draghi Report on EU Competitiveness**, which underpins the Commission's simplification agenda (that includes this DP) and repeatedly calls for simplification, flexibility, and outcome- or principle-based regulation rather than continued expansion of detailed prescriptive rules. Principles-based guidance provides clear supervisory expectations without imposing extensive lists of technical requirements. This reduces the need for continuous clarification, avoids unnecessary complexity, and prevents the rulebook from expanding further. In this regard, the direction taken in the DP does not appear to be strategically aligned with the spirit of the Draghi report.

Moving toward a principles-based framework would support supervisory consistency and the EU's long-term competitiveness, while keeping prudential standards strong. This EBF proposal is consistent with the simplification proposals in the **2025 EBF report *Simply Competitive***[3] to move away from detailed rule-based regulation.

2. Safeguard for Practical Implementation

To ensure the framework achieves greater clarity and predictability in practice, additional safeguards would be welcome. In particular, clearer transition timelines, stronger alignment with Level 1 legislation where needed, and careful calibration of simplified approaches are essential to avoid creating implicit conservatism or operational burden that would conflict with the core aim of simplification.

3. Consistency Between Products

We also underline the importance of ensuring **consistency across supervisory products**, notably between the EBA's guidelines and the ECB's Guide to Internal Models (EGIM). Divergent interpretations across these texts have led to repeated validation cycles, uncertainty over binding standards, and delays in model approval. A closer alignment between EBA and ECB expectations would significantly enhance regulatory stability, reduce duplicated efforts and support a more predictable supervisory process.

4. Zero-flooring of CCFs

[3] Available at https://www.ebf.eu/wp-content/uploads/2025/07/Simply-Competitive-report-EBF.pdf

The introduction in CRR3 Article 182(1) of a zero-floor for observed CCFs used in risk quantification is at odds with the original Basel Accord design principle (CRE 36.89). The Basel text specifies an effective output floor at the level of the current drawn amount:

"For on-balance sheet items, banks must estimate EAD at no less than the current drawn amount […]".

By contrast, the changes introduced in CRR3 shift this from an *output* floor (as intended by the Basel framework) to an *input* floor. This results in increased conservatism in the estimated EAD, reducing risk sensitivity, ignoring product-specific characteristics, and producing "best estimates" that are no longer *true* best estimates – with the consequence that they are not suitable for non-capital uses and therefore undermine the Use Test.

We therefore propose realigning the flooring specified in Level 1 with the original Basel design principle.

Should realignment at Level 1 not be feasible in the near term, we recommend clarifying at Level 2/3 how input floors interact with the best-estimate principle to preserve risk-management usability.

5. Use of Level 1 vs Level 2/3

Aligned with our proposal (under point 1 above) for more principle-based regulation, when shaping future revisions of the regulatory framework, we encourage the EBA and co-legislators to avoid embedding highly technical modelling specifications in Level 1 texts, such as reference-period selection methods and zero-flooring for CCF in CRR Article 182. Such details are better addressed in Level 2 or Level 3 instruments, where they can be updated more efficiently and, in a manner, consistent with the broader supervisory rulebook. Level 2 and Level 3 instruments should stay within the scope of Level 1 requirements and avoid undue prescriptiveness, especially where mature supervisory frameworks are in place and convergence can be ensured through principles-based supervision rather than granular rule-setting.

Accordingly, also the requirements for storing and processing customer data should be moved from level 2 and level 3 text to the CRR/level 1 in order to have a proper legal basis for modelling work. This would simplify internal processes in terms of GDPR-compliance.

6. Narrowing the scope of AI to exclude logistic and linear regression models

Although the AI Act is not in the scope of the EBA products covered in the DP, it has a direct and practical impact on areas that are governed by these EBA products, in particular internal models, related credit risk practices, and model governance.

In this regard, members extensively use **logistic and linear regression (LR) models** for estimating IRB parameters and credit scoring. The AI Act's relatively broad definition of an "AI

system", even when read together with the **2025 Commission guidelines**[4] on that definition, has led to **divergent** interpretations whether LR models quality as AI systems. These differing interpretations relate in particular to:

- whether LR models fall within the definition of an AI system;
- whether the grandfathering provisions, including the August 2026 end date, apply to such models;
- whether exclusions from scope apply generally or only in narrowly defined use cases, and
- whether the close link, due to Use Test requirements, between credit scoring models used for the creditworthiness assessment of natural persons (which are regarded as high-risk under the AI Act), and IRB models used for prudential capital requirements automatically brings these internal models within the scope of the AI Act.

These LR methods constitute **basic data processing** techniques. They are explainable, transparent, and they are implemented *without* any form of *automatic* recalibration in order to remain fully aligned with IRB regulatory requirements. For this reason, the EBF considers that LR models should fall **outside** the scope of the AI Act. This view also applies to the related LR-based credit scoring models used for assessing the creditworthiness of natural persons, which are often interpreted as falling automatically under the high-risk category.

The EBF therefore calls for a clear and explicit clarification in the appropriate EBA products that logistic and linear regression methods, when implemented in a fixed, non-adaptive, and fully transparent manner, are **excluded** from the scope of the AI Act. Such clarification would be consistent with:

- the recent **ECB Opinion CON/2026/10**[5] (notably paragraph 4.2);
- the revised **2025 ECB Guide to Internal Models** (Section 9.1 which does *not* consider LR models as machine-learning techniques for the purpose of the additional governance requirements set out in the Guide), and

[4] Guidelines on the definition of an artificial intelligence system established by Regulation (EU) 2024/1689 (AI Act) available at https://digital-strategy.ec.europa.eu/en/library/commission-publishes-guidelines-ai-system-definition-facilitate-first-ai-acts-rules-application

[5] OPINION OF THE EUROPEAN CENTRAL BANK of 13 March 2026 on a proposal for a regulation as regards the simplification of the implementation of harmonised rules on artificial intelligence (CON/2026/10) available at https://www.ecb.europa.eu/pub/pdf/legal/ecb.leg_con_2026_10.en.pdf

- with the **EBF's 2025 report *Simply Competitive*** (p. 32).

It would materially enhance legal certainty, proportionality, and regulatory consistency in the application of the AI Act, and its interaction with the EBA products.

III. Conclusion

The EBF welcomes the EBA's initiative to streamline and simplify the credit-risk framework and supports the ambition to enhance clarity, coherence and supervisory convergence. At the same time, our analysis across the Discussion Paper highlights several areas where further safeguards are necessary to ensure that simplification remains **proportionate, operationally feasible and risk-sensitive**.

In particular, the effectiveness of the proposed measures will depend on maintaining **genuine optionality** for fallback approaches, avoiding **excessive conservatism** in calibrations, and ensuring that simplifications do not evolve into **de facto floors** or implicit capital add-ons. The framework would also benefit from clearer planning and transition timelines, a strengthened focus on **low-default portfolios**, and careful alignment with **Level 1 requirements**.

Equally important is the need for greater **supervisory coherence**, especially between EBA guidelines and the ECB's Guide to Internal Models. Ensuring consistency across these instruments will reduce duplicated effort, accelerate model approval processes and support a more predictable and stable regulatory environment.

We trust that the detailed feedback provided in this response—covering fallback methodologies, representativeness, downturn quantification, facility definitions, recovery-cost treatment, ESG integration and real-estate exposures—will contribute to a prudential framework that remains **robust, usable and proportionate**, and that continues to support effective risk management across the European banking sector.