White paper

Supervisory stress testing expectations and impacts on European banks

Unlock nine principles for an integrated framework across all risk types

Foreword: When the scenario becomes the reality

This paper was completed in mid-March 2026, and uses the Basel Committee's nine Stress Testing Principles[1] as its organising framework. Its central argument is that geopolitical scenario design capability has become a supervisory necessity with direct balance sheet consequences, and that the institutions best positioned are those that can model compound geopolitical effects across credit, market, liquidity and operational risk simultaneously.

As this paper goes to review, that argument is being tested in real time. The U.S.-Israeli military campaign against Iran has effectively closed the Strait of Hormuz. As a consequence, it seemed appropriate to apply two geo-political scenarios to this paper for more real-world relevancy.

Oil prices have already surged past $100 a barrel. Gulf state energy infrastructure is under direct attack. The IEA has authorised the largest strategic reserve release in its history. European energy security, trade-exposed with corporate credit quality, and funding market stability are all under stress – precisely the transmission channels that the 2025 EU-wide adverse scenario was designed to model.[14]

Simultaneously, 110 ECB-supervised banks are preparing submissions for the 2026 geopolitical reverse stress test, due by mid-year[2]. Each must identify the institution-specific geopolitical scenario that would cause at least 300 basis points of Common Equity Tier 1 (CET1) ratio depletion, trace the transmission channels, and quantify the capital path. This work is being done under exactly the conditions the exercise was designed to test.

The paper's analysis of what the supervisory framework demands has not changed. What has recently changed is the distance between the hypothetical and the reality.

The question this paper poses: Can your institution model compound geopolitical stresses across risk types within a single integrated framework? This is no longer a forward-looking supervisory expectation, and smart institutions need to embed this approach.

[1]See BCBS (2018) "Stress testing principles", Bank for International Settlements (BIS), https://www.bis.org/bcbs/publ/d450.htm
[2]See European Central Bank (ECB) press release 12th December 2025, https://www.bankingsupervision.europa.eu/press/pr/date/2025/html/ssm.pr251212~69f656d4bf.en.html

Executive summary

The 2025 EU-wide stress test delivered a verdict that superficially reassured but also structurally demanded more.

Sixty-four banks absorbed projected losses of €547 billion under a severe geopolitical scenario and still finished with aggregate CET1 ratios comfortably above minimum requirements – capital depletion of 370 basis points, materially lower than the 479 basis points recorded in 2023.[1]

But the headline resilience numbers are not the entire story. The story is what the EBA and ECB did differently, and what those differences signal about the next three years.

- The ECB conducted on-site quality assurance visits to banks during the live exercise for the first time.[2]
- The results fed directly into SREP scores: quantitative capital depletion determined Pillar 2 Guidance, while qualitative findings on data quality and governance shaped Pillar 2 Requirements.
- In October 2025, the EBA published the most comprehensive revision of its SREP guidelines since 2014, incorporating DORA, ESG risk, and IRRBB provisions, applying from January 2027.[4]
- In December 2025, the ECB announced a geopolitical risk reverse stress test covering all 110 directly supervised banks.[3]

Running through all this change is CRR3. The 2025 stress test required full CRR3 restatement for the first time, revealing a system-wide CET1 reduction of 129 basis points fully loaded; 182 basis points for European G-SIBs.[5]

The new developments are the on-the-ground translation and operationalisation of the Basel Committee's Stress Testing Principles, nine principles published back in October 2018 that establish the international standards framework for stress testing across all member jurisdictions.[6]

This paper uses those nine principles as the organising framework, illustrating how each aligns with current European supervisory expectations,[3] where the gaps are widest, and what institutions at every tier need to consider in closing them.

We took the opportunity to outline two relevant stress scenarios as examples within this paper. These scenarios also broadly align with our FIS® survey issued in H2- 2025 on systemic risk, reflecting the key risks identified by fellow industry risk practitioners.

[3]European supervisory expectations as set out in EBA/CP/2025/21 (Supervisory Review and Evaluation Process Guidelines, October 2025), Title 11 (Supervisory Stress Testing), and ECB Banking Supervision, Supervisory Priorities 2026–2028, November 2025.

1. Clearly articulated objectives

Principle 1: Stress testing frameworks should have clearly articulated and formally adopted objectives.

This principle requires board-approved objectives that align with the institution's risk appetite and risk management framework. As a reminder, stress tests should inform capital and liquidity planning and serve as an integral element of risk management, not to be treated as a periodic regulatory reporting exercise.

The ECB's 2026–2028 supervisory priorities, geopolitical resilience and operational resilience,[7] define what "aligned to risk appetite" means in practice.

The EBA's objective is not only to evaluate whether a bank can absorb a prescribed scenario, but also whether a bank can identify, design and quantify the institution-specific geopolitical scenario that would trigger activation of a recovery plan.

This means stress testing linked to recovery planning, capital thresholds and the content of related information flow for board decision-making.

This goes beyond measuring in simple terminology what breaks the bank, to specifying the impact on your own business model. It incorporates the judgements and actions an institution needs to take to mitigate its recovery capacity, before reaching the point of non-viability (PONV).

We have designed two high-level potential scenarios to provide a basis when considering recent and ongoing events.

