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EURO AREA POLICIES

FINANCIAL SYSTEM STABILITY ASSESSMENT

July 2025

This Financial System Stability Assessment on the euro area was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in June 2025.

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June 20, 2025

KEY ISSUES

Context: The euro area financial system had proven resilient through multiple shocks, supported by significant bank capital and liquidity buffers. While nonbank financial intermediation (NBFI) has expanded rapidly, diversifying the financial landscape, renewed efforts to create deeper and more integrated markets remain hindered by national fragmentation. The sector is currently experiencing heightened volatility. At the outset of the FSAP, inflation was declining, monetary policy easing, and economic recovery was gradually gathering strength. However, geopolitical tensions and trade policy uncertainty have since clouded the outlook, amplifying financial market volatility.

Findings: The euro area banking system remains resilient to significant adverse shocks, including a severe geopolitical risk scenario. Risks may arise from a dislocation in sovereign debt markets, losses to counterparties, or liquidity demands including those arising from interlinkages between banks and NBFI. The authorities made significant advancements in the prudential framework since the 2018 FSAP, including strengthening banking supervision and establishing the nascent central Anti-Money Laundering Authority (AMLA). However, fragmentation continues to hinder the full benefits of the banking union and the development of a more diversified, deeper, and integrated financial system that supports economic growth and investment.

Policies: Completing the euro area financial architecture remains critical. Gaps in data availability and sharing persist, despite a robust surveillance framework. Legal barriers should be removed, data collection centralized at the European Supervisory Authorities (ESAs), and system-wide stress tests covering the full financial system conducted. The authorities should address deviations from Basel III and further harmonize the bank prudential framework, including macroprudential policies. The resources and prudential powers of the European authorities overseeing the NBFI sector should be strengthened, including by empowering the European Securities and Markets Authority (ESMA) to top-up national measures for significantly leveraged funds and to enforce cross-border reciprocation. The FSAP recommends introducing a common deposit insurance system and more flexibility into the single resolution mechanism (SRM), as well as strengthening emergency liquidity to the NBFI sector and to banks in resolution.

Approved By
May Khamis
Prepared By
The Euro Area FSAP team

This Report is based on the work of the Financial Sector Assessment Program (FSAP) missions that visited the euro area in November 2024 and February–March 2025. The FSAP findings were discussed with authorities during the Article IV consultation mission in May 2025.

- The team was led by Marc Dobler (Mission Chief), Fabiana Melo, and Laura Valderrama (Deputy Mission Chiefs) under the oversight of Marina Moretti. The team included Mark Adams, Guillaume Arnould, Carolina Claver, Cristina Cuervo, Ender Emre, Tamas Gaidosch, Mindaugas Leika, Elisa Letizia, Paavo Miettinen, Kristina Miggiani, Apostolos Panagiotopoulos, Luc Riedweg, Emrah Sagkol, Mariano Spector, Richard Varghese, Peter Windsor, Hannah Winterberg (all IMF) and Harold Gallagher, Darryl King, Jennifer Long, Aditya Narain, and Lyndon Nelson (external experts). The team are grateful for editorial and logistical assistance from Kene Ndir and Margo Vandenbroucke; research assistance from Raadhika Vishvesh and Rick Zheng; support for macro scenarios from Zoltan Jakab, and for modelling from Pierpaolo Grippa, Yuchen Zhang, and James Otterson.

- The FSAP met with key officials from the European authorities including the European Central Bank (ECB); the European Commission (EC); the European Banking Authority (EBA); the European Insurance and Occupational Pensions Authority (EIOPA); ESMA; the European Systemic Risk Board (ESRB); and the Single Resolution Board (SRB). The team thanks the authorities for the excellent cooperation, hospitality, and rich policy discussions.

- FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- In line with the 2021 Financial Sector Assessment Program Review (Decision No. 17041-(21/46)), the financial stability assessment under this FSAP is part of bilateral surveillance under Article IV of the Fund's Articles of Agreement for Fund members of the euro area with systemically important financial sectors that have delegated relevant financial sector policies to supranational institutions. The previous FSAP was completed in 2018.

- This report was prepared by Marc Dobler, Fabiana Melo, Laura Valderrama, and the IMF FSAP team for the euro area.

CONTENTS

TABLES

APPENDICES

Glossary

AIF	Alternative Investment Fund
AIFMD	Alternative Investment Fund Managers Directive
AML	Anti-Money-Laundering
AMLA	Authority for Anti-Money-Laundering and Countering the Financing of Terrorism
AML/CFT	Anti-Money Laundering and Combatting the Financing of Terrorism
AUM	Assets Under Management
BBM	Borrower Based Measure
BCP	Basel Core Principles for Effective Banking Supervision
BRRD	Bank Recovery and Resolution Directive
bps	basis points
CBC	Counterbalancing capacity
CCoB	Capital Conservation Buffer
CCPs	Central Counterparties
CCR	Counterparty Credit Risk
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
CFT	Countering the Financing of Terrorism
CMDI	Crisis Management and Deposit Insurance
CRD	Capital Requirements Directive
CRE	Commercial Real Estate
CRR	Capital Requirements Regulation
CTPP	Critical Third-Party Provider
DORA	Digital Operational Resilience Act
DSTI	Debt Service to Income
DTI	Debt to Income
EA	Euro Area
EAD	Exposure at Default
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EIOPA	European Insurance and Occupational Pensions Authority
ELA	Emergency Liquidity Assistance
ELB	Effective Lower Bound
EMDEs	Emerging Markets and Developing Economies
EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authority
ESM	European Stability Mechanism

ESMA	European Securities Market Authority
ESRB	European Systemic Risk Board
EU	European Union
FDI	Foreign Direct Investment
FMI	Financial Market Infrastructure
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GDP	Gross Domestic Product
G-SIB	Global Systemically Important Bank
HFCS	Household Finance and Consumption Survey
ICT	Information and Communications Technology
ITS	Implementing Technical Standards
IFRS	International Financial Reporting Standards
IRB	Internal-Ratings Based
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LMTs	Liquidity Management Tools
LSI	Less Significant Institution
LTV	Loan to Value
MFI	Monetary Financial Institution
MIFID	Markets in Financial Instruments Directive
ML	Money Laundering
MMF	Money Market Fund
MMFR	Money Market Funds Regulation
MoU	Memorandum of Understanding
MREL	Minimum Requirement of Eligible Liabilities
NAV	Net Asset Value
NBFI	Nonbank Financial Intermediation
NBFIs	Nonbank Financial Institutions
NCA	National Competent Authority
NCB	National Central Bank
NPL	Nonperforming Loan
NSFR	Net Stable Funding Ratio
OPEC	Organization of the Petroleum Exporting Countries
O-SII	Other Systemically Important Institution
PD	Probability of Default
PEPP	Pandemic Emergency Purchase Program
QT	Quantitative Tightening

RAM	Risk Assessment Matrix
RCAP	Regulatory Consistency Assessment Program
RoE	Return on Equity
RWA	Risk-Weighted Assets
SA	Standardized
SFTs	Securities and Finance Transactions
SI	Significant Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
STeM	Stress Testing Matrix
SyRB	Systemic Risk Buffer
TD	Top Down
TF	Terrorist Financing
TN	Technical Note
TTC	Through the Cycle
UCIT	Undertakings for the Collective Investment in Transferable Securities
U.S.	United States
WEO	World Economic Outlook

EXECUTIVE SUMMARY

Stress tests indicate that the banking sector in the euro area (EA) would be resilient to severe economic shocks, while pointing to vulnerabilities in some banks. The major EA banks would be resilient to severe stress scenarios, including an adverse geopolitical scenario with "trade wars" and a recessionary scenario with sovereign distress. Most banks' solvency buffers remain comfortably above regulatory capital requirements, some banks would dip into their buffers, and only a few banks would breach capital requirements. EA banks can also withstand significant liquidity outflows but their exposure to contingent liquidity risks, including from links to nonbank financial institutions (NBFIs), are on the rise. Joint stress testing of solvency and liquidity risk for global systemically important banks (G-SIBs) reveals important amplification risks arising from market shocks, loss of market confidence, and counterparty credit risk.

While banking supervision has significantly strengthened, there is scope to improve supervisory effectiveness and align with international standards. The single supervisory mechanism (SSM) is a highly capable supervisor, employing an intrusive approach and diverse supervisory tools, supported by excellent risk analysis and supervisory expertise. It has enhanced bank risk management across the EA in areas such as credit risk, liquidity risk, internal models, operational resilience, and climate-related financial risk. Supervision will further strengthen with the simplification of the supervisory process and introduction of a risk tolerance framework. Additional enhancements should include further delegating decision-making, ensuring the timely implementation of supervisory measures, and broadening enforcement tools. While the transposition of the final elements of the Basel III reforms into EU legislation is a positive step, further alignment with international standards is necessary to address Basel III deviations, implement the postponed fundamental review of the trading book, reduce dependence on national rules, enhance the definition of related-party transactions, and broaden sanctioning powers. Adopting and implementing robust prudential standards should remain the primary focus of financial regulators.

The macroprudential policy framework for banks would benefit from further harmonization. European Union (EU) legislation should facilitate the early activation of countercyclical capital buffers, streamline procedures for macroprudential tools to enhance the efficiency of the framework, and ensure that releasable capital buffers are in place and consistently used across EA countries (including through top-up powers). In addition, the methodology for setting buffers on other systemically important institutions (O-SII) should be harmonized, while allowing some flexibility to reflect country specificities.

Strengthening the oversight of NBFI is essential to address its expanding interlinkages and growing market impact. Bank interlinkages with nonbanks—such as central counterparties (CCPs), investment funds, money-market funds, and insurance firms—can amplify shocks through redemptions and collateral calls. In a severely adverse two-day market shock scenario, system-wide stress tests revealed liquidity gaps that may expose banks to counterparty losses. A prolonged two-week period of stress, comparable to the 2020 dash-for-cash episode, would significantly disrupt core euro area funding markets. To effectively assess and monitor these risks, the authorities

should undertake system-wide stress tests, remove legal impediments to data sharing, harmonize regulatory templates for stress testing, centralize data collection at EIOPA and ESMA, and enhance collaboration between the ESRB, ECB, and ESAs.

