ANALYSIS

«Beyond Capital: What the Results of the 2026 Geopolitical Reverse Stress Test Reveal»

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The results of the geopolitical reverse stress test published by the European Central Bank (ECB) mark a turning point in the way the resilience of the European banking sector is assessed. Rather than measuring banks' ability to withstand a common supervisory scenario, the exercise tested their capacity to identify those geopolitical events that could jeopardize their solvency and to understand how such risks would be transmitted to capital, liquidity and non-financial risks.

The methodological difference compared with the European Banking Authority's traditional biennial exercises is substantial. Instead of starting from a common supervisory scenario, the ECB first established a target deterioration of 300 basis points in the Common Equity Tier 1 capital ratio (known as "CET1") and asked each bank to identify which geopolitical scenario could produce such an outcome.

This threshold is aligned with the magnitude observed during historical crisis episodes, where capital depletion recorded median impacts of between 225 and 250 basis points, but it was conceived from a fundamentally exploratory and qualitative perspective.

One of the exercise's main conclusions is the growing maturity of banks' analytical capabilities. The diversity of scenarios developed by institutions reflects an increased ability to identify specific vulnerabilities. However, the ECB reminds banks that the quality of a scenario lies not in its originality but in its plausibility, sensitivity and consistency with the actual mechanisms through which risk is transmitted.

In this context, the exercise highlights several essential elements for the development of truly effective modelling frameworks. A deep understanding of the specific characteristics of each business remains a critical factor in building analytical tools that are aligned with institutions' operational realities and with the genuine mechanisms through which risk and profitability are generated.

The increasing complexity of geopolitical risks further reinforces the need for statistically robust methodologies capable of translating qualitative scenarios into consistent quantitative impacts on solvency, liquidity and financial performance. Ultimately, the reliability of stress testing exercises depends as much on the quality of the scenarios as on the robustness of the models used to estimate their effects.

It is precisely in this area that the ECB identified several weaknesses. The supervisor detected inconsistencies between certain geopolitical narratives and the impacts projected by some institutions, as well as excessive or insufficient sensitivities of key variables, such as net interest income or credit risk, to changes in fundamental macroeconomic variables. These observations demonstrate that increasingly sophisticated scenarios must be accompanied by modelling that is coherent, consistent and sufficiently risk sensitive.

Perhaps this exercise's most important lesson, however, is that geopolitics can no longer be analyzed solely from a financial perspective. The ECB has explicitly incorporated non-financial risks into its supervisory analysis, and the results are unequivocal. Cyber-attacks have emerged as the primary non-financial threat identified by institutions. These are accompanied by disruptions to critical third-party services, incidents related to customers and products, and other operational disruptions that now form part of the geopolitical risk landscape of the financial sector.

Geopolitics has evolved from being an exogenous contextual variable into a structural risk factor that must be fully integrated into capital, liquidity, recovery and operational resilience planning.

The true value of a reverse stress test lies not only in quantifying vulnerabilities but also in assessing whether planned management actions are genuinely executable under extreme conditions. The ECB appears reasonably comfortable with measures such as repricing loans and deposits, asset disposals and tighter lending criteria. However, it remains considerably more skeptical about assumptions based on capital increases in adverse market conditions or portfolio sales at optimistic valuations during episodes of systemic stress.

The question raised by the supervisor is particularly pertinent: a measure may appear reasonable on paper, but would it remain effective if dozens of institutions attempted to implement it simultaneously in a severe geopolitical scenario?

It is worth highlighting that the ECB has explicitly ruled out any direct impact on the P2G or on leverage ratio guidance. Nevertheless, the results may be incorporated into the qualitative assessments conducted under the SREP, particularly in areas related to governance, planning and modelling.

Ultimately, the ECB concludes that banks have demonstrated a reasonable capacity to design severe geopolitical scenarios and formulate management responses. However, areas for improvement remain in the consistency of models, the realism of contingency plans and the ability to manage systemic geopolitical crises. In an increasingly fragmented international environment, the main conclusion is perhaps the simplest one: geopolitics is no longer an exceptional risk, but a permanent dimension of banking management.

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