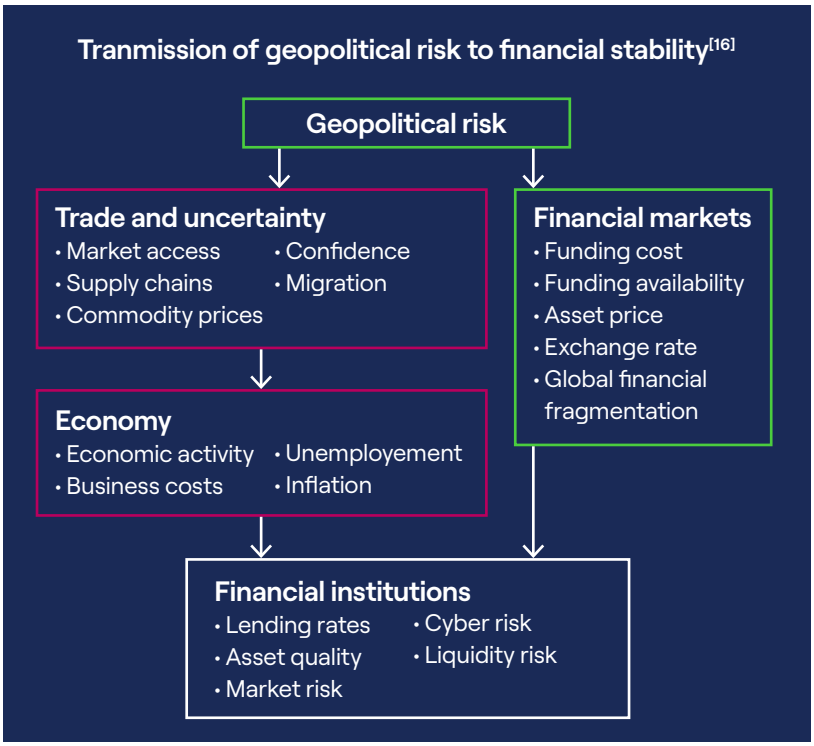
Scenario framework: Recovery plan triggers

Scenario A – State actor cyber-attack: Liquidity
Fast-moving and idiosyncratic. A coordinated state-sponsored attack[4] on critical financial infrastructure, compounded by the rising sophistication of GenAI and deep fake technology (DORA context).

Transmission: Operational disruption → liquidity stress → confidence shock → funding market dislocation.

Scenario B – Iran/Middle East conflict: Solvency
Slow-moving and systemic. Sustained conflict causing energy and food inflation, trade route disruption, and mobility/tourism contraction (macro-economic downturn).[5]

Transmission: Energy price spike → corporate credit quality deterioration → NII compression → capital depletion.



Both scenarios represent plausible recovery plan triggers. Institutions need to evaluate the geopolitical risk transmission and the impact on their own business model. This diagram summarizes the transmission paths.[6]

Scenario A activates liquidity thresholds through operational disruption.

Scenario B depletes solvency through compound macro-financial transmission.

An institution whose stress testing objectives were last formally reviewed before 2025 is probably not fully aligned with the revised framework.

For less significant institutions (LSIs), the same logic applies through national competent authorities (NCAs) bound by EBA guidelines, where proportionality shapes the intensity of the supervisory expectation, not its direction.

[4]https://www.cybersecurity-insiders.com/top-5-banking-data-breaches-of-2025/ and https://www.unsw.edu.au/newsroom/news/2026/03/commonwealth-bank-one-billion-dollars-suspected-loan-fraud-change-AI. [5]Economic disruption - 1970's (https://www.nytimes.com/2026/03/13/world/middleeast/oil-supply-shock-1973-embargo.html). [6]https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2024/nov-2024/impacts-of-geopolitical-risk-on-financial-stability

2. Effective governance that enables challenge

Principle 2: Stress testing frameworks should include an effective governance structure.

"Digital Operational Resilience Testing (DORT) and Threat-Led Penetration Testing (TLPT) are mandatory under the EU's DORA to strengthen financial sector cybersecurity. DORA requires regular testing of all ICT systems, while TLPT serves as an advanced, 3-year cycle test, simulating real-world attacks on critical systems for significant financial entities."

European Banking Authority, DORA Direct Supervision Guidance [13] 7

The 2025 SREP qualitative measures targeted internal governance and risk management as a primary area for follow-up, alongside credit risk and ICT resilience.[8] Quality assurance visits during the live 2025 exercise assessed whether stress test submissions reflected genuine analytical capability or merely formal compliance.[2]

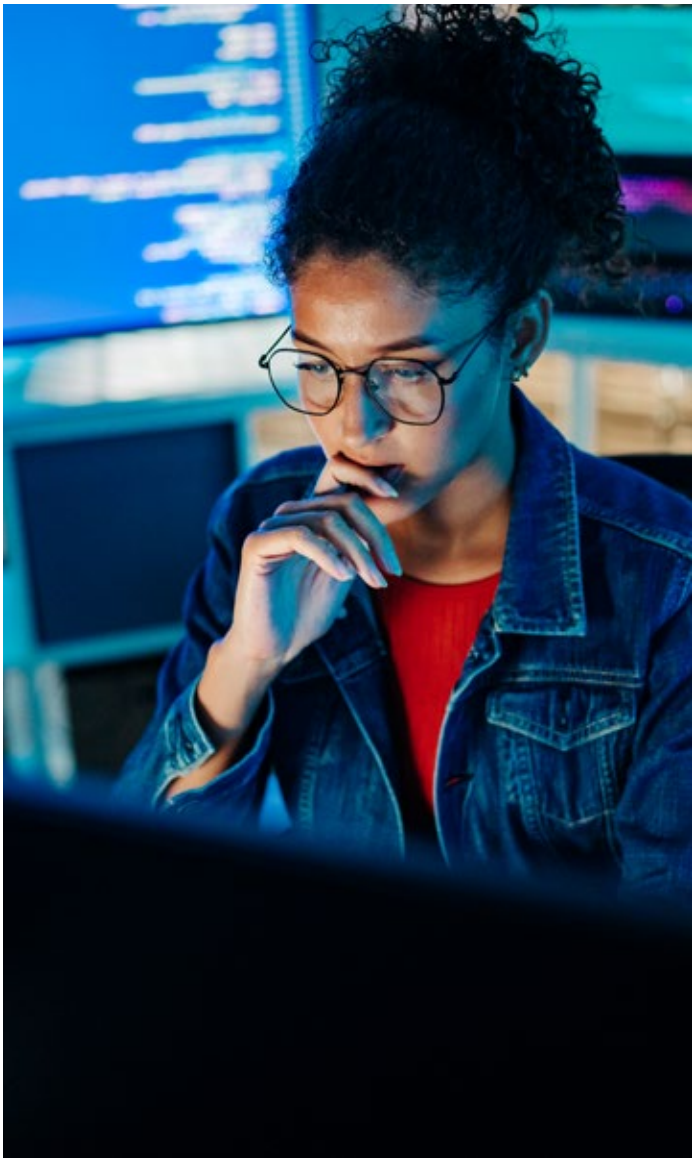
To discharge the principle requires clear roles and responsibilities within the second and third lines of defense, along with board-level understanding of material assumptions, and evidence of an active challenge of scenario selection and modeling assumptions. The underlying theme is internal capability to engage substantively with the stress testing framework, and input from all lines – not merely receiving and reviewing outputs. For example:

