Just in Time

EBA Report on the 2025 Credit Risk Benchmarking Exercise

July 2026

iason ESSENTIAL SERVICES FOR FINANCIAL INSTITUTIONS

Executive Summary

- The EBA published the **2025 Credit Risk Benchmarking Exercise** to assess the variability of own funds requirements generated by Internal Ratings-Based (**IRB**) models across European Union institutions. The exercise is mandated by Article 78 of the Capital Requirements Directive (CRD) and is based on data as of 31 December 2024, collected during 2025. The overarching objective is to monitor whether differences in risk-weighted assets (RWAs) and capital requirements reflect genuine differences in risk profiles or arise from divergent modelling practices.

- A central theme of the report is the **impact** of the **EBA's IRB Roadmap**, launched in 2016 to reduce unwarranted variability in capital requirements through harmonized supervisory expectations and modelling standards. The report confirms **significant progress** in **implementation**, with a growing proportion of material IRB models achieving compliance with the EBA Guidelines on Probability of Default (PD) and Loss Given Default (LGD). However, a meaningful number of institutions are still implementing model changes or awaiting supervisory approval, indicating that remediation efforts continue across the EU banking sector.

- The report finds that variability in PD estimates has generally declined over the last decade, suggesting **increasing convergence of modelling practices**. In contrast, LGD variability remains relatively stable, indicating that factors such as collateral structures, recovery processes, legal frameworks, and bank-specific credit policies continue to influence outcomes. The EBA investigates the relationship between PDs and observed default rates, as well as between LGDs and loan-to-value (LTV) ratios, to understand which portion of observed variability can be justified by differences in underlying risk.

At a Glance

Keywords: Credit Risk, IRB, Benchmarking

01

Introduction

Introduction

Just in Time

The **IRB framework** allows banks to use internally estimated risk parameters to calculate regulatory capital requirements. Under the Foundation IRB (**FIRB**) approach, banks estimate some risk parameters, while under the Advanced IRB (**AIRB**) approach they estimate most or all key parameters. Since these estimates directly influence **RWAs** and **regulatory capital**, ensuring their **comparability** across institutions is **essential** for maintaining a level playing field and preserving confidence in prudential metrics.

Since the introduction of the IRB framework within EU regulation, supervisors have expressed concerns regarding **excessive variability in RWAs among institutions** with apparently similar portfolios. Such variability may undermine confidence in capital ratios if it cannot be explained by genuine differences in risk profiles. To address this issue, the EBA launched a **comprehensive regulatory review of the IRB framework** through its **IRB Roadmap**, complemented by the ECB's Targeted Review of Internal Models (**TRIM**).

The **2025 benchmarking exercise** forms part of this ongoing supervisory effort. By comparing risk parameters across institutions and over time, the EBA seeks to **identify trends**, evaluate the **effectiveness** of **regulatory reforms**, and **support supervisory authorities** in assessing whether institutions' capital requirements adequately reflect underlying risk.

The report therefore serves **multiple objectives**:

- Monitoring the **consistency** of **IRB model** outputs.
- Assessing **implementation** of the **IRB Roadmap**.
- Evaluating whether **reductions** in **variability** are occurring.
- Identifying remaining **sources** of **unjustified divergence**.
- Supporting **supervisory convergence** across EU Member States.

02

General Statistics on the Materiality of the IRB Approach

General Statistics on the Materiality of the IRB Approach 1/5

Just in Time

IRB Coverage Ratio

The EBA analyzed data from approximately **2,749 institutions**, representing almost the **entire EU banking sector**.
Around **1,926 institutions** formed a **stable sample** covering 93% of total banking assets. The analysis considered both **institutions using IRB approaches** and those applying the **Standardised Approach** (SA).

A **major finding** is the **gradual decline** in the **proportion of exposures covered by the IRB approach**.
By June 2025, less than 50% of total performing exposure at default (EAD) was covered by IRB models. Nevertheless, coverage remains substantially higher for large institutions and corporate portfolios.
Large institutions report IRB coverage of approximately 58%, compared with only 13% among smaller banks.