Careful sequencing is needed to establish the appropriate institutional and supervisory arrangements for deeper, more integrated capital markets. ESMA has matured as a supervisory authority and laid the groundwork to assume carefully sequenced additional mandates. For these, ESMA will need a robust set of powers and supervisory tools, which should be established through founding regulation. Governance arrangements should be enhanced to ensure independence and agility, and sufficient expertise secured. The regulatory framework for investment funds remains fragmented, necessitating further steps to mitigate systemic risk. Recent legal amendments introduce essential requirements for liquidity risk management and reporting for collective investment schemes (UCITS) and alternative investment funds (AIFs), with full compliance expected by end-2027. Similar measures should align the regulation of money market funds (MMFs) with international good practice. ESMA should also be empowered to top-up national measures for leveraged investment funds deemed to pose systemic risk and enforce cross-border reciprocation.

The FSAP makes many further recommendations to strengthen the prudential framework of the EA financial system. These include:

- Improving data quality and availability and system-wide risk monitoring of the EA financial sector by enhancing timely and automatic data collection and sharing (including for NBFI and transaction-level data) and deepening collaboration of European financial authorities.

- Strengthening the resources and governance of the TARGET Services oversight team at the ECB, to further enhance its capacity to proactively identify and mitigate emerging risks.

- In light of the introduction of the Digital Operational Resilience Act (DORA), which will significantly enhance cyber security oversight, the authorities should be further empowered to fine critical third-party providers, accelerate the introduction of the pan-European cyber incident framework, and enhance cyber risk expertise and practices.

- Strengthening the resources and prudential powers of the supranational authorities, in particular those with prudential oversight of NBFIs, ensuring resources are adequate to meet existing and new responsibilities.

- In the context of ongoing reforms of the oversight framework for insurers that assign EIOPA a growing central role, EIOPA should be vested with stronger powers related to the supervision of internal models as well as for cross-border insurers and for market conduct; and a systemic risk score for individual insurers should be introduced in the European systemic risk assessment framework.

- With the introduction of a new Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Authority (AMLA) and Regulation, which aim to address fragmented

national approaches, AMLA should adopt a holistic methodology to classify risk profiles and a harmonized AML/CFT supervisory methodology, foster stronger cooperation through AML/CFT supervisory colleges, and take an active role in regulatory enforcement across the EA.

Finally, while operational preparedness for crisis management has improved since the 2018 FSAP, the banking union remains incomplete. The SRB has improved its operational preparedness, and banks' resolvability and the build-up of loss absorbing capacity in the EA is a major achievement. However, the absence of a common deposit insurance system, and the reliance on national emergency liquidity assistance (ELA) and on more flexible approaches for failing banks contribute to the fragmentation. The FSAP reiterates the recommendations from 2018, advocating for more flexibility in the single resolution mechanism (SRM), an EA-wide deposit insurance system with pooled loss-sharing and centralizing ELA to enhance coordination and risk-sharing. The FSAP recommends strengthening liquidity provision arrangements in resolution and the provision of ELA to systemically important NBFIs, accompanied by robust oversight and enhanced monitoring and transparency. In addition, while the introduction of an EU-wide regime for insurance resolution is a welcome development, harmonization of insurance guarantee schemes is recommended.

Table 1. Euro Area: Key Recommendations		
Recommendation	**Authorities**	**Timing[1]**
Systemic Risk Analysis		
Strengthen system-wide financial risk monitoring on a cross-country and cross-sectoral basis and conduct system-wide stress tests, including bank and nonbank sectors.	ECB, ESRB, ESMA, EIOPA, EC	MT
Enhance data collection and powers for automatic and timely sharing of financial stability data including for nonbank financial institutions and transaction-level data.	EC	MT
Continue enhancing macroprudential stress tests that account for the interaction between bank solvency and liquidity risk, in particular through margin calls, business risk, and credit sensitive funding.	ECB	MT
Financial Sector Oversight—Micro- and Macroprudential		
Banking		
Reduce the SSM's reliance on national legislative frameworks.	EC	MT
Improve governance of budgetary processes, further delegate decision-making, and align resources to current and expected future workload.	ECB	MT
Review capital requirements for EU internationally active banks and ensure that they are aligned with the Basel standards.	EC	MT
Make supervisory process more risk-focused, consider sovereign risk concentration when setting pillar 2 capital add-ons, and utilize the full panoply of corrective and sanctioning powers.	ECB	MT
Ensure that legislation explicitly allows for early activation of the countercyclical capital buffer (CCyB) even when cyclical systemic risks are not yet elevated.	EC	ST
Ensure that releasable capital buffers are in place and consistently used across EA countries, including through the use of recommendations or top-up powers.	ESRB, ECB	MT
Streamline the EU governance procedures for activating macroprudential measures.	EC	ST
Harmonize the methodology for implementing O-SII buffers, while allowing some flexibility to reflect country specific issues.	EC	MT
Insurance		
Provide EIOPA with stronger powers to foster supervisory convergence on internal models and policyholder protection risks from cross-border insurance.	EC, EIOPA	ST
Implement a minimum harmonization framework for Insurance Guarantee Scheme across member states to protect policyholders.	EC, EIOPA	MT
Ensure EIOPA is adequately resourced for the significant new permanent tasks it has assumed through legislative reform.	EC, EIOPA	I

Table 1. Euro Area: Key Recommendations (Continued)		
Investment Funds and Capital Markets Union		
Reform the MMF Regulation in line with international standards.	EC	ST
Introduce a single reporting mechanism for fund-level data and centralize data collection at ESMA.	EC, ESMA	MT
Introduce a more structured approach to stress testing at ESMA and systemic risk monitoring and further develop system-wide stress testing.	ESAs, ESRB, ECB, EC	MT
Introduce compulsory supervisory colleges and consolidated supervision for large cross-border asset management groups.	EC, ESMA	MT
Empower ESMA to top-up national measures (including leverage limits and liquidity requirements) for leveraged investment funds deemed to pose systemic risk and enforce cross-border reciprocation.	EC, ESMA	MT
Strengthen ESMA's institutional and governance arrangements for supervision—including amending its regulation to bestow a: (i) a wider range of supervisory powers; and (ii) a sustainable funding framework—before expanding its direct, risk based supervisory mandate.	EC, ESMA	MT
Payments System		
Review and augment resources of the TARGET Services oversight team, apply more forward-looking interventions to anticipate emerging risks and ensure oversight findings are addressed on a timely basis.	ECB	I
Strengthen procedures to identify and address potential conflicts of interest between the ECB's role as operator and overseer of TARGET Services, including by separating functions into different directorates.	ECB	ST
Cybersecurity		
Review the regulatory framework for any gaps in the ability to fine non-cooperating critical third-party providers (CTPPs), particularly for non-compliance with the ESA's recommendations made under the DORA oversight framework.	EC	MT
Strengthen the oversight of financial market infrastructures (FMIs) where the ECB is the lead overseer by executing on-site examinations of the cybersecurity control environment.	ECB	ST
Accelerate the development of cybersecurity risk oversight capacity at the ESAs in the context of DORA implementation.	EBA, ESMA, EIOPA	ST
AML/CFT		
Ensure AMLA, in close coordination with prudential and financial stability experts, adopts a holistic methodology to classify risk profiles and a harmonized AML/CFT supervisory methodology.	EBA, EC, AMLA	MT
Foster stronger cooperation among national competent authorities (NCAs), AMLA, and third-country supervisors, including through AML/CFT supervisory colleges.	AMLA, EBA	MT
Make sure that AMLA takes an active role in harmonizing AML/CFT regulatory enforcement practices across the EA to ensure consistent compliance and reduce regulatory arbitrage.	AMLA	MT

Table 1. Euro Area: Key Recommendations (Concluded)		
Financial Safety Nets and Systemic Liquidity		
Introduce a financial stability exemption for access to the Single Resolution Fund (SRF).	EC	ST
Establish a European deposit insurance system, including loss sharing and strong funding backstops.	EC	MT
Put arrangements in place for the SRF to provide guarantees to support central bank liquidity to banks in resolution, including, if possible, an EU fiscal backstop.	SRB, Eurosystem, EC, ESM	I
Maintain high priority of work on resolution execution and address third-country securities law issues in bail-in.	SRB	ST
Further harmonize and ultimately centralize emergency liquidity assistance (ELA) arrangements.	ECB, EC, Eurosystem	ST
Address the barriers to the provision of ELA to NBFIs, ensure appropriate oversight of relevant institutions, and operational readiness.	Eurosystem	MT
Consider the conditions to allow for the expansion of the counterparty framework for systemwide support to be used in times of stress.	ECB	MT

[1]I: immediately; ST: short term = less than 1 year; MT: medium term = 1–5 years.

BACKGROUND

A. Macrofinancial Context

1. The EA economy has remained resilient in the face of multiple shocks. Despite recurring shocks, including heightened geopolitical tensions, Europe's economy continues to remain resilient with record-low unemployment, declining inflation, and a stable financial system. GDP growth is projected at 0.8 percent this year and 1.2 percent in 2026 (April 2025, WEO). Higher tariffs, trade policy uncertainty, and geopolitical tensions are weighing on activity in 2025, more than offsetting an anticipated lift from fiscal policy support and easing monetary policy. Inflation is expected to remain broadly at the 2 percent target from the second half of 2025. Disinflation is supported by lower energy prices, subdued activity moderating nominal wage growth, and firmly anchored inflation expectations.