Under Scenario A (state actor cyber-attack), effective governance requires that the board can assess – not just receive – the institution's DORA compliance posture, TLPT findings and the operational resilience implications for critical business services. Recovery plan firedrills that test liquidity contingency activation under ICT disruption scenarios are a concrete governance mechanism.

Similarly aligned and under the guise of ICAAP, the challenge and next steps requirement is illustrative, as the concluding section of the ICAAP document should:

- Summarize the extent of challenge and testing of the ICAAP, outline board and senior management sign-off procedures, identify the nature of any third-party review, and identify plans to enhance the ICAAP going forward.[15]

The revised 2027 SREP guidelines place even greater weight on board accountability, both for the ICAAP and risk appetite framework.[4] The question supervisors ask is whether board members genuinely understand the key assumptions, have challenged them, and have used the results to inform strategic decisions about capital allocation and risk appetite.



[7]https://www.eba.europa.eu/activities/direct-supervision-and-oversight/digital-operational-resilience-act for additional information

3. Stress testing as a strategic tool

Principle 3: Stress testing should be used as a risk management tool and to inform business decisions.

For a Reverse Stress Test, business decisions can include Recovery Planning options. Depending on the scenario, e.g. fast-moving/idiosyncratic vs. slow-moving/systemic, options can range from raising capital and liquidity management actions to balance sheet reductions and cost-saving initiatives such as FTE reduction or projection deferral.

For each option, the bank must adequately assess the financial impact of execution across CET1 ratio, LCR, NSFR, Leverage Ratio and Franchise Value, controlling for operational and strategic impacts, while accounting for any necessary preparatory measures to support the strategy.

European supervisors are most aggressively operationalizing and integrating these options into senior management's ongoing planning process.

It boils down to a simple question: when did your board last change a strategic decision regarding business model, risk appetite limit, business line direction or recovery trigger calibration, because of the results of a stress test? If the answer is never, the stress test is not evidencing active risk management.

BCBS d450 states that stress test results should inform calibration of risk appetite and limits, capital and liquidity planning, recovery planning, portfolio management and corporate decision-making. Stress tests should be undertaken regularly according to a defined schedule, not only for periodic supervisory exercises.

The 2025 SREP results confirmed that Pillar 2 Guidance is now being calibrated using internal stress test findings.[8] Pillar 2 Requirements reflect qualitative findings on data quality and governance.[9]

This means the quality of your internal stress testing now directly affects the financial variables such as how much capital and unencumbered fungible assets you are required to hold.

The 2026 reverse stress test is Principle 3 in its most demanding form, by designating homework. This includes identifying the geopolitical scenario that would cause at least 300 basis points of CET1 depletion, describing your mitigation actions, and demonstrating this analysis is integrated into the ICAAP, not siloed in a standalone project team.[10] This approach tests the usability of your existing tooling and its application.

Under Scenario B (Iran/Middle East conflict), the tool requirement becomes more acute. Energy price inflation transmits into corporate credit quality deterioration across trade-exposed sectors; NII compression occurs simultaneously with rising credit losses; capital depletion is gradual but compound.

"The exercise will assess the extent to which banks' stress-testing capabilities take geopolitical risks into account. In this regard, the exercise will aim to foster banks' own risk-management capabilities, particularly in reverse stress testing, and their ability to design relevant and prudent capital and recovery plans."

ECB press release, December 12 2025[3]

4. Material risks and sufficiently severe scenarios

Principle 4: Stress testing frameworks should capture material and relevant risks and apply stresses that are sufficiently severe.

This principle requires a comprehensive risk identification process, internally consistent scenarios with a narrative articulating how they capture material risks, and using reverse stress testing to identify core vulnerabilities. Scenarios should not be limited to those used in prescribed supervisory exercises.

The 2025 EU-wide adverse scenario was anchored in geopolitical risk for the first time. This included trade fragmentation, tariff escalation and persistent supply shocks producing a 6.3% GDP decline below baseline, sharp Commercial Real Estate (CRE) corrections, and simultaneous NII compression and credit losses.[1] This was a deliberate signal to supervisors to consider the dominant tail risks to be external, fast-moving and compound – not conventional domestic credit cycles that most banks are more familiar with.

Compound scenario design involves activating credit, market, liquidity, IRRBB and operational risk channels simultaneously under a coherent geopolitical narrative. It's the methodological "gold standard" the ECB is pushing. Institutions that stress each risk type separately and aggregate after the fact are not meeting this standard.

Both geopolitical scenarios in the 2026 reverse stress test framework demonstrate the level of severity now expected.

Scenario A (the cyber-attack vector) must be modeled as an acute operational shock with systemic funding implications, compounded by the risk that deepfake technology is used to accelerate confidence erosion; this could be related to fraud or to more fundamental threat vectors.

Scenario B (the Iran/Middle East conflict) must capture the full transmission chain including energy price spike to CRE and SME credit quality, trade route disruption to export-dependent corporate books, tourism and mobility contraction to retail credit performance.

The 2025 exercise also involved CRR3 restatement illustrated system-wide CET1 drag of 129 basis points, with the output floor accounting for 85% of the total impact.[5] The capital architecture has changed. Institutions with significant internal model portfolios were required to run scenarios using both the current and fully loaded CRR3 frameworks to understand the actual impact.

