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Technical note on

Simplification and assessment of the credit risk framework

EBA´s Discussion Paper

1. Executive summary

2. Simplification in the Standardised Approach

3. Simplification in the IRB Approach

3.1 Consolidating and increasing consistency in the IRB rules

3.2 Simplifications across IRB components

A Annex

1 Executive summary
Main Content

The new EBA Discussion Paper (DP) marks a shift in the European regulatory approach to credit risk: from the expansion and incremental detailing of the regulatory framework towards its consolidation, rationalisation, and improved coherence, without reopening the Basel international standards or altering the level of prudential requirements

Context

- In December 2023, the EBA published its roadmap for the Banking Package, identifying the implementation of the **Capital Requirements Regulation (CRR3)** as an opportunity to **streamline, update** and **enhance coherence** between existing regulatory documents and mandatory reporting requirements, with particular focus on **credit risk**.
- In October 2025, the EBA published its report on the **efficiency** of the regulatory and supervisory framework, presenting **21 measures** and reviewing both the existing body of rules (**stock**) and the new **flow** of mandates under the Banking Package. This exercise led to the **deprioritisation** of certain mandates (e.g. dilution risk and specialised lending) and to a **reassessment** of how to improve the **simplicity** and **efficiency** of the remaining mandates in the EBA's future work.
- In February 2026, the EBA published this **DP**, which outlines preliminary proposals to advance the review of the **credit risk** framework. The document does **not address the simplification of supervisory** practices, which is dealt with separately (including the rationalisation of the SREP and supervisory reviews of **internal models**). The proposals are **preliminary and non-binding**, and aim to **foster debate** and gather feedback ahead of any potential policy decisions.

Objectives and Scope

- **Support the analysis** of the extent to which the current **prudential credit risk framework** could gain in **simplicity**, **coherence** and **operational efficiency**, without compromising risk sensitivity or the robustness of the Basel III framework.
- Improve the **presentation** and **readability** of the single rulebook through the consolidation of regulatory documents and the harmonisation of definitions.
- **The paper does not propose** changes to prudential **calibrations**, regulatory **capital levels** or the functioning of the **output floor**, focusing exclusively on the efficiency, coherence and applicability of the existing framework.

Next Steps

- **The public consultation is open until 10 May 2026**.
- The feedback received will inform the EBA's **future regulatory work**.

Access to the document

1. The simplification of the supervision of rules is addressed in parallel in the EBA consultation on the *revised Guidelines on the supervisory review and evaluation process (SREP) and supervisory stress testing* (24 October 2025) and in the consultation on the *draft regulatory technical standards specifying material changes and extensions to the Internal Ratings-Based (IRB) approach* (15 July 2025)

1 Executive summary
Key elements on the simplification proposal

The simplification proposal is built around two main levers, the Standardised and the IRB Approach, to make the prudential framework clearer, more consistent and more proportionate, by clarifying definitions, harmonising criteria and simplifying technical requirements

Content Structure

Simplification of the Standardised Approach

- Measures to simplify the Standardised Approach (SA) are analysed, particularly in the **prudential treatment** of **real estate exposures** and in the **use of external credit assessments**.
- For **real estate exposures**, the paper proposes harmonising the **definition** of **losses reported** under Article 430a CRR, **clarifying** for which **prudential decisions** this information should be used, and narrowing its scope of application, given that a single indicator, as currently defined, presents limitations in terms of comparability, interpretation and predictive capacity.
- In parallel, regarding **external credit ratings**, the EBA proposes a **pragmatic** and **transitional approach**: allowing the use of ratings without implicit government support by relying on the existing mappings to External Credit Assessment Institutions (ECAI).