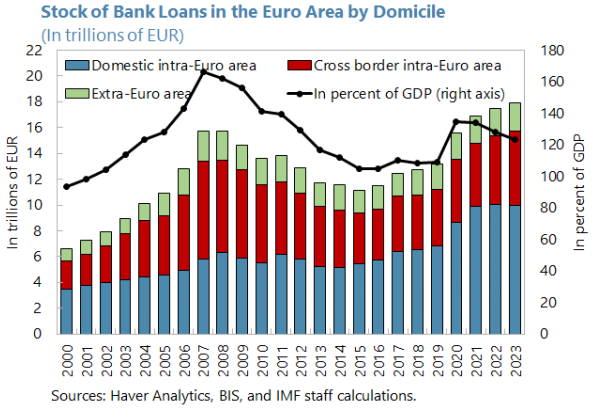
2. Risks to growth are tilted to the downside, while inflation risks are balanced. Output could be weaker than projected if a rise in trade policy uncertainty, an escalation of tariffs, and continuing weakness in manufacturing, further weigh on consumer confidence and business sentiment. On inflation, trade diversion lowering non-energy goods import prices, weaker-than-expected growth, and euro appreciation could result in lower inflation than expected. These risks are countered by upside factors, such as higher imported inflation due to the escalation of geopolitical and trade tensions as well as the possibility of higher-than-expected wage growth. Fiscal spending (including on defense) might also turn out larger or more inflationary than in the baseline.

3. Credit to the real economy has continued to decline, albeit at a slower pace, while trade-related market volatility and NBFI risks remain significant sources of systemic risk. Credit to nonfinancial corporations and households continued to contract in real terms in 2024Q4, both about-1.5 percent (year-on-year), but the pace has slowed. With the normalization of monetary policy, credit standards have started to ease from their restrictive levels driven by mortgage lending; but borrowing costs remain high (Figure 3) and credit standards tightened for firms during 2024Q4 and 2025Q1. Quantitative tightening is expected to progress in an orderly way but warrants careful monitoring of liquidity conditions in banks, NBFIs, and core funding markets, especially as financial conditions are likely to remain volatile given heightened trade policy uncertainty.

B. Financial Sector Structure

4. Assets of the EA financial sector amount to over five times GDP (Table 3). Banks hold about half of total financial sector assets, 70 percent of which are accounted for by 114 significant institutions (SIs) directly supervised by the ECB, of which 7 are G-SIBs. The remainder comprises about 2,000 less significant institutions (LSIs) supervised by the national authorities in close cooperation with the ECB (13 percent) and (non-EU) branches not subject to harmonized EU/European Economic Area regulation and supervision (17 percent). Assets of NBFIs are more than

twice EA GDP, dominated by investment funds.[1] While these funds have diverse investment strategies, about 90 percent of total assets are held in open-ended funds subject to liquidity risk arising from investor redemptions. Ninety percent of fund assets are domiciled in France, Germany, Ireland, Luxembourg, and the Netherlands. The consolidated balance sheet of the Eurosystem remains sizeable, despite having declined since end-2021 from 68 percent to 42 percent of GDP.



Sources: Haver Analytics, BIS, and IMF staff calculations.

5. Banking integration has slowed. Price-based and quantity-based banking integration indicators developed by the ECB[2] show that intra-EA cross-border bank integration has not substantively increased since the inception of the Economic and Monetary Union (text chart).[3] This is likely driven by a combination of differences in banking markets across member states (e.g., different structures for key products such as mortgages), differences in policy (e.g., on tax-favored savings accounts), and lack of progress in completing the EA-wide financial safety net.[4]

C. Financial Risks and Vulnerabilities

6. The banking system has remained resilient through recent shocks (Figure 5). In aggregate, a robust capital and liquidity position, a diversified deposit base, and limited unrealized losses underpinned the resilience of EA SIs. The banking sector's solvency position has strengthened gradually while liquidity ratios have remained robust after peaking before the start of the tightening cycle. Benefiting from rapid monetary policy tightening, sticky retail deposit rates, and the lagged effects of the rate-hiking cycle on asset quality, profitability reached post-global financial crisis highs in 2023. While nonperforming loans (NPLs) have declined and remain broadly stable, recent "Stage 2 loans" indicators suggest a slight deterioration in asset quality.[5] The liquidity coverage ratio remained stable at about 160 percent in December 2024. Looking across types of institutions, G-SIBs' return on equity (at 7.9 percent) lagged that of more diversified lenders (at 12.2 percent). Larger banks also posted lower capital and liquidity ratios than medium-/small-sized banks.

[1] NBFIs include investment funds, insurance companies, pension funds, and other financial intermediaries (OFIs), accounting for 130 percent, 60 percent, 24 percent, and 16 percent of GDP, respectively.

[2] Financial Integration and Structure in the Euro Area.

[3] The chart shows cross-border intra-Euro area, excluding lending within domestic country (red bars) relative to domestic intra-Euro area lending, including lending within own country (blue bars).

[4] See the 2024 European Parliament report: Banking union and the long wait for cross-border integration.

[5] NPL ratios (excluding cash balances) declined from about 3.5 percent in 2020Q2 to 2.3 percent in 2022Q3 and have since remained broadly stable. Stage 2 loans increased to about 10 percent in 2024Q4 from 8.4 percent in 2020Q2.

7. Looking forward, global risks are on the rise and the outlook has become more uncertain. Volatile financial conditions are likely to pose challenges going forward. Adverse dynamics could be triggered by negative macrofinancial surprises or the materialization of geopolitical risks (Table 6). Growing interlinkages of banks to complex and opaque NBFIs could pose challenges and act as amplifiers of systemic risk.[6] Commercial real estate (CRE) remains vulnerable to further asset price declines. More broadly, stretched valuations and risk premia are vulnerable to an even sharper correction as investors reassess global growth and inflation outlook (Figures 4 and 7). Highly indebted firms and households have been under pressure from higher debt service costs. However, following recent rate cuts financial conditions have started to ease, but the delayed impact of the past tightening, which peaked in September 2023, is still working through the system.[7] The recent increase in trade policy uncertainty after the April 2 U.S. tariff announcement led to a short-lived tightening of financial conditions and a further increase in volatility. The potential widening of sovereign spreads could raise borrowing rates and heighten credit risk. If fiscal headroom erodes, banks' exposures to highly indebted sovereigns could act as a transmitter of shocks and adversely affect the availability of credit to the real economy. Deteriorating asset quality, lower lending, stress in core financial markets, and contagion from strains in NBFI are risks going forward.

8. Financial market vulnerabilities could amplify shocks and pose risks to financial stability. Stretched asset valuations and liquidity fragilities in NBFI could expose banks to financial market stress through multiple channels (Figure 7). First, banks are exposed to a sudden correction in sovereign debt markets, as home bias is significant (see Figure 5).[8] Second, banks are also active participants in repo markets, accounting for over half of the total EUR 9.6 trillion outstanding volume in December 2024. Non-centrally cleared repos (60 percent of the total) are often backed by government bonds without haircuts (ESMA, 2024) which can amplify procyclical effects in a downturn. Market shocks, such as sharp drops in asset prices and high market volatility, can translate into increases in initial and variation margins across centrally and non-centrally cleared markets. Third, banks and investment firms hold 80 percent of derivative notional amounts, exposing them to unexpected margin calls and counterparty credit risk (CCR) during times of stress.[9] Fourth, banks and NBFIs are vulnerable to geopolitical risks that may trigger sharp asset price fluctuations and impair portfolios' credit quality. Market strains could put pressure on investment funds due to structural liquidity mismatches and cyclical liquidity risk from investor outflows and spikes in collateral calls. Intrasectoral and intersectoral interconnectedness with some highly leveraged investment funds could lead to contagion and amplify shocks to financial stability. Under

[6] The impact of market shocks could be amplified by wrong-way risk in SFTs if the value of margin collateral is correlated with their creditworthiness or the value of their positions.

[7] The economic impact of tighter financial conditions is yet to fully materialize because of the lags in the repricing of outstanding loans in some EA countries

[8] A zero risk-weight is assigned to sovereign exposures in domestic currency.

[9] Notional derivative amounts reached EUR 314 trillion in 2022, of which 80 percent were interest rate derivatives. While notional values are not a direct measure of risk, they reflect potential exposures and risks associated with these contracts.

stressed market conditions, NBFIs may suffer liquidity pressures from redemptions and margin calls. Firms seeking liquidity may withdraw funds from banks, sell assets to buy eligible collateral, redeem shares from MMFs and open-ended funds leading those sectors to sell assets, thus testing the resilience of core funding markets. Illiquid funds may also generate elevated CCR as they may default on their derivative and repo positions. G-SIBs and universal banks are particularly exposed to NBFIs, and to stress in repo and derivative markets.

SYSTEMIC RISK ASSESSMENT

9. The capacity of the financial system to absorb shocks was assessed against two adverse macrofinancial scenarios to capture economic and policy uncertainty as well as bank heterogeneity.[10] First, a "geopolitical scenario" featuring a further escalation of geopolitical conflicts and heightening commodity price volatility with large adverse trade, price and tariff shocks ("trade wars"). Second, a "recessionary scenario" showing a synchronized global slowdown amplified by sovereign debt distress in the EA, the widening of credit spreads, term premium decompression, and confidence losses softening aggregate demand (Figures 9–12).[11]

A. Household and Corporate Vulnerability Assessment

10. Household resilience varies significantly across the EA. Vulnerabilities increase with household leverage, the share of cost-of-living expenses relative to income, and the prevalence of floating-rate mortgages. There is significant heterogeneity in the share of adjustable-rate mortgages (Figure 13, a). The impact of macrofinancial shocks on household balance sheets was quantified using microdata sourced from the latest (2021) Household Financial and Consumption Survey (HFCS).[12] Simulations suggest that, by end 2026, 15 percent of households in the EA, holding 17 percent of outstanding debt, could become overburdened under IMF WEO baseline conditions, with essential payments (including housing costs, basic expenses, and debt payments) exceeding 70 percent of income. In the geopolitical scenario, this share could increase to over 20 percent of households holding 22 percent of debt. In the recessionary scenario, the impact would be cut by half due to the offsetting effects of lower interest payments and cost-of-living expenses (Figure 13, b, c). A further tightening of financial conditions combined with an income shock could create additional stress for households.[13]

[10] Subdued growth due to productivity challenges is reflected in baseline projections (January 2025 WEO) as well as in the adverse scenarios (i.e., tail risk is calibrated as deviations from baseline). The adverse scenarios are simulated using a global macrofinancial model, a structural macroeconometric model covering forty economies.

