

## Regulatory Blog

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# EBA's consultation on new Guidelines for Proportionate Retail Diversification Methods

**Under the standardised approach for credit risk, to be eligible for the retail exposure class specified in Article 123 CRR, an exposure shall be one of a significant number of exposures with similar characteristics so that the risks at portfolio level are reduced by diversification.**

# Content

<b>Background</b>	3
Requirements for the Diversification Test according to the proposed EBA Guidelines	3
(Proposed) Iterative Process for the Diversification Test	3
Non-Iterative process for the diversification test	5
Next Steps	5
Expected impact of the EBA's new Guidelines on Proportionate Retail Diversification methods	5

While some attempts have been made by the Basel Committee and at national level to further specify this requirement, no clear guidance exists at EU level. Thus, within CRR3, the EBA has been mandated to develop Guidelines to further specify this criterion.

Based on this mandate, the EBA has published a consultation paper on the 12th of November 2024 (EBA/CP/2024/22) to specify proportionate diversification methods. These methods determine when a retail exposure can be recognized as one of a substantial number of similar exposures. Exposures that do not meet these criteria will need to be assigned a risk weight of 100% instead of 75%. This could have significant impacts on banks with less diversified retail portfolios.

## Background

Basel III international standards consider retail portfolios as sufficiently diversified when no aggregate exposure to one counterparty exceeds the threshold of 0.2 % of the overall portfolio (i.e. a portfolio of 500 exposures of equal size would be considered sufficiently diversified). However, Basel III also gives a discretion to national supervisors to determine an alternative approach.

## Requirements for the Diversification Test according to the proposed EBA Guidelines

The scope of the retail exposure class in the standardized approach is defined through criteria for exposures to be considered as 'retail'. One of these criteria is the sufficient diversification mentioned above. The EBA's draft guideline proposes a method to test sufficient diversification that build on the Basel framework outlined above. Exposures which per se cannot be considered as retail exposures according to Art. 123 CRR3 are consequently not in scope of the diversification test. For example, certain non-debt exposures bearing a subordinated, residual claim on the assets or income of the issuer, cannot be retail exposures and hence are not subject to the test.

To perform the diversification test as per the EBA draft guideline:

- Defaulted retail exposures must be excluded,
- The test must be performed at each reference date and the execution must occur at the level of application of the prudential requirement (solo and/or consolidated level),
- Group of connected clients (GCC) level must be considered,
- Retail exposures secured by immovable property must be considered when performing the retail diversification test.

## (Proposed) Iterative Process for the Diversification Test

To apply the preferential risk weight of 75 %, a diversified portfolio must be determined via the following steps:

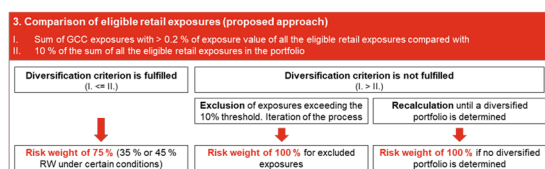
**Step 1:** Institutions must identify all exposures exceeding the 0,2 % threshold at the level of the GCC and

sum up their exposure value.

**Step 2:** the sum of exposures exceeding the 0.2 % threshold must be compared with 10 % of the sum of exposures in the eligible retail portfolio (i.e. those below the 0.2 % threshold). If the sum of identified exposures is less or equal to 10 % of the eligible retail positions, the portfolio can be considered as sufficiently diversified and the preferential risk weight can be assigned to all retail positions.

**Step 3:** If the second step did not yield a sufficiently diversified portfolio, some or all exposures exceeding the 0.2 % and 10 % thresholds must be excluded from the retail portfolio. Step 1 and step 2 should be recalculated (and additional positions excluded) until a sufficiently diversified portfolio has been determined.

Only positions within the sufficiently diversified portfolio can be assigned the preferential risk weight of 75 %. If no sufficiently diversified portfolio is determined, the excluded positions are assigned a risk weight of 100 % in case of natural persons (Art. 123 (4) CRR3) or assigned a risk weight based on the applicable rules for exposures to corporate SMEs.



