Pills

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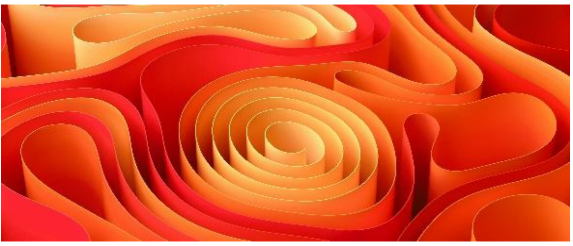

TOPICS:

Stress Test

SOURCE:

European Central Bank

ECB Publishes Results of 2026 Geopolitical Risk Reverse Stress Test

- The ECB has published the results of its **2026 thematic reverse stress test on geopolitical risks,** covering **110 euro area banks** under its direct supervision. The objective was not primarily to measure capital impacts but to assess banks' ability to identify institution-specific vulnerabilities and understand how **geopolitical events** could affect their business models.
- Unlike traditional stress tests, which apply a common adverse scenario to all institutions, this exercise required each bank to design a **plausible geopolitical scenario** severe enough to reduce its **Common Equity Tier 1 (CET1) ratio by 300 basis points**.
- Overall, **banks demonstrated a strong ability to develop economically meaningful and tailored scenarios**. However, the ECB identified **several areas requiring improvement**, including more granular and sensitive risk assessments, better alignment between scenario narratives and projected solvency and liquidity impacts, more realistic assumptions regarding mitigating actions during systemic crises and stronger integration of solvency–liquidity interactions within stress-testing frameworks.
- The scenarios covered a broad range of **geopolitical events**, including military conflicts, trade disputes, energy and supply chain disruptions, sanctions, macroeconomic shocks, and cyber incidents. Banks assessed these risks through **three transmission channels: financial markets, the real economy and safety and security**, with the real economy most frequently identified as the primary channel. **Credit risk**, loan impairments, reduced profitability, and weaker trading income emerged as the principal drivers of capital erosion. Although most banks maintained **liquidity** above regulatory minimums, some underestimated the interaction between capital stress and liquidity pressures. The ECB also emphasized the importance of incorporating **operational resilience** and **cyber risks** into stress-testing exercises.
- The exercise required banks to specify management actions such as raising capital, reducing costs, selling business lines or adjusting payout ratios. While these actions were generally credible, the ECB considered some assumptions overly optimistic under adverse market conditions. **The findings** will inform the ECB's ongoing supervisory dialogue and qualitative assessments within the Supervisory Review and Evaluation Process (SREP), but **will not directly result in changes to Pillar 2 Guidance or leverage ratio Pillar 2 Guidance**.