[11] In the "geopolitical scenario," fiscal policies in countries with fiscal space partly are used to counteract the fall in demand and support consumption. In the "recessionary scenario," monetary policy accommodation is used to mitigate the adverse impact on aggregate demand.

[12] The HFCS survey includes 83,000 households and 200,000 personal files across 22 countries.

[13] For details, see Technical Note on Stress Testing the Banking Sector.

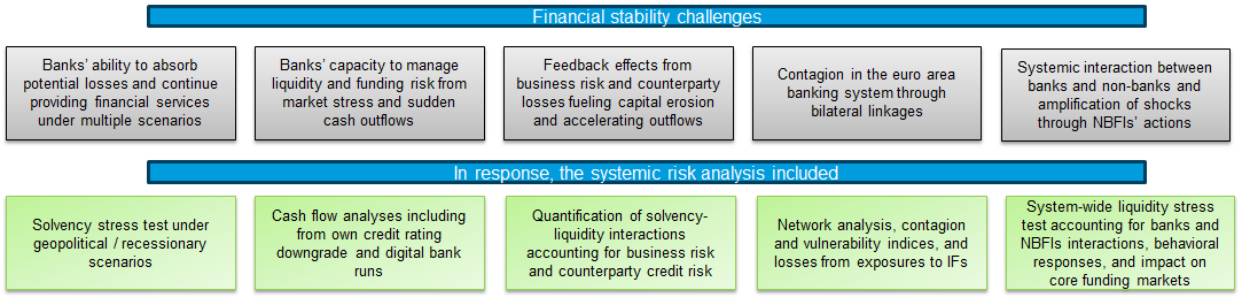
11. The EA corporate sector continued to deleverage from its post-COVID peak, while the pace of profit decline has slowed. Nonfinancial corporations' debt-to-GDP ratio decreased to 68.8 percent in the third quarter of 2024 from 70.7 percent in the third quarter of 2023. Nonfinancial corporations' gross operating surplus declined at an annual rate of 1.2 percent—lower than the rate in the first and second quarters of 2024. However, business bankruptcies continued to remain elevated, in part due to post-COVID normalization, and corporate vulnerabilities could rise if downside risks to growth were to materialize. CRE firms are particularly vulnerable, as monetary tightening and structural changes triggered a correction in the CRE segment (Figure 4). Simulations confirm that CRE firms' defaults under stress would more than double at the trough of the scenario, especially due to U.S. exposures.

B. Bank Stress Tests

Solvency

12. The FSAP performed a wide range of EA bank stress tests (Figure 1, Table 7). The stress tests included 95 out of 109 SIs (excluding custodian and developmental banks).[14] To test the resilience of business models, banks were grouped into four broad categories: G-SIBs, lenders (including diversified lenders, retail/consumer credit lenders, corporate/wholesale lenders, and small market lenders), investment banks (also including asset managers), and universal banks. The stress tests were conducted using December 2024 regulatory data at the highest level of consolidation over a 3-year stress test horizon (2025-27).

Figure 1. Euro Area: Complex Financial Stability Challenges in the EU/EA



13. The impact of stress was projected by geography, exposure class, portfolio, and risk factor. Overall, there are 40 material geographies for large EA banks, including 20 home jurisdictions. Separate credit risk models were estimated for households and corporates, for most material geographies, using microdata. Net interest income forecasts used a repricing gap methodology. Net fee and commission income was projected using a suite of panel regressions.

[14] From the 114 SIs supervised by the ECB, there are 109 for which common reporting (COREP) and financial reporting (FINREP) is available.

Market risk was quantified using a partial revaluation approach drawing on banks' reported sensitivities to risk factors.

14. Stress test results show that banks remain resilient under adverse conditions, maintaining capital levels above minimum requirements. Under the baseline scenario, the aggregate common equity tier 1 (CET1) capital ratio grows, reaching 16.6 percent in 2027 from a starting point of 15.7 percent in December 2024 (Figure 14). Under the adverse scenarios, the depletion in system-level CET1 ratio ranges between 423 bps (geopolitical scenario) and 456 basis points (recessionary scenario). The depletion is larger for G-SIBs at around 500 bps due to higher reliance on credit sensitive funding. Overall, capital depletion is driven by credit risk and a softening of net income in the geopolitical scenario, with moderate credit losses and steeper revenue compression in the recessionary scenario.

15. While a few banks could breach capital requirements, they represent a small share of banking system assets. Eight (nine) banks could face challenges in meeting capital requirements under the geopolitical (recessionary) scenario. In the geopolitical scenario, the capital shortfall is small, amounting to 0.05 percent of total risk-weighted assets at an aggregate level (0.3 percent of total equity). In this situation, 23 banks, including 14 lenders, would need to dip into their capital buffers, leading to a 1.0 percent SI's capital depletion relative to their total risk-weighted assets (6.4 percent of total equity). In the recessionary scenario, the capital shortfall would be slightly higher at 0.1 percent of total risk-weighted assets (0.7 percent of total equity). Here, 28 banks, including 17 lenders, would breach their buffers, resulting in a 1.1 percent SI's capital depletion relative to their total risk-weighted assets (7.1 percent of total equity). The stress test results also shed light on the relative resilience of banks' business models (Figure 15). G-SIBs are disproportionally affected by loan loss provisions in the corporate portfolio and funding costs. Lenders are more vulnerable to a deterioration in credit quality and unrealized losses in the recessionary scenario. By contrast, an inflationary environment supports income generation which partly offsets higher loan losses, amid the asymmetric pass-through of rate hikes to lending/deposit rates. Universal banks are comparably more resilient due to their diversified operations across income sources.

Liquidity

16. The EA banking system's liquidity buffers remain high (Figure 16). Aggregate EA banks' liquidity risk exposure (overnight contractual liquidity gap) increased by 4 percentage points to 31 percent of total assets in 2020–24, driven by a decrease in the share of stable deposits and a corresponding increase in securities financing transactions (SFTs) comprising both repos and collateral swaps. The level of asset encumbrance is relatively low, with half of the banks having an asset encumbrance ratio of less than 15 percent of total assets. Banks have encumbered non-tradeable loan portfolios (almost EUR 0.5 trillion) with the ECB, thus most of the remaining unencumbered assets (except for loans) are of high quality. Overall, reserves at the central banks and highly rated sovereign bonds constitute almost half of the liquidity buffers.

17. Multiple cash flow stress tests reveal that banks can withstand significant liquidity outflows under severe scenarios (Figure 17).[15] All banks in the sample comfortably meet LCR and NSFR requirements, with unweighted average LCR close to 190 percent and NSFR at 136 percent. Monthly intra-quarter LCR volatility is low. Volatility of U.S. dollar LCR and U.S. dollar liquidity buffers is high, albeit the system maintains positive U.S. dollar liquidity buffer over the 30-day horizon. Cash flow stress tests show that survival horizons exceed two months for most banks under various stress scenarios. No large bank moves into negative counterbalancing capacity (CBC) in the mild outflows scenario within the first month of stress. The severe outflows scenario, which includes large outflows of deposits, would lead to a negative CBC (i.e., become illiquid) in 10 percent of banks within one month. LCR stress tests reveal (Figure 18) that banks with a significant share of retail funding will be mostly affected by the severe outflows scenario. Overall, G-SIBs and universal banks are the most affected by the stress scenarios; however, these banks still have substantial liquidity buffers. U.S. dollar cash flow test results reveal that several large banks would face a U.S. dollar liquidity gap within the first week of stress, but the gap is small (0.5 percent of total assets). Also, in case of U.S. dollar shortage and/or swap market dysfunction, EA banks would rely on the ECB/FRB swap facility. Subsidiaries of U.S. banking groups could also rely on intragroup funding provided by parent banks.

18. Overall, banks' exposure to contingent liquidity risks has increased since 2020 and requires continued monitoring and analysis. The increase is via several channels, namely a higher share in secured funding, increased use of collateral swaps, and potential margin calls from derivatives. LCR stress tests reveal that the impact of asset fire-sale haircuts on HQLA of banks due to a system-wide liquidity stress in NBFI is not negligible, with the average LCR declining by almost 50 percentage points (while remaining above 100 percent). This analysis focused on haircuts (i.e., price effects only) and not on redistribution of liquidity within the system, and it should be noted that outflows from NBFIs could end up in banks.

C. Solvency-Liquidity Interactions

19. Joint stress testing of solvency and liquidity risk for EA G-SIBs reveals important amplification effects from endogenous liquidity flows, business risk, and CCR.[16] In a two-week market shock scenario, banks could become insolvent due to feedback loops between solvency and liquidity pressures (Figure 19).[17] A "credit sensitive" scenario compounded with "business as usual" dynamics can significantly increase the regions of failure (Figure 20). The amount of liquidity that banks can generate under stress could materially decrease in a "trapped liquidity" scenario. Business risk from client attrition over concerns of business model sustainability could amplify the risk of insolvency (Figure 21). Bank resilience decreases significantly when CCR losses are considered.

[15] These focused on hypothetical liquidity stress scenarios ranging from overnight to a one-year horizon.

[16] The analysis builds on Cont, A., Kotlicki, A., and Valderrama, L. (2020), Liquidity at risk.

[17] Market shocks are based on the expected shortfall at 0.1 percent of risk factors' marginal distributions and are applied to fair value positions. Banks can monetize assets to absorb liquidity shocks by pledging collateral in market / CB repos and can access short-term unsecured funding markets. However, the analysis excludes cash inflows from margin calls on derivatives at negative replacement value.

Reverse stress tests suggest that plausible combinations of market shocks and endogenous liquidity shocks are unlikely to push banks into insolvency in a two-day scenario when CCR losses are excluded. However, default risk increases notably when losses from the unexpected default of banks' three largest, most vulnerable, counterparties are included (Figure 22). When CCR is measured by the projected NBFIs' inability to meet margin calls in their derivatives and SFTs (Section E), the region of failure expands significantly, particularly under high market volatility (Figure 23).[18]

D. Bank Network Analysis

20. The interbank analysis suggests that the risk of contagion through interbank exposures within the EA is currently low (Figure 24). The analysis covers 72 banks within the EA. Under a baseline parameterization,[19] the findings suggest that G-SIBs have the potential to induce high system-wide losses but do not appear vulnerable to shocks originating from within the EA banking system. It also identifies two banks with the potential to amplify spillovers across the EA banking system given their high contagion and vulnerability scores. The top ten hypothetical (exogenous) default events in terms of contagion scores induce on average 1.3 percent of capital losses to the EA banking system with contagion transmitted entirely through credit losses.