The report also highlights the **impact of Basel III finalization** (CRR3 implementation). Beginning in 2025, **exposures under the FIRB approach increased materially**, reflecting regulatory changes that limit the use of AIRB for certain portfolios and encourage migration toward FIRB methodologies.

Implications

The declining share of IRB exposures suggests a **gradual simplification of capital frameworks in some segments of the banking sector**. However, IRB models remain highly material for large cross-border institutions and corporate lending portfolios where internal risk differentiation is considered particularly valuable.

General Statistics on the Materiality of the IRB Approach 2/5

Just in Time

Risk Parameters by Asset Class

The EBA examined **trends** in **average EAD-weighted PDs**, **LGDs** and **Credit Conversion Factors** (CCFs) across several asset classes during the last four benchmarking exercises.

Key observations include:

Probability of Default

Average **PDs increased slightly for**:

- Corporate exposures
- Other retail portfolios
- Credit card exposures

Observed default rates have continued increasing since 2022, particularly within **retail portfolios**. However, PD estimates have not always increased at the same pace. This may indicate that some models remain slow to incorporate changing economic conditions due to the long-term nature of PD calibration.

The EBA warns supervisors to ensure compliance with Article 46(3) of the RTS on IRB assessment methodology, requiring long-run average default rates used in calibration to adequately capture expected variability in default behaviour.

Loss Given Default

LGDs remained **broadly stable** across most portfolios during the last four years. Slight increases were observed in selected asset classes, but no major structural changes emerged. This relative stability contrasts with the increase in default rates observed in certain portfolios.

General Statistics on the Materiality of the IRB Approach 3/5

Just in Time

Risk Parameters by Asset Class

Credit Conversion Factors

CCFs remained **generally stable** but displayed differences across exposure classes reflecting differing utilization patterns and portfolio characteristics.

Interpretation

The divergence between increasing default rates and more stable PD estimates highlights the tension between:

- Through-the-cycle prudential modelling
- Point-in-time economic developments

The findings indicate that model conservatism remains substantial but may vary across institutions.

General Statistics on the Materiality of the IRB Approach 4/5

Just in Time

Comparison Between IRB and IFRS 9 Risk Parameters

A new feature of the 2025 exercise is the **inclusion of IFRS 9 accounting risk parameters** following amendments introduced by CRD VI. The EBA compared prudential estimates (IRB) with accounting estimates used for expected credit loss calculations.

PD Comparison

Across most asset classes, **accounting 12-month PDs are lower than IRB PDs**. Several factors explain this:

- Prudential margins of conservatism
- Regulatory floors
- Through-the-cycle calibration requirements

Nevertheless, approximately one quarter of institutions report accounting PDs higher than IRB PDs. This likely reflects the **greater sensitivity** of **IFRS 9 models** to **current economic conditions**.

LGD Comparison

Accounting **LGDs** are **generally lower** than **prudential LGDs**. The difference is particularly pronounced for:

- Mortgage portfolios
- FIRB exposures

Key drivers include:

- Prudential margins of conservatism
- Regulatory floors
- Through-the-cycle calibration requirements

The report specifically highlights the 10% LGD floor applied to certain mortgage exposures, noting that many institutions would otherwise report lower LGDs. Under **CRR3** this **floor** will be reduced to **5%**, potentially affecting future comparisons.

General Statistics on the Materiality of the IRB Approach 5/5

Just in Time

Comparison Between IRB and IFRS 9 Risk Parameters

Variability Analysis

Accounting PDs and LGDs exhibit greater variability than prudential measures. This is unsurprising because **IFRS 9 estimates**:

- React more strongly to macroeconomic developments.
- Include lifetime expected credit loss considerations
- Are influenced by differing Significant Increase in Credit Risk (SICR) methodologies
- Lack prudential floors