An example derived from the EBA clarifies the process. In the example, exposures that generally fulfill the requirements to be treated as retail exposures (apart from the diversification criterion) are grouped as subsets based on their exposure value:

Subset	A	B	C	D	Total
No. exposures	360	500	10	50	920
Exposures value (individual)	10 €	20 €	40 €	200 €	/
Total exposures	3 600 €	10 000 €	400 €	10 000 €	24 000 €

As per step 1 above, the 0.2 % granularity threshold at the overall portfolio level must be calculated:

$$0.2 \% * 24,000 \text{ €} = 48 \text{ €}$$

The calculation shows that exposures exceeding 48 € exceed the 0.2 % threshold. This applies to the exposures in subset D (exposure value = 200 € per exposure).

As per step 2 above, the 10 % threshold is calculated at the overall portfolio level:

$$10 \% * 24,000 \text{ €} = 2,400 \text{ €}$$

The sum of all exposures in subset D is then compared to the 10 % threshold. In sum, the subset D exposures (10,000 €) exceed the 10 % threshold of 2,400 €.

In step 3, exposures of subset D are excluded from the diversification test until the 10 % threshold is complied with:

- subset D exposures of an aggregate exposure value of 7,600 € must be excluded (38 exposures of 200 € each).
- The remaining 12 subset D exposures in sum remain below the 10% threshold and may thus be treated as part of the sufficiently diversified portfolio.

The portfolio is sufficiently diversified. A, B and C receive a risk weight of 75 %. 12 Exposures (12 \* 200 € = 2 400 €) of D receive a preferential risk weight as well. The excluded exposures of subset D, in the amount of 7,600 €, receive a risk weight of 100% (as per Art. 123 (4) CRR3) or according to the rules for exposures to corporate SMEs.

Subset	A	B	C	D	D excluded
Total exposures	3 600 €	10 000 €	400 €	2 400 €	7 600 €
Risk weight	75 %				100 %

### Non-Iterative process for the diversification test

As an alternative, the EBA presents a non-iterative approach for the diversification test. In this method, the comparison of eligible retail exposures needs to be conducted only once. Additionally, the threshold for exposures exceeding 0.2 % is set at 5 %, rather than 10 % as in the proposed iterative process. Hence, the calculation procedure is easier but at the expense of lower eligibility for the preferential retail treatment.

### Next Steps

The EBA consultation runs until the 12th of February 2025. Institutions are encouraged to evaluate whether they want to respond to this consultation to provide their input on the proposed guidelines.

### Expected impact of the EBA's new Guidelines on Proportionate Retail Diversification methods

While currently only a consultation paper to result in a guideline rather than a Regulatory Technical Standard (RTS), the potential impact must not be underestimated from both an effort and RWA perspective:

On the one hand side, non-eligible exposures receive a risk weight of up to 100%, i.e. a 33 % increase as compared to the 75 % risk weight currently applicable. Also, the requirement to perform the test at each reporting date means that possible exclusions from the regulatory retail portfolio can be quite volatile and

will only be known at or close to the reporting reference dates.

On the other hand, performing the test and its iterations presents an additional driver of effort. Given the large numbers of retail exposures usually encountered in banks, adequate computational power is required to perform the test.

We provide support in navigating the EBA's new Guidelines on Proportionate Retail Diversification methods under CRR3. We help you to understand and implement the diversification criterion to ensure the retail exposures qualify for preferential risk weights. Our team conducts detailed portfolio analyses to assess current diversification levels and identify necessary adjustments. With that we support you to achieve regulatory compliance and assigning risk weights correctly.

Get ongoing updates on the topic via regulatory horizon scanning in our research application, PwC Plus. [Read more about the opportunities and offerings here.](#)

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## Keywords

[Capital Requirements Regulation \(CRR III\)](#), [Credit](#), [Credit Risk](#), [Retail Banking](#), [Risk-weighted asset \(RWA\)](#)

## Contact



**Martin Neisen**

Frankfurt am Main

[martin.neisen@pwc.com](mailto:martin.neisen@pwc.com)



**Christoph Himmelmann**

Frankfurt am Main

[christoph.himmelmann@pwc.com](mailto:christoph.himmelmann@pwc.com)