E. Systemic Risk from NBFI[20]

CCP Counterparty Credit Risk

21. Analysis of CCR arising from CCPs' reverse repo positions showed that potential losses are modest overall but could be significant relative to CCP's own resources. CCPs use reverse repos to invest cash received from clearing members as margin. These bilateral reverse repo positions are characterized, on average, by lower haircuts on the collateral received than that typically applied by CCPs to cleared transactions (both repo and derivatives). The sample covered both EA and Tier 2 CCPs operating in the EA. Distribution of losses were assessed in a value-at-risk set up, using historical simulations over the past 5 years, to capture market and default conditions[21] over a wide range of conditions, without the need for modeling complex market dependencies. In most cases losses were modest when compared to the total cash investment, but they amounted to up to 120 percent of CCP's own capital exposed to clearing member default losses ("skin-in-the-game"). Losses are concentrated in just a few CCPs, characterized by relatively less skin-in-the-game. Losses from investments are not absorbed via the CCP waterfall,[22] but similar arrangements are typically in place in most cases, with the CCP covering only a pre-determined

[18] CCR losses could be partly mitigated by the initial margin posted by NBFIs.

[19] The baseline analysis is calibrated in line with Covi, Gorpe, and Kok (2021). The analysis quantifies the potential knock-on effects from the hypothetical default of a bank in the EA throughout the network of exposures.

[20] The NBFI analyses were conducted in close collaboration with ESMA.

[21] Time series of probabilities of default were sourced from National University of Singapore, Credit Research Initiative, which was chosen for the better coverage of the counterparties in the data considered for the exercise.

[22] Article 45 Default waterfall | European Securities and Markets Authority.

amount. This suggests that in some cases a significant portion of the estimated potential losses from CCR could be distributed to clearing members.

System-Wide Spillovers from Investment Funds' Liquidity Distress

22. The FSAP conducted a stress test to quantify system-wide spillovers stemming from the investment funds sector. The analysis estimated the impact on core markets and financial institutions from investment funds' liquidity needs stemming from redemption shocks, margin calls on derivatives, and collateral demand on repos; the analysis does not account for a potential policy response. The sample includes around 33,000 funds domiciled in the EA, representing half (90 percent) of assets under management for UCITs (AIFs) in the region. The stress test was conducted based on data for the end of 2024Q2. In addition, the FSAP analysis considered spillovers from the insurance sector to money market funds (MMF) due to margin calls.

23. The stress tests consider two market scenarios, with horizons of two days and two weeks. The steps of the stress tests are illustrated in the first panel chart in Figure 25. The scenarios differ in terms of the size of the liquidity shocks and scope of mitigating actions available to the funds. In the two-day scenario (given two-day settlement), share redemptions and asset sales are excluded, and funds cannot re-employ margins received. In the two-weeks scenario, the market-induced decline in funds' net asset value (NAV) triggers investor redemptions, which were calibrated via a flow/performance analysis. The funds may re-employ margin received to cover liquidity demand through redemptions and collateral calls. The decline in funds' NAV varies between 3 to 23 percent, depending on their strategy and asset composition, with a higher impact observed for equity funds and funds of funds. Redemption rates vary between one and 13 percent of assets under management. Combined liquidity outflows from redemptions, margin and collateral calls amount to EUR 16 billion in the two-day scenario, which is concentrated in bond funds. This is comparable in size to the margin calls faced by EA funds in March 2020 with estimates ranging between EUR 10 and 30 billion.[23] In a two-week scenario, combined liquidity outflows are close to EUR 700 billion, corresponding to an aggregate outflow rate of 4.7 percent of assets under management (AUM), concentrated in equity funds.

24. In the two-day scenario, available liquidity is insufficient to meet aggregate liquidity demand, resulting in a shortfall of up to EUR 9.8 billion. Funds with insufficient liquid buffers, which in this scenario are made of cash and MMF shares, hold EUR 1.6 trillion in AUM, or 11 percent of the sample, concentrated in UCITS Bond funds. Repo borrowing can help overcome such a liquidity shortfall in short time horizons. However, most funds do not engage in repo and operational hurdles may make it difficult to access the market quickly. Importantly, expanding repo borrowing remains contingent on the willingness and ability of counterparties to provide funding[24]—eligible unencumbered collateral (as per the ECB's definition for general collateral)

[23] See ECB (2020), Financial Stability Review, May.

[24] For comparison, the Bank of England's system-wide exploratory scenario exercise found that an additional repo demand of GBP 6 billion would be close to the maximum amount banks would be willing to extend to the NBFI included in the sample, due to counterparty risk considerations.

available to affected entities could cover up to EUR 7 billion. For those funds engaging in repo, currently around 80 percent of the counterparties are located outside of the EA.

25. In the two-week scenario, funds primarily meet liquidity demands by selling assets—disrupting core markets and amplifying the initial shock. Estimated price impacts heavily rely on scenario setting. Price impacts on EA government bonds ranged between 12 and 350 bps, depending on rating and maturity, translating into a yield impact of up to 40 bps. For corporate bonds, price impacts ranged between 45 and 174 bps. The impacts diminish sharply if funds tap into the repo market, avoiding sales in a stressed market. Recent regulation and especially liquidity management tools (LMTs) seek to avoid this effect, but the mitigating impact could not be measured due to lack of data on LMTs' prevalence and extent.

26. Financial institutions are affected via different channels, depending on how investment funds respond to liquidity needs. Funds often hold MMF shares for liquidity purposes and the shares of other investments funds, including ETF, for investment purposes. In this stress test, MMFs face up to EUR 40 billion in redemptions—comparable to recent stress events, such as the dash-for-cash in 2020. In the most severe scenarios, MMFs would first use their cash buffers and then liquidate around EUR 21.5 billion in corporate paper, the majority of which is issued by banks. Margin calls on insurance companies' derivatives portfolios could add further EUR 9 billion in MMF redemptions, bringing the total pressure on the CP market to EUR 26 billion. Under the assumption of waterfall liquidation, most investment funds have sufficient higher ranked assets to avoid selling their shares of other investments funds (for the specific rankings per asset type, please refer to the TN on Systemic Risk Analysis - NBFI). However, when asset sales are assumed on a pro rata basis, investment funds also frequently face redemptions from other investment funds. This leads to up to 0.5 percentage points in additional redemptions, with bond funds hit hardest. Deposits outflows would amount up to EUR 70 billion when funds use cash before starting asset sales, corresponding to a 45 percent runoff rate.[25] The market impact would drive high-quality liquid assets down an additional 80 bps, compounding the decline from the market scenario.

FINANCIAL SECTOR OVERSIGHT

27. The 2025 FSAP focused on supranational aspects of financial sector oversight in the EA, including progress on regulatory reforms. The EU regulatory and supervisory architecture is complex and multilayered (Figure 2). Among other issues, the FSAP conducted a full assessment of the Basel Core Principles for Effective Banking Supervision (BCP). It also assessed the regulatory framework for NBFI and resolution reforms. The FSAP took place in the context of the establishment of an EU-wide anti-money laundering authority and renewed political impetus for capital markets

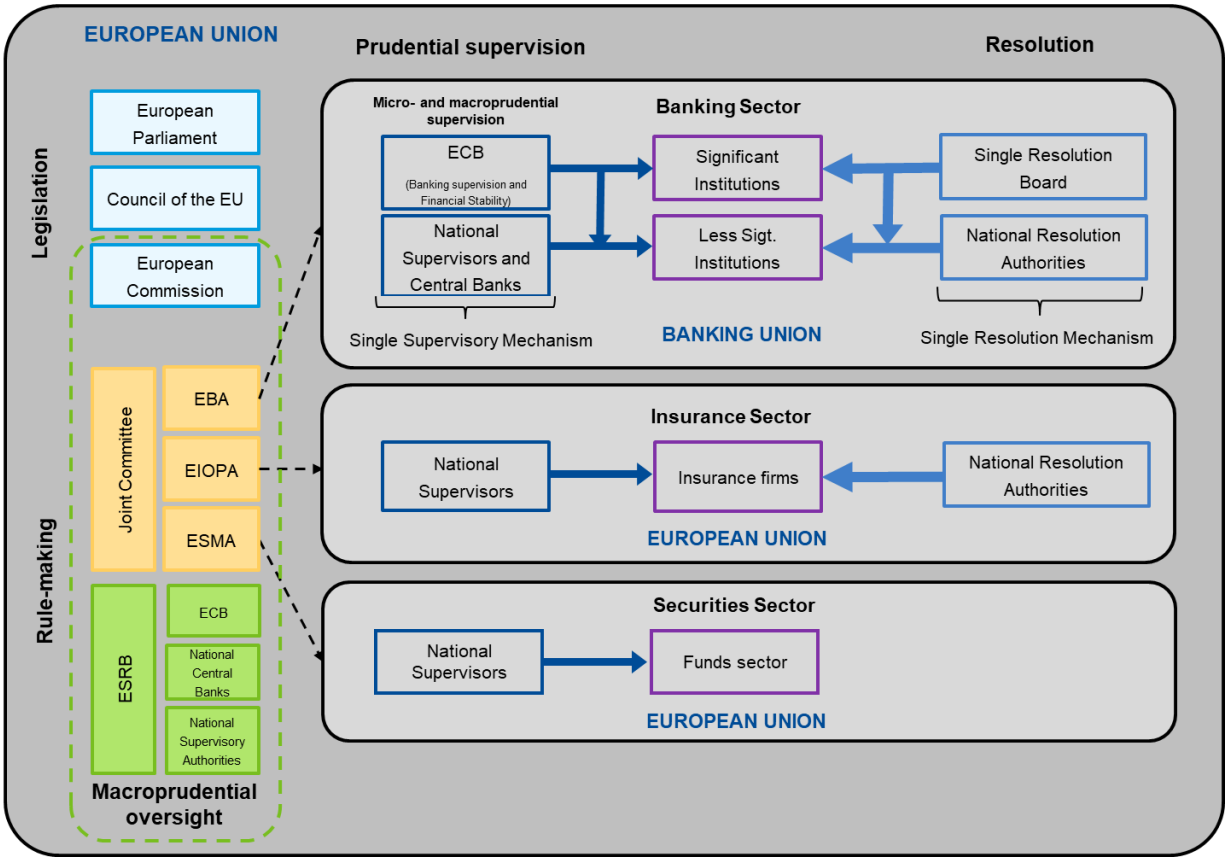
[25] LCR requirements assign 25 percent weight to "operational deposits" and 100 percent to "excess operational deposits" and "non-operational deposits" from financial customers. Should banks assign these exposures to "operational deposits", the LCR would underestimate the potential liquidity outflow.

union. On the other hand, political pressure for paring back regulation is growing and political deadlock to significant reforms to the EA financial safety net continues.