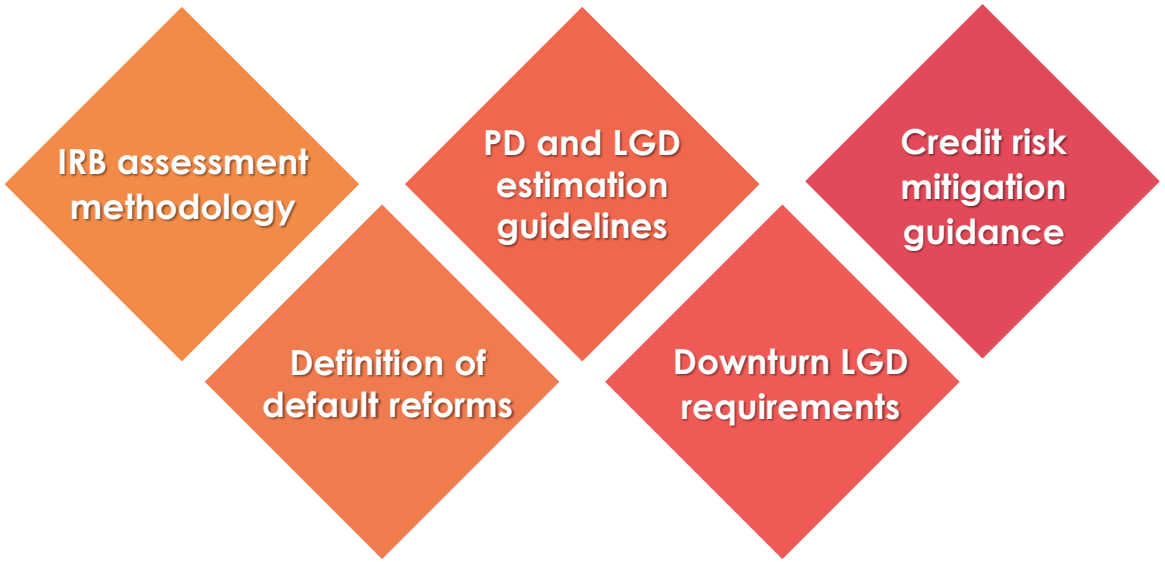
03

Impact of the IRB Roadmap

Impact of the IRB Roadmap 1/2

The **EBA IRB Roadmap**, launched in 2016, is one of **the most ambitious regulatory programmes ever implemented for internal models** in Europe.

It encompasses:



The programme aims to:

1. Increase consistency across institutions
2. Reduce unwarranted variability
3. Strengthen supervisory convergence
4. Improve risk sensitivity

Impact of the IRB Roadmap 1/2

Just in Time

Status of Implementation

The EBA collected supervisory assessments covering 87 institutions. Supervisors reported **implementation status as of September 2025**. The results show:

- A **significant proportion of material models are now broadly compliant.**
- Many institutions co**ntinue implementing substantial model changes**.
- Some validated models are **awaiting** final **supervisory approval**.

Implementation progress differs across:

- Asset classes.
- Jurisdictions.
- Portfolio complexity.
- Data availability.
- Supervisory priorities.

Importantly, supervisors expect certain **remediation programmes** to continue into **2026** despite the original implementation target of January 2022.

Supervisory Use of Benchmarking Results

Nearly half of supervisory responses indicated that **benchmarking results did not identify new underestimations** because existing supervisory measures were already addressing these issues.

Nevertheless, **benchmarking** remains an **important complementary supervisory tool**.

Competent authorities assessed approximately:

- 50% of estimates as adequate.
- 10–13% as exhibiting unjustified negative deviations.
- Less than 5% as exhibiting unjustified positive deviations.

These findings indicate that while **substantial progress has been achieved,** pockets of unwarranted variability remain.

04

Variability Over Time

Variability Over Time

Just in Time

The EBA examined **risk parameter variability** from 2015 to 2025 using a stable sample of institutions. The analysis **focused on percentile ranges** rather than standard deviations to reduce the influence of outliers.

PD Variability

A clear **reduction in PD variability** is observed for:

- Corporates
- Institutions
- Retail mortgages
- Several SME portfolios

For corporate portfolios, the spread between the most extreme observations narrowed significantly over the decade. This indicates convergence among institutions, particularly among banks previously reporting unusually high or low estimates.

LGD Variability

LGD variability shows **no comparable reduction**. For most portfolios:

- Variability remains broadly stable
- Reductions are limited
- Differences between institutions remain material

The EBA attributes this persistence partly to:

- Differences in collateral structures
- National insolvency frameworks
- Divergent recovery processes
- Bank-specific lending policies

Interpretation

The **declining PD variability** provides evidence that the **IRB Roadmap** and **supervisory interventions** have been **effective**. However, **LGD** remains inherently more **sensitive** to **structural** and **jurisdictional factors** that cannot be fully harmonized through modelling standards alone.

