Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

ABBL response

EBA - Discussion Paper on Credit Risk Framework Simplification (EBA-DP-202601)

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General Key Message

The Luxemburgish Banking associations' members welcome the EBA's initiative to simplify the credit risk framework, aligning with the 2025 EBA Report on regulatory efficiency.

We advocate proportionality, greater competent authority discretion to reflect national specificities, particularly in real estate, consolidation of IRB products, cautious and supportive use of Article 430a data, proportionate ESG integration, and practical simplifications such as representativeness adjustments and fallbacks for non-material segments.

The following responses therefore address selected questions from the Discussion Paper, focusing on areas where Luxembourg-based institutions have practical experience or where EBA proposals are likely to have a material impact on model design, validation, and supervisory practice.

Q1/14: For the purpose of reporting under CRR Article 430a, which definition of loss should be used?

Our members favour a definition of loss based on realized credit losses, as this would better reflect economic loss in a timely manner and support comparability across institutions.

Safeguards such as harmonised treatment of provisions, incomplete recoveries, exposure values, and collateral timing would be essential to ensure consistency across SA and IRB institutions.

Q2/Q15: 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 availability of harmonised loss data under Article 430a could represent a valuable input for supervisory monitoring and policy analysis. However, we would caution against relying on such data as a stand-alone or mechanistic basis for assessing risk weights under Articles 126(4) and 465(11).

At this stage, Article 430a data may not yet provide a sufficiently granular or fully comparable basis for consistent cross-country calibration, given differences in market structures, legal frameworks, foreclosure processes, and other structural factors affecting observed loss outcomes.

In our view, the data should therefore be used as a supporting indicator within a broader prudential assessment, alongside historical loss experience, forward-looking indicators, loan-to-value ratios, default rates, and relevant market-specific factors. This would help preserve risk sensitivity, proportionality, and supervisory judgement, while avoiding undue mechanistic reliance on a dataset whose comparability and predictive power may still evolve over time.

Q3/Q16: Which elements of the real estate framework should be further simplified?

Further simplification could be achieved by empowering competent authorities to exercise supervisory judgement when granting preferential treatments, considering national market specificities, risk profiles, and established practices. In parallel, the framework should clarify relevant distinctions between IPRE categories and limit the use of Article 430a data to a supporting role.

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

No specific comments were identified from the input received. More generally, a pragmatic approach would be preferable, including continued reliance on existing ECAI mappings for former government support ratings, provided the underlying rating scales remain consistent with prior assessments and updated mappings are not yet supported by sufficient data.

Q5: Should the consolidation of regulatory products for credit risk be a priority or should regulatory stability be preferable instead? Have you identified any redundancies in IRB products?

Priority should be given to consolidating IRB regulatory products into a single coherent set of modelling guidance, with a view to improving readability, reducing duplication, and supporting compliance and model development.

Simplification should be favoured over maintaining the current structure, provided that risk sensitivity is not compromised.

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?

ESG integration should be enhanced in a proportionate manner through clarifications on historical data limitations, acceptable proxies, and suitable testing frameworks.
Priority should be given to strengthening practices in origination screening, portfolio alignment, and ICAAP or stress testing, rather than introducing mandatory IRB parameter adjustments, until ESG data availability and quality have sufficiently matured. This approach would help preserve simplicity while supporting prudent risk management.

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 compliant with CRR, Part Three, Title II, Chapter 3, Section 6?

Continuous rating models can enhance risk differentiation by assigning individual PD estimates to exposures. However, as highlighted in the discussion paper, several validation requirements within the IRB framework are defined at the level of rating grades, including tests related to homogeneity, minimum observations and back-testing. This may create practical challenges when continuous rating scales are used, as individual PD estimates must be compared with binary default outcomes.

In this context, the proposal to discretise continuous rating scales for the purpose of certain validation tests appears reasonable. Grouping exposures into buckets for testing purposes would allow institutions to maintain the benefits of continuous modelling while ensuring that validation requirements can be applied in a consistent and statistically meaningful way. Such an approach would also facilitate supervisory review and improve comparability across institutions.

At the same time, discretisation should remain limited to validation and testing purposes and should not constrain the underlying modelling approach. Continuous models can provide valuable granularity in risk differentiation, and preserving this flexibility is important to maintain the risk sensitivity of the framework.

Overall, introducing harmonised testing approaches for continuous models could contribute to simplifying the IRB framework and limiting unwarranted variability in risk-weighted assets, while preserving modelling flexibility for institutions.

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

For continuous ranking models (as opposed to purely discrete scales), it is recommended to discretise model outputs into buckets for grade-level testing—covering aspects such as homogeneity, back-testing, and overrides—to facilitate validation, enhance comparability, and promote RWA stability. This approach would maintain modelling flexibility without necessitating full model redevelopment.

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

The key challenge lies in identifying related sets of contracts to ensure consistent LGD and CCF estimation and linkage over time, particularly where recovery patterns diverge from off-balance sheet behaviours—such as credit card facilities routed via overdraft accounts—which complicates the alignment of exposure classification, loss recognition, and risk parameterisation.

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

A consistent facility definition should, as far as possible, apply across PD, LGD, and CCF to reduce arbitrariness, prevent arbitrage, and improve the coherence of risk parameter estimation, particularly for LGD and CCF where recoveries diverge from behavioural draw patterns. Guidance should be provided to ensure that modelling approaches are aligned with actual business structures and recovery practices.

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 proposed simplifications for CCF are broadly also relevant for PD and LGD, provided that parameter-specific characteristics are properly reflected.
A harmonised approach would support proportionality and reduce unnecessary complexity, while preserving the distinct modelling logic of each parameter.

Q12: Do you consider further simplification of the representativeness requirement, as proposed for the CCF parameter, as necessary for PD and LGD? If so, what simplification?

Representativeness should be assessed in a manner consistent with the nature of each parameter. For LGD and CCF, this should focus on defaulted populations rather than the full portfolio, reflecting their default-conditional nature and distinguishing them from PD. This would help avoid mechanical remediations driven solely by variations in default rates.

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

The proposed simplifications should be pursued where they preserve risk sensitivity and supervisory comparability, including possible conservative fallbacks for non-material segments (such as exposures representing less than 1% of the portfolio or small exposures), thereby ensuring proportionality, reduced implementation and compliance costs, and the possibility of finer granularity for institutions with rich data available.