System Wide Oversight

28. The EA has a comprehensive institutional framework for financial sector surveillance and macroprudential policies for banks. The institutional framework works well despite the complexities involved in melding national and supranational collaboration and decision-making. Overall, the authorities work collaboratively both within business areas as well as across different supranational institutions regarding surveillance and policy reforms. National authorities are integrated into surveillance, policy-making, and legislative review processes, and member states' expertise is used in advancing work in new areas as well as for peer-learning.

Figure 2. Euro Area: A Complex and Multilayered Architecture[1]



[1] This representation is a simplification of a complex institutional structure involving national and supranational authorities. For instance, the chairs of EBA, EIOPA, ESMA and a representative of the EC have voting rights at the ESRB General Board.

Source: ECB, ESRB, SRB, EC, and IMF staff.

29. To improve systemwide monitoring, the authorities should enhance data sharing and advance system-wide stress testing. Fragmented reporting from NBFIs hampers effective monitoring of systemic risks in the EA, resulting in an incomplete view of financial stability. Current frameworks use early warning indicators and macroprudential stress testing. However, legal restrictions on data use among national authorities create gaps that must be addressed. The

absence of a reporting framework for UCITS limits oversight, while data quality issues in the AIF framework require attention. Further, data harmonization will support macroprudential fund and system-wide stress tests. Authorities should implement reforms to the Alternative Investment Funds Managers Directive (AIFMD) to establish a unified reporting framework for investment funds and improve data accessibility, with ESMA serving as a data hub for NCAs and EU authorities. Insurance supervisory data collection should also be centralized at EIOPA, which should become the recipient of data from insurers, with NCAs granted access. EIOPA should develop its European Systemic Risk Assessment Framework, which currently lacks a systemic risk score for individual insurers and an outward-looking risk assessment dimension, and publish individual insurer stress test results would provide necessary transparency for risks in the insurance sector. More broadly, the FSAP recommends a more structured approach to systemic risk monitoring across the ESAs, the ESRB and the ECB and further develop system-wide stress testing building on the FSAP approach.

Banks

30. Banking supervision has significantly strengthened since the 2018 FSAP. The ECB, in cooperation with the NCAs, is exclusively responsible for the prudential supervision of credit institutions (banks) established in the participating EU Member States. Together the ECB and the NCAs form the Single Supervisory Mechanism (SSM) which became operational in 2014. The SSM has made significant progress in raising the quality of supervision of SIs and implementing the recommendations of the 2018 BCP assessment. Banking supervision is underpinned by a clear mandate and independence from government or industry interference in individual supervisory decisions. The SSM is a highly capable supervisor supported by excellent risk analysis and a robust skill set in all aspects of supervision. It conducts an intrusive approach to supervision, uses a broad range of tools, and relies on a fully articulated supervisory framework. Supervisory cooperation with third countries has improved. In areas that the SSM makes a priority (e.g., credit risk, liquidity risk, internal models, operational risk and resilience, and climate-related financial risk), it delivers a thorough assessment and has been effective in improving bank risk management. Banking systems, both globally and in the EA, have been exposed to a series of severe shocks and the SSM has been agile in responding to these events. On average, banks in the EA maintain solid capital and liquidity positions, well above regulatory requirements. The SSM is also transparent in its approach to supervising banks.

31. Nonetheless, the SSM continues to face several legal and operational challenges. Like many supervisors, SSM resources are stretched, with pressures in some key areas (e.g., information and communications technology (ICT risk) and internal models). The dependency on NCA staff is both a strength and a vulnerability that affects the planning and delivery of supervisory tasks, with more than half the NCAs being unable to meet their staffing commitments to the SSM. The banking supervision business lines' consultation on the budget seems pro forma and late stage. Moreover, the governance of the SSM is complex and highly centralized, and the SSM must navigate a complex legal framework. The ECB must apply different national laws which may not be fully harmonized where there is no sufficiently detailed common EU-wide legal standard (e.g., in the areas of licensing and fit and proper assessments of banks' managers). This fragmentation can provide opportunities

for regulatory arbitrage and lead to an unlevel playing field, thereby reducing the effectiveness of the SSM. To address these issues, the FSAP recommends further delegating decision-making, improving governance of budgetary processes, ensuring alignment of resources to current and expected future workload, and reducing reliance on national frameworks.

32. Adoption of the EU banking package—the Capital Requirements Regulation 3 (CRR3) and the Capital Requirements Directive 6 (CRD6)—is a positive step, though gaps persist compared to international standards. Although it is not mandatory under the Basel standards, the application of the Basel capital requirements to all EU credit institutions (beyond the scope of internationally active banks) helps strengthen banks' safety and soundness and financial stability and eliminate the potential for regulatory arbitrage between banks. While the final elements of the Basel III reforms have been transposed into EU legislation, earlier deviations from the Basel prudential standards were not rectified (e.g., the Danish compromise as to the non-consolidation of insurance companies, the support factor for small and medium sized enterprises, the limited scope of credit valuation adjustments), new permanent and temporary deviations were introduced in CRR3 (e.g., transitional arrangements combined with a longer phase-in period for the output floor, allowing banks to apply reduced-risk weight for the calculation of the minimum level of capital requirements that banks using internal models must hold based on the standardized floor) and implementation of the fundamental review of the trading book proposals was postponed.[26] While CRD6 will improve the supervision of third-country branches and acquisition of material holdings, several issues persist (e.g., narrow definition of related-party transactions, limited sanctioning powers). There is also a need to remain vigilant that the focus on banks' safety and soundness is not lost in the context of the current debate on the future of the EU economy, where there are some calls (both in in the private and public sectors) for financial regulators to explicitly consider the competitiveness of the EU financial sector in their decision making. Adopting and implementing robust prudential standards should remain the primary focus of financial regulators and gaps with international standards should be addressed.

33. The SSM operates with a strong risk-based approach and efficiency, but there is still potential to further refine and enhance its effectiveness. To ensure a level playing field and consistency in the supervisory assessment, the SSM adopted a highly codified approach to support convergence of supervisory processes. The SSM acknowledges that it needs to adapt and has started to take action to reduce the administrative burden and improve supervisors' agility. Some key initiatives, such as simplifying the supervisory review and evaluation process (SREP), including planning with a multi-year horizon and implementing a risk tolerance framework, are expected to foster risk-based supervision when fully implemented. Other supervisory processes such as those relating to fit and proper assessment and internal models' approval could be further streamlined and made more risk focused. The codified approach generates many findings and, consequently, presents a challenge for effective follow-up remediation. In this regard, the ECB intends to use its escalation policy more actively, including through enforcement actions. Supervision of concentration risk is based on an overall robust process, but further attention should be given to sovereign risk

[26] See Detailed Assessment of Observance with the Basel Core Principles.

concentrations, which are not included in the concentration risk indicators of the SREP and only assessed if deemed relevant by SSM supervisors. Capital add-ons reflecting high sovereign concentration risks have only been imposed in a few instances. Regarding the ECB oversight of LSI supervision, the use of moral suasion vis-a-vis NCAs has been effective in disseminating best supervisory practices for LSIs, but more work is needed to improve supervisory convergence and the consistency of supervisory priorities across member states.

34. The ECB has been a leader in incorporating climate and nature-related financial risks in its supervisory approach. A wide range of initiatives to improve the supervision of climate and nature-related financial risks have been undertaken by the ECB, including climate stress tests, thematic reviews, and firm-specific work (Box 1). The ECB has issued several binding supervisory decisions relating to management and governance of climate risks leading, in some cases, to the potential imposition of periodic penalty payments in cases where banks fail to meet the requirements set out in supervisory decisions. These are commendable efforts, and the ECB should ensure that, in a context of budget stabilization, it maintains sufficient supervisory focus on all aspects and drivers of traditional risk categories—in addition to climate risk.

Box 1. The Supervision of Climate and Nature-Related Financial Risks

The ECB is a leader in incorporating climate and nature-related financial risks in supervision.[1] The ECB has various initiatives to enhance climate-related financial risk supervision, including climate stress tests and thematic reviews. In 2020, it published expectations for credit institutions to manage financial risks related to climate change (Guide on climate-related and environmental (C&E) risks) within their governance and risk management frameworks. This guidance addresses both climate-related financial risks and nature degradation. After a thematic review on C&E risks in 2022, the ECB released three good practice reports on risk management, climate stress testing, and disclosures. It established staggered, institution-specific deadlines by year-end 2024 for institutions to fully integrate these expectations. Supervisors regularly evaluate banks' effectiveness in adopting climate risk governance and risk management framework. The ECB has also issued binding supervisory decisions, including potential penalties for non-compliance.