05

Drivers of Variability

Drivers of Variability

Just in Time

PDs versus Default Rates

The EBA tested whether differences in **PD estimates can be explained by differences in underlying risk**. To do so, institutions were grouped according to their ten-year average default rates. Since IRB PDs are intended to represent long-run averages, a ten-year default rate provides a reasonable benchmark.

The analysis shows:

- **PDs are generally higher than long-run observed default rates.**
- **Higher-risk groups tend to exhibit higher PDs.**
- **The relationship is directionally correct but weak**.

A **significant degree of overlap** remains between institutions with different default histories. In some asset classes, institutions with similar default experiences report markedly different PDs.

The EBA therefore concludes that **underlying risk explains only part of observed PD variability**.

Other factors likely include:

- Different calibration horizons.
- Different margins of conservatism.
- Alternative calibration methodologies.
- Divergent modelling assumptions.

LGD and Collateralisation

The report next examines whether **LGD variability can be explained by differences in collateralisation levels**, measured through Loan-to-Value (LTV) ratios.
The expected relationship is straightforward:

Lower LTV → stronger collateral protection → lower LGD.
Higher LTV → weaker collateral protection → higher LGD.

However, **empirical results reveal a surprisingly weak relationship**.

For **corporate portfolios**:

- LTV explains only about 15% of LGD variation.
- Institutions with similar LTV ratios often report widely different LGDs.

For **mortgage portfolios**:

- LTV distributions are more homogeneous.
- The statistical relationship with LGD is even weaker.

These findings imply that **collateralisation alone cannot explain LGD variability**.

Other potential drivers include:

- Recovery processes.
- Legal frameworks.
- Collection effectiveness.
- Collateral enforceability.
- Portfolio composition.
- National insolvency regimes.

06

Conclusions & Take-aways

Conclusions & Take-aways

Just in Time

1. **IRB exposure coverage continues to decline**, although it remains highly significant among large European banks.
2. **PD variability has decreased substantially** since 2015, indicating increased convergence of modelling practices.
3. **LGD variability remains persistent**, reflecting structural differences beyond modelling methodologies.
4. **IRB Roadmap implementation has progressed considerably**, but many institutions remain engaged in remediation programmes extending into 2026.
5. **Accounting (IFRS 9) risk parameters are generally lower and more volatile than prudential IRB parameters.**
6. **Observed default rates explain only part of PD variability**, suggesting that modelling choices and conservatism remain important determinants.
7. **Collateralisation explains only a limited portion of LGD variability**, highlighting the importance of recovery practices and legal environments.

Regulatory Implications

I. Continued supervisory focus on model convergence remains necessary.

II. Remaining IRB Roadmap remediation actions should further reduce unwarranted variability.

III. Greater understanding of LGD drivers may become a future supervisory priority

IV. Comparisons between IFRS 9 and IRB estimates are likely to gain importance following CRD VI implementation.

ESSENTIAL SERVICES FOR FINANCIAL INSTITUTIONS

iason is an international consulting firm that has been supporting both financial institutions and regulators in topics related to Risk Management, Finance and ICT since 2008

Strategy

Strategic advisory on the **design** of **advanced frameworks** and **solutions** to fulfil both **business** and **regulatory needs** in Risk Management and IT departments

Methodology & Governance

Implementation of the designed **solutions** in bank departments **Methodological support** to both **systemically important financial institutions** and **supervisory entities**

Solution

Advanced **software solutions** for **modelling, forecasting, calculating** metrics and **integrating** risks, all on cloud and distributed in Software-as-a-Service (**SaaS**)

KEEP IN TOUCH

iason

Company Profile

iason is an international firm that consults Financial Institutions on Risk Management. **iason** integrates deep industry knowledge with specialised expertise in Market, Liquidity, Funding, Credit and Counterparty Risk, in Organisational Set-Up and in Strategic Planning.

Dario Esposito

Lorena Corna

www.iasonltd.com