Simplification of the IRB Approach

- The document addresses the **simplification of the Internal Ratings-Based (IRB) approach**, proposing the consolidation and harmonisation of the set of rules applicable to IRB models, which are currently dispersed across multiple technical standards, guidelines and interpretative documents.
- In parallel, it analyses how to **integrate environmental** and **social risks** more **systematically** into **risk differentiation** and **quantification processes**, assessing the impact in terms of complexity.
- It also examines the **use** of **continuous rating scales**, analyses the need to **clarify** the **definition** of **exposure** introduced by CRR3, and proposes **reviewing** and **simplifying** the **requirements** regarding data **representativeness**.
- Finally, the EBA proposes reviewing certain **elements of the IRB framework** where **modelling costs** are **not proportionate** to the benefits in terms of **risk sensitivity**.
- In particular, it proposes: (i) **simplifying** the quantification of the **Margin of Conservatism (MoC)**; (ii) **standardising** the **treatment** of **direct** and **indirect costs of the recovery processes** in the estimation of Loss Given Default (LGD); (iii) **simplifying** the estimation of **downturn** parameters; (iv) introducing **simplified methods** for **exposures** in **default**; and (v) **expanding** the **use** of **fixed conversion factors** under the IRB approach and introduce greater **flexibility** in the **requirement** of a **fixed 12-month horizon** for their estimation.

2 Simplification in the Standardised Approach
Real estate exposures and the treatment of external credit assessments

CRR3 strengthens risk sensitivity in real estate exposures, but its application remains challenging due to national specificities, the lack of harmonised data, and the uncertain usefulness of Article 430a CRR loss data as a single metric

2.1 Balancing national specificities and supervisory convergence for real estate exposures

- Exposures secured by immovable property are reviewed in the Discussion Paper because they account for a significant share of the **complexity** of the **credit risk framework** and combine **high systemic relevance** with **strong national specificities**, making them a priority area within the exercise to simplify the prudential framework.
- **CRR3** strengthens risk sensitivity in the treatment of real estate exposures by maintaining the distinction between **residential and commercial immovable property**, introducing greater granularity through the identification of **income-producing real estate exposures (IPRE)**, where repayment depends primarily on the **cash flows generated by the underlying property**, and reinforcing the role of the **loan-to-value (LTV) ratio** as the main risk driver.
- Assessing the appropriateness of risk weights is challenging due to constraints in accessing sufficiently **granular and harmonised data** and because mandates interact with multiple **discretions, derogations and macroprudential tools** embedded in the real estate framework.
- **Loss data** associated with **exposures secured by immovable property** and reported under **Article 430a CRR** are questioned as a single metric: they may have limited **predictive power** and reduced harmonisation value, lacked a precise definition of **loss**, and generated inconsistencies between institutions applying the **SA** and those using the **Internal Ratings-Based** (IRB) **approach**.
- The coexistence of several derogations and overlapping measures raises the possibility of further **streamlining and aggregation**, particularly in the context of potential revisions to the **stacking order** and the treatment of the **systemic risk buffer**.

2.2 Relying on existing ECAI mappings where possible

- **CRR Article 138(g)** restricts the use of **ECAI credit assessments** incorporating assumptions of **implicit government support**, creating operational complexity in implementation.
- Credit rating agencies have developed **stand-alone ratings reflecting intrinsic creditworthiness without government support**, but these currently lack sufficient historical data for a full quantitative remapping.
- The existing **ECAI mapping methodology operates at rating-scale level**, allowing new products to rely on previously assessed rating scales without requiring a completely new mapping exercise.
- A comprehensive remapping would require significant **methodological adjustments** and additional **default data**, which are not yet available for robust back-testing.
- Given materiality considerations, ratings without government support may be used **temporarily** where their **rating scales are fully compatible** with those previously assessed.