Specific exercises, such as stress tests and scenario-analyses, inform risk assessments. The 2022 climate stress test contributed to the overall SREP and prompted banks to advance their climate stress testing efforts. The ESAs and the ECB also conducted a "Fit-For-55" climate scenario analysis based on three scenarios from the European Systemic Risk Board.[2] The report emphasized the need for a coordinated policy to finance the green transition and for financial institutions to timely integrate climate risks into their risk management. In its Guide on climate-related and environmental risks, the ECB highlights that environmental factors, such as water stress, biodiversity loss, and resource scarcity, drive financial risk. It is integrating biodiversity loss as a risk component that banks should consider across their business strategy and business model, governance framework, risk tolerance risk management, capital adequacy, and fit-and-proper assessments.

1/ https://www.bankingsupervision.europa.eu/press/speeches/date/2024/html/ssm.sp240906~7691e4e508.en.html. For an overview of ECB activities on nature-related risks, see also FSB (2024), Stocktake on Nature-related Risks: Supervisory and regulatory approaches and perspectives on financial risk.

2/ The EU's Fit-for-55 package is a set of legislative proposals and policy initiatives designed as part of the European Green Deal with the aim of ensuring that EU policies achieve an emissions' reduction of 55 percent by 2030 and climate neutrality by 2050.

35. To strengthen the macroprudential framework for banks, EU legislation should ensure that early activation of countercyclical capital buffers is possible, and procedures for activating macroprudential tools should be streamlined. The set of macroprudential instruments in the EA contains capital tools from the Basel framework, as well as additional EU-specific measures to address systemic risk. Several countries have started to build releasable capital buffers by activating the CCyB early in the cycle. Legal uncertainty concerning the early activation of the CCyB should be removed from the relevant EU legislation to allow for all EU members states to set a positive buffer rate when cyclical systemic risks are not yet elevated. The ECB should ensure that releasable capital buffers are in place and consistently used across EA countries, including by means of its top-up powers if needed. The ESRB should ensure that releasable capital is available by revising its recommendations regarding the use of the CCyB. Activation of the CCyB should avoid procyclical effects. The availability of banks' voluntary capital buffers and bank profitability—both at the aggregate and in terms of its distribution across banks—can guide the activation together with expert judgement. The use of some macroprudential tools (e.g., sectoral systemic risk buffer (SyRB) in the CRD and risk-weight measures in the Art. 458 of the CRR) is unnecessarily complicated, including in part because of complex governance procedures and should be streamlined. There is significant heterogeneity in the implementation of O-SII buffers that address too-big-to-fail risks. The EC should mandate the EBA, in consultation with the ESRB, to harmonize the methodology, while allowing some flexibility to reflect country specificities.

Insurers

36. While EIOPA is assuming a greater role, insurance supervision remains primarily a national responsibility. The EC's retail investment strategy proposal—an initiative aimed at boosting retail participation in EU capital markets—will likely result in increased roles for EIOPA, as will DORA. EIOPA's efforts in supervisory convergence are crucial, but it faces challenges in cross-border insurers, market conduct, and internal model supervision. Difficult cross-border cases have highlighted that EIOPA and the EC lack sufficient authority to protect policyholders when NCAs do not fulfill their obligations. EIOPA should be endowed with emergency powers to take binding decisions when home NCAs are unwilling or unable to act. EIOPA should also be given stronger powers to improve convergence of internal model supervision.

37. Solvency II is a sophisticated, risk-based solvency regime that has helped enhance the resilience of the EA insurance sector. EA insurance groups are generally well capitalized. Solvency capital requirement (SCR) ratios have been stable during the market turmoil in 2020 and as interest rates increased. However, the regime has been the subject of incremental reform alongside the significant Solvency II Review, which was completed in January 2025. The Solvency II review was completed based on the EC's overall aim to increase the insurance sector's investment in the economy to meet EU goals. A substantial increase in insurers' surplus capital over SCR (compared to the original EIOPA advice) will be the result of changes introduced by the EC and European Parliament. While the EC performed impact assessments on its proposal for the Solvency II review, there has been insufficient overall focus on the impact on the calibration of the SCR after these

changes. While there may be multiple objectives for the Solvency II review, prudential policy should be the primary objective, and other objectives should be secondary.

38. EIOPAs resources are stretched and should be augmented. Over the last five years, EIOPA needed to deprioritize some activities to accommodate the heavier workload from regulatory reform. EIOPA has been unable to recruit to meet its existing resource envelope. EIOPA should explore new ways to recruit a full complement of staff and NCA's should ensure seconded positions at EIOPA are filled. EIOPA's budget and staff establishment plan should be reviewed considering the new legislative tasks it has been given. Other funding mechanisms should be explored given budgetary challenges at the NCAs and EIOPA.

Securities Markets

39. The regulatory framework for investment funds is complex, remains fragmented, and requires further reforms to ensure supervisory convergence. Differences in national implementation may lead to regulatory arbitrage and affect the resilience and effectiveness of the prudential framework. Recent amendments to the UCITS and AIF Directives introduce essential requirements for liquidity risk management and reporting, including a new reporting framework for UCITS that will take time to implement (full compliance by end 2027). The regulation of MMFs should also be revised to better align with international good practices.[27] The implementation of compulsory supervisory colleges for large cross-border asset managers, coordinated by ESMA, is recommended.[28] Furthermore, introducing consolidated supervision for these asset managers would allow for a better identification of risk exposures at the level of the group and across jurisdictions.

40. The authorities are considering further measures to mitigate risks arising from NBFI.[29] In this context, the FSAP recommends that ESMA be empowered to top-up national measures—for significantly[30] leveraged investment funds that include the imposition of leverage limits and other measures (including for liquidity) and to enforce cross-border reciprocation.[31] Going forward, the authorities should consider developing additional tools in line with EU authorities' proposals under the EC macroprudential consultation to enhance further the liquidity risk management framework once recent amendments to UCITS and AIFMD have embedded.

[27] To bring the framework more in line with the FSB's Policy Proposals to Enhance MMF Resilience, including to remove the use of amortized accounting for low volatility NAV funds, decouple liquidity thresholds from LMT usage, strengthen liquidity buffers and allow partial release in periods of stress, and increase the frequency of reporting.

[28] Colleges should aim to include third-country supervisors where relevant.

[29] Consultation document - Targeted consultation on assessing the adequacy of macroprudential policies for NBFI.

[30] Investment funds that are more likely to pose risks to the financial system, as determined further to the process established by Article 25 of the AIFMD and the relevant ESMA Guidelines.

[31] This expansion of powers should build on the current framework of Article 25 AIFMD and considered for both AIFs and UCITS.

41. Proposals to deepen capital markets, including through enhanced retail participation as part of a "capital markets union" need to be carefully sequenced.[32] While ESMA's increasing maturity as a supervisor has laid the groundwork for a potential further expansion of its mandate, significant differences in national securities, corporate, pensions, tax and insolvency laws, remain significant impediments to market consolidation. In this context, supervisory reforms would need to be carefully calibrated and sequenced:

- **Strengthening ESMA's powers and governance.** ESMA needs a robust set of powers and supervisory tools to effectively monitor firms under its direct supervision. These should be established through ESMA's founding regulation rather than via sectoral legislation, which at times constrains it to be unduly rule-based, insufficiently agile in responding to emerging risk and less efficient than it could be in utilizing resources. Supervisory powers should ensure that ESMA can use its remediation tools without requiring formal investigations or the imposition of sanctions.[33] Additionally, enhanced governance arrangements are needed to support efficient, independent decision making, e.g., by introducing independent non-executive members to the board or exploring alternative configurations for executive decision making. ESMA's founding regulations should be made consistent with the Principles of Securities Regulation of the International Association of Securities Commissions in the next ESA review.

- **Funding and resources.** ESMA needs a more sustainable funding framework, including for levying fees, to be established in its founding regulation. ESMA will also need funding from the EU budget for preparatory work before it can recoup costs from the industry. These should be set at a proportionate and realistic level to avoid mid-year shocks to either the regulated entities themselves or to the NCAs who pay a share of ESMA's budget.

- **Risk-based supervision.** ESMA has built expertise and effective supervisory frameworks for a range of conduct supervision mandates for credit rating agencies, benchmark administrators and market transparency infrastructures.[34] It has increasingly used the full range of its tools and refined its risk-based approach. It has built respected technical expertise for CCPs and, within the constraints of its EMIR remit, started to apply that in a supervisory context. Going forward, ESMA will need to articulate a risk tolerance to inform the more complex resource allocation choices it would face under an enlarged mandate and set stakeholder expectations.

- **Building supervisory expertise.** Practical arrangements to draw upon highly specialized expertise and institutional knowledge of NCA staff currently supervising the relevant entities will be critical. Appropriate co-ordination arrangements with NCAs, the ECB and the SSM and with national resolution authorities will also be needed. To minimize the risk of disruption to the authorities and market participants, prudent transition periods will be required. Given internal

[32] The EC reframed capital markets union within a broader savings and investments union in March 2025.

[33] Including powers to require a firm to: (i) appoint an external skilled person to assess and report to the authority; (ii) take, or desist from taking, a specified action; and (iii) replace a member of the board or management body.

[34] Trade repositories, and data reporting service providers.

market passporting, minimum supervisory capabilities also need to be maintained across the EA for those entities that continue to be supervised at the national level.

- **Investor protection.** The supervisory focus on investor protection should be enhanced as retail access to markets grows, so that investors continue to trust that their assets are appropriately safeguarded and segregated such that they are not lost to fraud, operational failure or insolvency across the EA. Consideration should also be given to revisiting the Investor Compensation Scheme Directive to ensure it remains adequate.

Payment Systems

42. The resources and governance arrangements for the oversight of Target Services should be strengthened. TARGET Services is a systemically important FMI in the EA that went live in March 2023, by consolidating three major FMIs for real time gross settlement, securities settlement and instant payments. The ECB's oversight of TARGET Services was reviewed against the five responsibilities for authorities in the Principles of FMIs.[35] The FSAP also examined the ECB's oversight via a focused analysis of the implementation of select recommendations of an independent review launched by the ECB, following several major incidents in 2020.[36] The FSAP recommends that the ECB augments its small team for the oversight of TARGET Services, reflecting the complexity and systemic importance of TARGET Services. Changes to address potential conflicts of interest related to the Eurosystem's dual role as operator and overseer of TARGET Services are also recommended, by separating the operator and oversight functions into separate directorates. Additionally, the ECB oversight team should further use forward-looking interventions to help anticipate emerging risks before they materialize, as well as ensure that the TARGET Services operators address oversight findings on a timely basis.