In early 2026, the ECB confirmed a thematic review of credit underwriting practices across directly supervised banks. This exercise targeted new lending and vulnerable portfolios, particularly SMEs and commercial real estate, where supervisors see weakness in collateral valuation, early warning design and data quality.[11] In March 2026, the ECB imposed periodic penalty payments on Crédit Agricole for failing to sufficiently identify climate-related risks; the first enforcement action of its kind under the ESG supervisory framework.[12] The regulatory signalling is fairly unambiguous: risk identification failures at some point carry direct financial consequences, not just qualitative SREP findings.

5. Adequate resources and organizational structures

Principle 5: Resources and organizational structures should be adequate to meet the objectives of the stress testing framework.

This is the least addressed principle in European supervisory communication, and the one most relevant to the practical challenge facing mid-tier and less significant institutions. BCBS d450 requires skill sets including expertise in liquidity risk, credit risk, market risk, capital rules, financial accounting, modeling and project management. Where third-party services are used, appropriate due diligence, oversight and control are required.

For a significant institution with hundreds of finance, risk and treasury professionals, the challenge lies primarily in integration and communication – ensuring specialist teams operate within a coherent framework rather than in silos. For an LSI with smaller teams, the challenge is different. The breadth of expertise required cannot always be delivered through headcount alone.

The revised 2027 SREP guidelines, which incorporate DORA, ESG risk and IRRBB into the core assessment framework, expand the meaning of "adequate."[4] An institution that previously satisfied supervisory expectations with credit risk stress testing and basic NII sensitivity analysis must now also demonstrate IRRBB and credit spread risk capability, ESG scenario analysis, operational resilience assessment, and geopolitical compound scenario design. Each requires specialist methodology.

The Scenario A (cyber) requirement – DORT, TLPT, and integrated operational resilience testing – requires capabilities spanning IT, risk and operations. The Scenario B (macro-systemic) requirement spans credit, market, IRRBB, liquidity and capital modeling simultaneously. For an institution without integrated platform support, these are separate workstreams with separate teams, separate assumptions and no mechanism for compound effect.

The BCBS standard acknowledgement of third-party services is not incidental. It recognizes that the resource challenge is structural. When institutional resources cannot deliver the required breadth of specialist capability internally, the platform must embed it. This is the architecture that integrated balance sheet management platforms are designed to provide: the specialist methodology spanning NII, EVE, liquidity, credit and capital within a single analytical environment, accessible to institutions whose risk functions cannot replicate it through headcount alone.

Proportionality is not a licence for opacity. A smaller institution that takes concentrated risk, such as in commercial real estate, in a specific sector or in a concentrated deposit base, will face supervisory expectations proportionate to that risk, not proportionate to its balance sheet size.

FIS editorial position

6. Accurate data and robust IT systems

Principle 6: Stress tests should be supported by accurate and sufficiently granular data and by robust IT systems.

This principle requires data that is accurate, complete and available at sufficient granularity and in a timely manner. Infrastructure should be sufficiently flexible to accommodate targeted or ad hoc stress tests during rapidly changing market conditions.[6]

The BCBS 239 principles for effective risk data aggregation and risk reporting (RDARR) have been on the supervisory agenda since 2013. More than a decade later, the ECB continues to identify the topic of RDARR as an area of weakness and has included the requirements in their 2025-27 supervisory priorities.[8]

This persistence reveals something important: data quality remediation is genuinely difficult, infrastructure can create structural barriers, and the gap between stated compliance and operational reality remains material across the European banking system and beyond.

The DORA integration into the revised SREP guidelines elevates this issue from data governance to an operational resilience requirement. An institution whose stress testing depends on fragile data pipelines, single-point-of-failure model infrastructure or manual aggregation across siloed systems is vulnerable in exactly the way DORA addresses.

The Scenario A stress (cyber-attack) crystallizes this directly. Under a coordinated ICT disruption, the institution must demonstrate that its stress-testing infrastructure is resilient — that data aggregation, scenario run capability and management information can function under operational stress.

An institution that cannot run a meaningful IRRBB or liquidity sensitivity analysis within hours or a day of a market shock, or cannot aggregate cross-entity exposure data under a geopolitical stress scenario, has a Principle 6 failure that supervisors will identify.

For stress testing, data quality is the binding constraint. You cannot model impacts without dependable, granular RWA data across asset classes. You cannot run credible IRRBB sensitivity analysis without accurate repricing schedules for the entire loan and deposit book.

You cannot reliably execute solid compound geopolitical scenarios if balance sheet data cannot be aggregated reliably across business lines and geographies and used for decision-making until the data foundation is right and trusted.

[8]See Priority (2) "Banks should remedy persistent material shortcomings in an effective and timely manner" https://www.bankingsupervision.europa.eu/framework/priorities/html/ssm.supervisory_priorities202412~6f69ad032f.en.html

7. Fit-for-purpose models and cross-risk integration

Principle 7: Models and methodologies to assess the impacts of scenarios and sensitivities should be fit for purpose.

This principle requires that risk modeling considers the interactions between various risk types and the connections between solvency and liquidity stresses. Collaboration among various experts is especially important for bank-wide stress testing to ensure all material risks are included and results are properly aggregated.

Most banks run credit risk stress tests, IRRBB sensitivity analyses, liquidity stress tests and operational risk assessments as separate exercises with different teams, often different assumptions, different timelines and different reporting channels.

The results are aggregated into an ICAAP document after the fact, with limited analytical connection between the risk-type assessments. This architecture was adequate when SREP focused on whether each risk type was assessed in isolation.

The current supervisory direction – covering complex geopolitical scenarios, IRRBB provisions integrated into SREP, and DORA operational resilience – requires supervisors to evaluate whether institutions understand how different risk types interact. A geopolitical scenario that causes credit losses, IRRBB exposure, funding market volatility and operational disruption simultaneously cannot be assessed credibly through four separate risk engines that do not communicate with each other, especially when you need the results for timely decision making.

