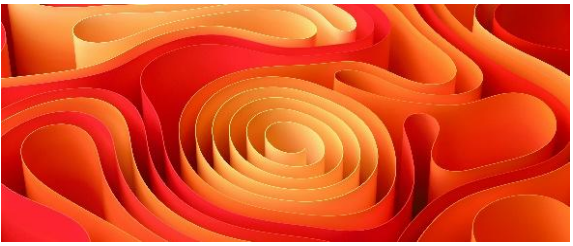
Pills

Regulatory/Supervisory Pills | N.167 November 2026

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TOPICS:

Credit Risk

SOURCE:

SUERF - The European Money & Finance Forum

SUERF: Banks' Internal Models and RWA Variability - Strategic Modelling and Portfolio Reallocation?

- The paper examines **how the adoption of internal ratings-based (IRB) models affects banks' risk-weighted assets (RWAs), capital management and credit allocation** within the European banking system. It investigates whether reductions in RWA density reflect strategic manipulation of risk estimates or genuine changes in banks' portfolio composition.
- **Using supervisory data covering 124 significant euro-area banks** between 2015 and 2023, representing approximately 84% of Single Supervisory Mechanism (SSM) banking assets, the authors assess the impact of IRB adoption under harmonised European supervision.
- The findings demonstrate that **IRB adoption leads to a persistent reduction in RWA density**, reflecting lower measured capital intensity. However, weakly capitalised and financially fragile banks do not exhibit significantly greater reductions than stronger institutions. This contrasts with earlier research suggesting that banks facing capital constraints strategically exploit internal models to minimise regulatory requirements.
- The results are consistent with the possibility that harmonised **SSM supervision and the ECB's Targeted Review of Internal Models (TRIM) have constrained opportunistic modelling practices**, although their causal effectiveness cannot be established. Importantly, IRB adoption influences banks' lending strategies, encouraging increased exposures to large non-financial corporations while reducing sovereign and central-bank exposures. Effects on SME lending remain statistically insignificant.
- Overall, the study highlights that **internal models affect both regulatory capital calculations and credit allocation**. It emphasises the importance of maintaining robust supervisory oversight, ensuring model comparability and assessing capital regulation not only through regulatory ratios but also through its broader implications for banks' balance-sheet composition and financial stability.