3 Simplification in the IRB Approach

Consolidating and increasing consistency in the IRB rules

IRB requirements are spread across multiple Regulatory Technical Standards (RTS), Guidelines, and Q&As, so simplification focuses on improving readability, coherence and consistency by consolidating texts and clarifying practical topics such as continuous rating scales testing, the CRR3 definition of facility, and representativeness

3.1.1 Aggregate the IRB rules

- IRB requirements are currently spread across multiple **RTS, Guidelines, Q&As** reducing readability and increasing fragmentation; aggregating documents of the same legal nature would improve **coherence and consistency** without altering substantive prudential requirements.
- Consolidation would allow removal of duplicated clarifications developed at different stages of the **IRB repair programme**.
- In parallel, the EBA is examining how **Environmental and Social (E&S) risks** can be integrated more systematically into the risk differentiation and quantification steps, while recognising that adding new risk drivers may increase modelling complexity and requires careful balancing.

3.1.2 Harmonise testing requirements for continuous and discrete models

- The CRR allows the use of **continuous rating scales**, making the EU framework more flexible but also more complex than **Basel standards**, since many requirements are formulated at **grade level**.
- Continuous models raise practical challenges in validation, application and back-testing, as each exposure may effectively represent its own grade.
- The concave shape of the **Risk-Weighted (RW) function** may mechanically lead to lower **Risk-Weighted Assets (RWA)** under continuous scales without improving estimation accuracy.
- Requiring **discretisation of continuous models for testing purposes** could simplify application, enhance comparability and reduce unwarranted RWA variability.

3.1.3 Clarify and harmonise the definition of facility

- **CRR3 introduces a new definition of facility**, allowing a credit exposure to arise from a contract or a set of contracts, which affects the **definition of default**, Probability of Default (PD) counting, and the estimation and application of **LGD and Credit Conversion Factor (CCF)** parameters.
- A consistent facility definition across risk parameters would simplify the framework and reduce potential arbitrage.
- However, enforcing a single aggregation level may constrain modelling practices and could require **model redevelopment and supervisory approval**, increasing operational burden.

3.1.4 Clarify and harmonise representativeness

- The CRR requires model data to be **representative of actual obligors or exposures**, ensuring that models function appropriately for their intended scope.
- Updated guidance distinguishes between **development data and testing data**, allowing more flexibility in model development while maintaining strict requirements for performance assessment.
- Representativeness dimensions have been simplified and situations of **limited historical data**, particularly for CCF modelling, are addressed more explicitly.
- Similar clarifications could be extended to **PD and LGD estimation**, with targeted amendments reflecting parameter-specific characteristics and interaction with **external/pooled data** and **portfolio-level calibration**.

3 Simplification in the IRB Approach

Simplifications across IRB components

Modelling and validation burden may outweigh incremental gains in risk sensitivity, so the paper considers optional simplified approaches for MoC, direct and indirect costs of recovery processes, downturn estimation, LGD for defaulted assets, and CCF (including fixed CCF and more flexibility around the 12-month fixed horizon approach)