Under the Iran/Middle East Scenario B, the interaction chain is concrete: energy price inflation increases business costs for SME borrowers (credit transmission), simultaneously drives interest rate volatility affecting the banking book NII and EVE position (IRRBB transmission), creates funding market uncertainty as confidence in energy-exposed counterparties shifts (liquidity transmission), and may trigger commodity trading operational disruptions (operational risk transmission). A siloed architecture produces four separate numbers. An integrated architecture produces a capital path.

The ECB also flagged insufficiently prudent submissions in the 2025 exercise, as supervisors in some submissions could not distinguish genuine prudence from optimistic bias dressed as conservatism. The ECB embedded measures within the supervisory priorities for 2025-27 to disincentivise this unwanted behaviour.[9]

This is the international standards expression of the integrated balance sheet approach, combined with rapid execution to free up time for better analysis and validation of areas where practice is most lacking. Enterprise-wide stress testing within a unified analytical framework – where NII, EVE, liquidity and capital impacts are modeled together, transmission channels between risk types are explicit and the full chain of cause and effect is visible – is the structural solution. Start-up and monoline banks have a distinct advantage in this area if they adopt this design philosophy.

[9]https://www.bankingsupervision.europa.eu/press/blog/2025/html/ssm.blog20250120~424509dc36.en.html

8. Challenge, validation and regular review

Principle 8: Stress testing models, results and frameworks should be subject to challenge and regular review.

This principle requires validation and independent review of key components, back testing or benchmark comparison, board-level challenge of processes, assumptions and outcomes, and regular review by the independent control functions (model validation, audit).

The ECB's on-site quality assurance visits during the 2025 exercise represent the most direct implementation of this principle so far. Supervisors evaluated institutional capability in real time, not retrospectively from documents.[2] The ECB's intentional delay in publishing credit risk benchmarks until after a bank's initial submissions reflects the benchmarking requirement; it limits the variation in bank submissions to ensure results show actual analytical capability rather than over-optimism based on benchmarks.[10]

The 2026 reverse stress test raises the bar. Banks must not only show they can withstand a prescribed scenario but also create institution-specific scenarios, trace transmission channels and quantify capital paths.[10] Any weaknesses found will influence the SREP process. This reflects Principle 8 applied across the entire framework discussed in this document, rather than individual model parts.

The geopolitical scenario framework introduces a specific challenge requirement: that the scenario design for Scenario A (fast moving/idiosyncratic) and Scenario B (slow moving/systemic/ economic) is subject to independent review, that the transmission channel assumptions are documented and challengeable, and that the recovery trigger calibration – liquidity and solvency thresholds – is tested against the institution's balance sheet under each scenario.

A scenario that has never been stress-tested against the institution's specific funding structure, loan book composition and capital position is a scenario in name only.

The gap in practice is often both cultural and an ingrained inefficiency in executing the core task of validating the key question, "Does the methodology applied produce a credible result that we can stand by?"

A strong foundational data layer (Principle 6) with clear lineage, relevant data and an integrated risk approach (Principle 7) speeds up the stress test cycle.

This then creates the time and opportunity for both the second and third lines to be more effective, enabling the right dialogues to occur, both to fully explore the key question above, and, if needed, design a remediation approach.

[10] https://www.bankingsupervision.europa.eu/press/blog/2025/html /ssm.blog20250120~424509dc36.en.html

9. Communication within and across jurisdictions

Principle 9: Stress testing practices and findings should be communicated within and across jurisdictions.

This principle requires banking groups to aggregate and report stress test results across legal entities with consistent approaches and impacts across jurisdictions.

For cross-border institutions and specialized lenders operating across multiple EU member states – approaching the significance threshold without the consolidated infrastructure of a fully developed banking group – this principle addresses a practical and urgent challenge. Coordinated SREP assessment across various NCAs with different applications of proportionality, potential inconsistency in capital buffer calibration, and the need for coherent consolidated stress testing creates complexity that the principle requires institutions to resolve.

The EBA's January 2025 peer review on proportionality found significant inconsistencies in how NCAs apply proportionality across member states – particularly in liquidity risk assessment, business model analysis and capital add-on calibration.[4] The revised guidelines aim to improve consistency, but for institutions operating across multiple NCA regimes, the only variable they can control is the internal consistency of their own framework.

The geopolitical scenarios add a cross-jurisdictional dimension.

- **A cyber-attack on critical financial infrastructure may affect operations across multiple legal entities in different member states simultaneously.**
- **An Iran/Middle East macro shock affects European banking systems with different energy import dependencies, different trade exposure profiles, and different CRE sector vulnerabilities.**
- **Institutions with cross-border operations must be able to aggregate the scenario impact across legal entities, not just report it separately to each NCA.**

An integrated enterprise-wide stress testing platform is the mechanism through which Principle 9 is operationally implemented: applying consistent scenarios, maintaining uniform methodology, and providing consolidated reporting across legal entities that may be overseen by different national competent authorities.

10. The practical roadmap

These nine principles create a common diagnostic framework, but the practical priorities differ by institutional tier and by the geopolitical scenario context that now frames the entire exercise.

Significant institutions face the most immediate agenda: CRR3 restatement into stress testing is already in place. The ECB's on-site quality assurance visits require the stress testing function to demonstrate its methodology and data infrastructure under live conditions. The 2026 reverse stress test demands institution-specific geopolitical scenario design integrated into the ICAAP, covering both Scenario A (fast moving/idiosyncratic) and Scenario B (slow moving/systemic) transmission paths.

BCBS 239 / RDARR remediation should be treated as a prerequisite for credible stress testing, not a parallel programme. Geopolitical scenario development should be a core component of the scenario library, documented with the rigour supervisors expect under Principles 4 and 8.

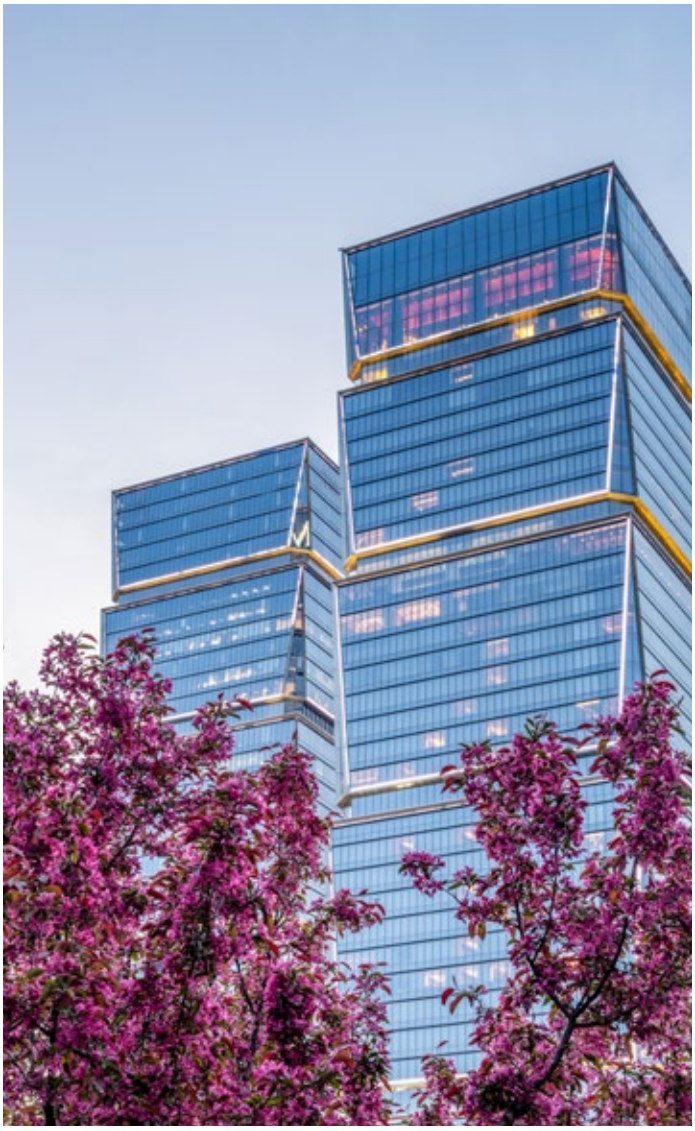
Less significant institutions face a planning horizon defined by the January 2027 revised SREP guidelines. The extended assessment frequency (up to five years for SNCIs) reduces supervisory intensity, but the framework will be more demanding at the next assessment.

The practical priorities are: an honest assessment of whether IRRBB sensitivities are credibly captured; whether CRE concentration risk is stress-tested at portfolio granularity; whether the ICAAP reflects a current view, not the risk profile at some historical date; and and whether geopolitical scenario capability exists at all, even in a basic form.

Cross-border institutions face the additional complexity of Principle 9: coordinated assessment across NCAs, consistent methodology across legal entities, and consolidated reporting that satisfies multiple supervisors simultaneously.

An integrated platform is the only practical solution at this tier. The geopolitical scenarios are particularly acute for cross-border institutions: the Iran/Middle East macro stress affects different legal entities with different severity depending on their trade exposure, energy dependency and CRE portfolios. A fragmented analytical architecture cannot produce a coherent group-level view.

All tiers face the resource question of Principle 5. The skill sets required by the international standard – liquidity, credit, market risk, capital rules, geopolitical scenario design and operational resilience modeling – represent a breadth of expertise that few institutions below the significant threshold can fully resource internally.



11. Conclusion: The quality imperative

It's clear, via the publication of supervisory priorities and press releases, that effective data management and robust stress testing capabilities are two fundamental tenets of the EBA's approach to promoting the banking sector's short-term financial resilience.

The importance of the geopolitical factor is no longer theoretical. Whether it's the war in Ukraine in 2021, the U.S. administration's release of tariffs in 2025,[11] or the current conflict in the Middle East, the real-world outcomes of the scenarios European supervisors built their frameworks around are no longer just hypothetical.

- The institutions that have built compound geopolitical scenario capability are running the scenario now.

- The institutions that have not done so may be facing costs.

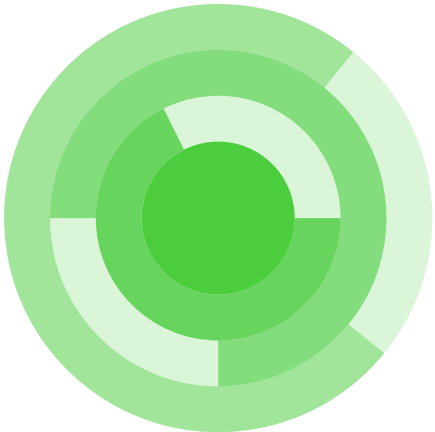
The ECB's parallel simplification agenda – streamlining reporting requirements, reducing SREP process complexity and increasing use of digital tools – does not soften this regulatory direction. What may soften or delay it is the banking sector's fundamental role in powering the economy, business and trade through uncertainty. However, the overall long-term trajectory is clear. We can rationally infer the following:

- An Institution whose SREP assessment reflects high-quality internal processes will benefit from lower P2G, more productive supervisory engagement and greater strategic flexibility long term.

- An institution whose assessment reflects data quality weaknesses, undocumented assumptions and performative governance will face higher capital requirements longer term.

Institutions best positioned for an uncertain future treat stress testing as a continuous, integrated analytical capability. They can effectively communicate their resilience to key stakeholders so supervisors, boards, depositors and counterparties can successfully navigate any headwinds they might face.