3.2.1 Simplified approach for MoC	• CRR requires institutions to apply a MoC to address **model deficiencies** and **estimation uncertainty**; however, the quantification of MoC categories A[2] and B[3] can be complex and may entail a risk of double counting, while the approaches applied to MoC C[4] show significant heterogeneity across institutions. • A simplified, **optional fallback approach** for MoC A and B, together with greater standardisation of MoC C, could reduce modelling burden and improve comparability while preserving an appropriate level of conservatism.
3.2.2 Simplified approach for direct and indirect costs of recovery processes	• Institutions must collect and include **direct and indirect recovery costs** in realised LGD but allocating indirect costs can be operationally burdensome and resource-intensive. • A simplified fallback approach, for example a conservative fixed uplift to realised or estimated **LGD,** could ensure prudential soundness while significantly reducing modelling complexity and supervisory review effort.
3.2.3 Simplified approach for Downturn estimation	• The framework requires LGD and CCF estimates to reflect **DT conditions**, based on detailed RTS and Guidelines and involving comparison with both the **long-run average** and a non-binding **reference value**, making the process technically demanding. • Given the limited incremental gain in risk sensitivity in some cases, simplification could give greater prominence to the **reference value** or to a **fixed downturn add-on** approach, where sufficient historical data is available.
3.2.4 Simplified approach for estimation of LGD for defaulted assets	• For **in-default exposures**, the risk of undercapitalisation is mitigated by minimum provisioning requirements under the **Non-Performing Loans (NPL) backstop**, reducing prudential concerns. • A simplified approach for **in-default LGD** could therefore be considered where materiality and underestimation risk are low, potentially using an **SA-like approach** as a basis for own funds calculation, subject to appropriate safeguards such as back-testing.
3.2.5 Apply the fixed IRB-CCF derogation to a larger scope	• **CCF modelling** often shows limited discriminatory power and involves significant modelling and validation complexity, particularly given the interaction with LGD and the presence of regulatory floors. • Extending the optional use of a **fixed CCF** to a broader scope of exposures could improve proportionality by reducing modelling burden, while maintaining prudential safeguards and consistency requirements between LGD and CCF.
3.2.6 Introduce more flexibility around the CCF 12-month fixed horizon approach	• The **12-month fixed-horizon approach** requires linking default events to obligor and facility characteristics observed exactly 12 months prior to default, creating technical challenges in estimation, calibration and application. • Allowing greater flexibility, for example incorporating elements of a **cohort approach,** could improve consistency between modelling and application phases and reduce complexity, while safeguards such as the IRB-CCF input floor continue to protect prudential soundness.

2. MoC A: Identified deficiencies in data or methodology.
3. MoC B: Additional uncertainty associated with those deficiencies.
4. MoC C: General estimation error.

Annex I
Why Management Solutions?

Management Solutions has in-depth knowledge of financial regulation and extensive experience in supporting OSIs through different types of collaboration, adapting to the needs of each entity and making available the profiles that make up the Firm

REGULATORY EXPERTS

MS has a **Regulatory Observatory** that provides in-depth knowledge of the regulatory requirements of financial and non-financial institutions at the European level

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Extensive experience working with supervisors and **G-SIBs** and **D-SIBs** on the practical implementation of regulation

MS PROFILES

- **Functional** profiles
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- **Technical** profiles

POSSIBLE TYPES OF COLLABORATION

PMO SUPPORT

- **Stakeholder** coordination
- Development and monitoring of the OSI **work plan**
- Preparation of **meetings with the supervisor**

AREAS SUPPORT

- Support in the preparation of **documentation** associated with each area
- Support for necessary **qualitative and quantitative analyses**
- Support in the **Loan Tapes file**

DOCUMENTATION IMPROVEMENT

- **QA** support for **updating and** improving existing **documentation**
- Collecting and challenging **evidence**

SUPPORT FOR REMEDIATION PLANS

- **PMO** support in the **identification**, **execution**, and **monitoring** of remediation plans.

Annex II
Abbreviations

Abbreviation	Meaning
A-IRB	Advanced Internal Ratings-Based Approach
ADC	Acquisition, Development and Construction
CCF	Credit Conversion Factor
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSRD	Corporate Sustainability Reporting Directive
CSDD	Corporate Sustainability Due Diligence Directive
DoD	Definition of Default
DP	Discussion Paper
DT	Downturn
EBA	European Banking Authority
ECAI	External Credit Assessment Institution
ESG	Environmental, Social and Governance
F-IRB	Foundation Internal Ratings-Based Approach

Abbreviation	Meaning
GL	Guidelines
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
IPRE	Income Producing Real Estate
IRB	Internal Ratings-Based
LGD	Loss Given Default
LRA	Long-Run Average
LSI	Less Significant Institutions
LTV	Loan-to-Value
MoC	Margin of Conservatism
NPL	Non-Performing Loans
PD	Probability of Default
RTS	Regulatory Technical Standards
RWA	Risk-Weighted Assets
SA	Standardised Approach
SNCI	Small and Non-Complex Institutions

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