"Strong performance of the EU banks in the 2025 EU-wide stress test is reassuring. Nonetheless, this should not lead to complacency among banks or supervisors. Maintaining adequate capital remains essential to ensure that the EU banking system can continue to support the economy under adverse conditions and avoid becoming a source of amplification during crises."[12]



[11] investmentnews.com: tariffs and refund frenzy -130bn litigation battle

[12] https://www.eba.europa.eu See exec summary - 2025 EU wide stress tests

Notes and references

[1] European Systemic Risk Board, "Macro-financial scenario for the 2025 EU-wide banking sector stress test," January 2025. EBA, "2025 EU-Wide Stress Test — Results," 1 August 2025. 64 banks, 17 countries; aggregate CET1 starting ratio 15.76%; adverse scenario CET1 low point 12.06% (-370bps); total projected losses €547bn; credit losses €394bn; geopolitical narrative centred on trade fragmentation, tariff escalation, and persistent supply shocks.

[2] KPMG ECB Office, "The EU-Wide Stress Test 2025," May 2025. ECB confirmed on-site quality assurance visits to banks with suspected data quality or modeling weaknesses during the active 2025 stress test submission period — the first time such visits were conducted during a live exercise. Quantitative results (capital depletion) determine P2G; qualitative findings (data quality and governance) likely affect P2R.

[3] ECB, Press Release: "ECB to assess banks' stress testing capabilities to capture geopolitical risk," 12 December 2025. ECB to conduct geopolitical risk reverse stress test on 110 directly supervised banks in 2026. Banks required to identify geopolitical scenario causing at least 300bps CET1 depletion; describe mitigation actions; exercise integrated into 2026 ICAAP. Aggregate results to be communicated summer 2026.

[4] EBA, EBA/CP/2025/21: Consultation Paper on Revised Guidelines on Common Procedures and Methodologies for the Supervisory Review and Evaluation Process (SREP) and Supervisory Stress Testing, 24 October 2025. Consultation closed 6 February 2026 (extended from 26 January); guidelines expected to apply from 1 January 2027. Key changes: DORA integration; ESG risk embedded in business model analysis; IRRBB and CSRBB provisions incorporated; SNCI assessment frequency extended to five years. EBA peer review on proportionality in SREP found substantial inconsistency across NCAs.

[5] Alvarez & Marsal, "2025 EBA Stress Test Analysis," August 2025. CRR3 fully loaded impact: -129bps system-wide CET1; -182bps for European G-SIBs; output floor accounts for -110bps (85% of total CRR3 drag).

[6] Basel Committee on Banking Supervision, "Stress testing principles," October 2018 (BCBS d450). www.bis.org/bcbs/publ/d450.htm. Nine principles establishing the international standards framework for stress testing. Replaces the 2009 Principles for sound stress testing practices and supervision. Principles are intended to be applied on a proportionate basis depending on the size, complexity, and risk profile of the bank or banking sector.

[7] ECB, Supervisory Priorities 2026–2028, November 2025. First consolidation to two priorities in five years. Priority 1: resilience to geopolitical risks and macro-financial uncertainties. Priority 2: operational resilience and ICT capabilities (DORA compliance, BCBS 239/RDARR).

[8] ECB, Press Release: "ECB keeps capital requirements broadly stable for 2026 amid persisting global challenges," 18 November 2025. Assessment covers 105 significant institutions. Overall CET1 requirement and guidance 11.2%. KPMG ECB Office, "SREP 2025: Results for SSM Banks," 18 November 2025. Qualitative measures focused on: credit risk, ICT and operational resilience, internal governance and risk management including BCBS 239.

[9] ECB, Aggregated Results of the 2025 SREP, November 2025. Weighted average CET1 16.1% of RWA; leverage ratio 5.9%; LCR 158%; NSFR 127%; return on equity 10.1%. P2R add-ons: six banks (leveraged finance), fourteen banks (leverage ratio), ten banks (NPE).

[10] Reuters, "ECB to quiz 110 banks on geopolitical risk impact," 12 December 2025. ECB statement: any weakness revealed will feed into the SREP process, which is used to set the capital banks must hold above the regulatory minimum.

[11] ECB Banking Supervision, speech by Supervisory Board member, 25 February 2026. ECB confirmed thematic review on credit underwriting planned for 2026, targeting new lending to vulnerable portfolios including SMEs and CRE. Focus on underwriting discipline, stress-aligned affordability metrics, risk-based pricing, collateral valuation, and early warning design.

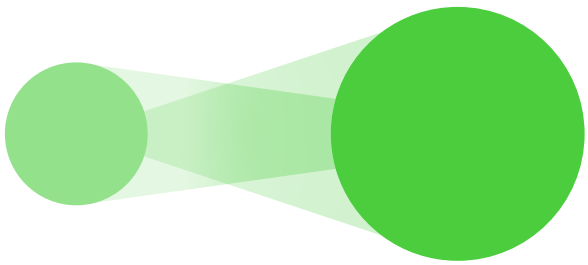
[12] ECB Banking Supervision, March 2026. ECB imposed periodic penalty payments on Crédit Agricole for failing to sufficiently identify climate-related risks. First enforcement action of its kind under the ESG supervisory framework.

[13] European Banking Authority. Digital Operational Resilience Act (DORA) — Direct Supervision and Oversight. See: https://www.eba.europa.eu/activities/direct-supervision-and-oversight/digital-operational-resilience-act. DORA mandates Digital Operational Resilience Testing (DORT) for all in-scope financial entities, including Threat-Led Penetration Testing (TLPT) on a 3-year cycle for significant institutions. TLPT simulates real-world adversarial attacks on critical systems.

[14] US-Israeli military campaign context: as of March 2026, the US-Israeli military campaign against Iran has effectively closed the Strait of Hormuz to normal commercial traffic. Oil prices have surged past $100 per barrel. Gulf state energy infrastructure is under direct attack. The IEA has authorised the largest strategic reserve release in its history. This paper uses this live scenario as illustrative of the type of geopolitical compound stress event that the ECB's 2026 reverse stress test exercise is designed to capture.

[15] ECB Guide to the internal capital adequacy assessment process (ICAAP), covers board and senior management responsibilities for icaap challenge, sign off procedures, third party review obligations, and continuous improvement obligations https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.icaap_guide_201811.en.pdf

[16] ECB/ESRB, "Financial stability risks from geoeconomic fragmentation," January 2026. Joint report published 22 January 2026. Section 4 establishes the macro-financial transmission framework: geopolitical shock → trade and uncertainty / financial markets → economy → financial institutions. Key finding: geopolitical shocks propagate through credit, market, operational and funding risk channels simultaneously, with heterogeneous impact across EU member states. www.ecb.europa.eu/press/pr/date/2026/html/ecb.pr260122~0b138afc39.en.html



Appendix A: Geopolitical scenario framework

The following two geopolitical scenarios define the recovery plan trigger framework applied throughout this paper. Each scenario represents a distinct archetype — fast moving/idiosyncratic and slow moving/systemic — and activates a different recovery plan threshold.

Scenario A: State actor cyber attack; Nature - Fast moving/idosyncratic; Recover trigger - Liquidity

Dimension	Scope
Description	A coordinated state-sponsored attack on critical financial infrastructure, compounded by the rising sophistication of GenAI and deep fake technology operating under the DORA regulatory context.
Transmission	Operational disruption → liquidity stress → confidence shock → funding market dislocation.
Key risks activated	Operational risk (ICT), liquidity risk (LCR/NSFR), market risk (funding repricing), capital (operational losses + fire sales).
DORA relevance	Direct — the scenario is the DORA resilience test. DORT and TLPT gaps are the transmission mechanism. Inadequate ICT governance is the root cause.
CET1 depletion range	150–300 bps depending on duration of disruption and recovery plan readiness.
Speed of onset	Hours to days — acute, fast-moving, idiosyncratic to the institution.
BCBS 450 principles most tested	P1 (objectives linked to recovery planning), P2 (governance / DORT/TLPT), P6 (data and IT resilience under stress), P8 (challenge and validation of ICT assumptions).

Scenario B: Iran / Middle East Conflict; Nature - Slow moving/Systemic; Recovery trigger - Solvency

Dimension	Scope
Description	Sustained armed conflict producing energy and food inflation, trade route disruption through the Strait of Hormuz, and mobility/tourism contraction across the Mediterranean and MENA.
Transmission	Energy price spike → corporate credit quality deterioration → NII compression → capital depletion over 12–18 months.
Key risks activated	Credit risk (SME/CRE ECL), IRRBB (NII compression, EVE sensitivity), liquidity risk (funding spread), capital (CRR3 output floor amplification).
Macro context	Oil >$100/bbl. IEA strategic reserve release. ECB stagflationary dilemma. European energy security under live stress as of March 2026.
CET1 depletion range	300–450 bps. CRR3 output floor adds approximately 85 bps system-wide for institutions with internal model portfolios.
Speed of onset	Weeks to months — slow-moving, systemic, affecting all European institutions with energy-exposed or trade-exposed balance sheets.
BCBS 450 principles most tested	P3 (stress testing as strategic tool), P4 (material risks and scenario severity), P5 (adequate resources for compound modeling), P7 (cross-risk integration: credit + IRRBB + liquidity simultaneously).

Addendum

This addendum records material regulatory and macroeconomic developments published between mid-March and 30 April 2026. The paper's nine-principle analytical framework and central arguments are unchanged. These developments corroborate — and in two cases accelerate — the paper's core thesis that geopolitical scenario capability is no longer a forward-looking supervisory expectation; the adverse scenario has transitioned to become the new base case operating environment.

Publication	Key finding relevant to this paper
World Economic Outlook "Global Economy in the Shadow of War" 13 April 2026[1]	Global growth revised down to 3.1% for 2026 (from 3.4% in 2025). Downside risks described as dominant. The severe scenario modeled by the IMF — oil prices 100% above January 2026 baseline, food commodity prices up 10%, corporate risk premiums rising 200bps in emerging markets — maps directly onto the transmission chain described in the paper's Scenario B. **Paper relevance:** Principles 3, 4 and 7. The IMF's severe scenario is functionally identical to the paper's Iran/Middle East Scenario B compound transmission chain: energy price spike → corporate credit quality deterioration → NII compression → capital depletion.
Global Financial Stability Report "Global Financial Markets Confront the War in the Middle East and Amplification Risks" 14 April 2026[2]	Global financial stability risks characterized as elevated. The GFSR identifies the same amplification channels the paper foregrounds: energy prices → inflation expectations → yield rises → sovereign and corporate credit stress. Markets described as having absorbed the shock in orderly fashion so far, but resilience assessed as fragile — risks remain asymmetric to the downside. **Paper relevance:** The GFSR explicitly validates the paper's argument that compound geopolitical scenarios activating credit, market, liquidity and operational risk simultaneously cannot be assessed through siloed risk engines. The IMF calls for targeted prudential measures, robust supervision, and effective stress testing as the primary policy response.
Financial Stability Board Letter to G20 finance ministers and central banks by Andrew Bailey 13 April 2026[3]	Financial markets are experiencing heightened volatility and tightening conditions. When combined with existing vulnerabilities — such as stretched asset valuations, concentrated leverage in the non-bank financial sector, liquidity mismatches and increasing market complexity — these factors could lead to multiple shocks materialising simultaneously." Bailey specifically identified three areas for heightened monitoring: sovereign bond markets, private credit valuations, and foreign exchange and derivatives markets — and warned of a potential **"double or triple whammy"** threat to financial stability if these vulnerabilities crystallize together. **Paper relevance:** The FSB's "triple whammy" framing is precisely the compound transmission channel argument at the centre of Principle 7 (cross-risk integration) and Principle 4 (sufficiently severe scenarios).

[1]https://www.imf.org/en/publications/weo/issues/2026/04/14/world-economic-outlook-april-2026
[2]https://www.imf.org/-/media/files/publications/gfsr/2026/april/english/text.pdf
[3]https://www.fsb.org/uploads/P130426.pdf

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