Cyber Resilience

43. The FSAP reviewed cyber risk supervision and operational resilience of SIs and systemic FMIs within the ECB's remit in the EA. The banking sector's reliance on interconnected ICT systems makes cyber risk a significant operational risk with systemic implications. Discussions included recent cyber threat evolution, SIs' preparedness, lessons from the 2024 cyber resilience stress test, and DORA's impact on supervision. While global cyber risk is rising, the EA banking sector's overall risk level has remained stable since 2023. However, ICT security, outsourcing, and change risks showed worsening trends, attributed to more frequent cybersecurity incidents, increased cloud service reliance, and critical ICT projects. Supervisory focus will now shift to cyber resilience reviews, outsourcing arrangements, and cloud computing expectations.

44. The FSAP makes several recommendations to address DORA related resource

[35] Regulation, supervision, and oversight of FMIs; regulatory, supervisory, and oversight powers and resources; disclosure of policies; application of the principles for FMIs; and cooperation with other authorities.

[36] These were on TARGET2 (a forerunner system). A major incident on February 27, 2025, toward the end of the second FSAP visit, was not discussed with the authorities.

constraints, and process improvements. DORA, applicable since January 2025, is expected to improve the stability and reliability of the EA financial sector by strengthening cyber resilience. ICT and cyber security expectations previously set out in guidance issued by ESAs are now strengthened and legally binding requirements. In addition, critical third-party providers (yet to be designated) have been brought under an oversight framework to ensure that financial entities' reliance on external service providers does not compromise their operational resilience. DORA has significant resource implications for both supervised entities and supervisory authorities. The ESAs and the ECB are hiring significant additional specialists to discharge their DORA responsibilities. The FSAP recommends that the regulatory framework is reviewed for any gaps in the ability to fine non-cooperating CTPPs, particularly for non-compliance with the ESAs' recommendations made under the DORA oversight framework. The full operationalization of the pan-European systemic cyber incident coordination framework should be accelerated. An EU-wide centralized cyber incident reporting technical infrastructure should be implemented. Cyber risk expert capacity should be increased in FMI oversight and on-site inspections should be conducted regularly. Institutions' internal audit or external audit should be leveraged more for follow-up work. Internal standards on documenting bank supervision activities should be strengthened e.g., using common templates across all on-site teams, and a single filing and archiving tree structure in the supporting applications.

Financial Integrity

45. The EA is transitioning from domestic to EU-wide AML/CFT supervision as recommended in the 2018 FSAP. This aims to enhance the integrity of the financial sector and curb financial abuse, marking a highly positive development since the 2018 FSAP. Two key developments underpin this transition—the AML/CFT Regulation, which harmonizes rules for obliged entities which will apply from July 2027[37], and the creation of AMLA, which will begin operations later in 2025 (Appendix III). Harmonizing AML/CFT supervision will help address well-documented challenges currently faced with fragmented, national approaches, including:

- Gaps in understanding domestic, regional, and cross-border ML/TF risks,[38] compounded by inconsistent data collection, varying quality levels of national risk assessments, and a lack of collection and reporting of ML/TF statistics at the regional level; and

- Challenges in cross-border cooperation among AML/CFT and prudential NCAs, weak cooperation mechanisms and inconsistent enforcement actions, including with third country supervisors of entities operating in member states.

46. AMLA should develop holistic methodologies for identifying the entities for direct risk-based supervision and enhance data sharing arrangements. The methodologies for

[37] Obliged entities include crypto-asset service providers; crowdfunding platforms; mortgage credit intermediaries and consumer credit providers that are not financial institutions. AML/CFT rules previously were in directives that allowed some leeway in national transposition and led to divergences and potential regulatory arbitrage.

[38] E.g., illicit proceeds to and from third countries substantial enough to constitute a material ML threat.

selecting entities for direct and risk-based supervision should encompass national, cross-border, and sectoral risks. Given high cross-border activity and increasingly complex financial crimes, AMLA should prioritize their understanding of ML/TF risks and adopt a flexible approach to account for diverging national and sectoral risks. AMLA will need to build operational capacity and expertise to leverage agile, data-driven and advanced technologies, particularly in less mature supervision areas (e.g., NBFI and crypto assets), while fostering cooperation with domestic and international counterparts, as well as the private sector. Enhancing AML/CFT colleges, improving information exchange, and increasing coordinated actions across member state and third-country authorities are critical. AMLA should establish better information sharing arrangements and involve financial stability experts in cases of egregious AML/CFT violations. In the transition to a new AML/CFT database,[39] AMLA should ensure that access remains prompt while strictly limiting circumstances in which justified supervisory requests are denied, supported by an effective system of incentives for timely, comprehensive and accurate data submission and an adequate enforcement framework in case of non-compliance.

FINANCIAL SAFETY NET AND SYSTEMIC LIQUIDITY

Banks and Insurers

47. While operational preparedness for crisis management has improved since the 2018 FSAP, significant gaps remain. The SRB has improved cooperation with the SSM, with national and third-country authorities, and with other financial sector participants, and developed detailed crisis contingency plans. The build-up of loss absorbing capacity in EA banks is a major achievement and provides significant protection against losses to taxpayers. Additionally, the SRF has reached its target level. Work to address concerns about third-country securities law issues in bail-in in coordination with third-country authorities remains a high priority. However remaining gaps in the framework prevent the creation of a more unified crisis management regime better equipped to manage the rapid failure of a large bank or G-SIB.

48. More flexibility is needed on access to the SRF in a systemic crisis. Unlike in other jurisdictions, where greater flexibility is afforded to resolution authorities to resolve systemic banks, the unified banking union resolution regime is more constrained in some respects than national tools, especially in access to resolution funding and loss sharing.[40] These constraints drive continued reliance on national options (national insolvency, voluntary industry support, state support) which de facto provide flexibility in the system. Since the introduction of the banking union many problem banks have been handled through these approaches rather than through the SRM, contributing to ongoing market fragmentation. The FSAP recommends (as in the 2018 FSAP) that a financial stability exemption to the overly restrictive rules on access to the SRF should be introduced, and the European Stability Mechanism (ESM) backstop ratified**.** The governance and decision-making arrangements for resolution, including for the use of SRF and the ESM backstop, are complex and,

[39] The EBA's database has been instrumental for enhancing information sharing and should be built upon by AMLA.

[40] See the accompanying Technical Note on the Financial Sector Safety Net for a more detailed discussion.

despite operational testing of the process, rely on rapidly reaching a high degree of consensus between national and EA authorities and should also be streamlined.

49. Progress on a common EA-wide system of deposit insurance—a key plank of the banking union—remains stalled even as the disparity in risks across member state banking systems has greatly reduced.[41] Authorities should take advantage of political support for the savings and investment union, and European economic integration more generally, to restore momentum. A common industry-funded system including pooled loss-sharing would be better able to deal with medium or large bank failures, be a better source of resolution financing, and reduce the risk of national authorities being unable to finance a deposit payout. The minimum funding targets for national deposit guarantee schemes should be increased, especially if reliance on national solutions remains prevalent and in the continuing absence of a European deposit insurance scheme. Stronger backstop liquidity arrangements for deposit guarantee schemes are also needed in many member states.

50. Arrangements for banks' access to liquidity in resolution need urgent progress. The U.S. and Swiss bank failures in 2023 vividly illustrated the rapid and extensive liquidity support that may be needed. The resolution of a large EA bank, especially in a fast-burn liquidity crisis, would be quite likely to require more liquidity than the funds available through the SRF and the ESM backstop (once ratified). The SRB, the Eurosystem, and the EC should urgently put in place arrangements for the SRF to be able to provide guarantees to enhance a bank under resolution's ability to access central bank liquidity (including in amounts exceeding the size of the SRF and ESM backstop), subject to adequate safeguards to protect central bank balance sheets. These should include, if possible, an EU fiscal backstop.

51. Finalization of the Insurance Recovery and Resolution Directive is a welcome development that should be buttressed by minimum harmonization for insurance guarantee schemes. Establishing a minimum common framework for insurance guarantee schemes would significantly enhance the protection of policyholders and foster greater trust in the single market. There should be a temporary pause on further insurance-related regulatory reform to allow ongoing reforms and the harmonization of insurance guarantee schemes to be implemented.

Systemic Liquidity

52. Balance sheet normalization has progressed smoothly, and core funding markets are functioning well. All targeted longer-term refinancing operations have been repaid, and the ECB balance sheet is expected to take about three years to reach "steady state." The ECB maintains a demand-driven operational framework, supplying reserves inelastically through its main refinancing operation, with the spread to the deposit facility reduced to 15bps. Core funding markets function well, despite some volatility in the secured market due to quarter-end window dressing (which is being addressed) and collateral availability. An estimated EUR 4.7 trillion of eligible collateral is held

[41] For example, the 95th percentile of national NPL ratios in the EU, as reported by the EBA, has fallen from 20.3 percent in Q4 2018 to 4.4 percent in Q4 2024.

by counterparts, of which EUR 1.5 trillion is mobilized with the ECB, compared to a peak of EUR 2.2 trillion during the crisis. A demand-driven operational framework, combined with broad collateral eligibility (justified by the fragmented EA financial sector), necessitates continuing close monitoring. The ECB's banking supervision collaborates with monetary policy for information exchange and proactive case signaling. Efforts are underway to extend this framework to NCAs for institutions not under direct ECB supervision. The ECB's risk management includes horizon scanning and early warning indicators based on market data and liquidity monitoring. Additionally, it supports U.S. dollar funding markets through a weekly standing facility and maintains confidence in its U.S. dollar supply via a network of swap lines with four major central banks.

53. The Transmission Protection Instrument provides a framework for ECB system-wide interventions. Programs aimed at monetary accommodation after the euro area sovereign debt crisis (in the absence of an explicit financial stability mandate) were enhanced and sometimes modified while new ones were introduced during COVID-19, also to address transmission problems, primarily targeting sovereign bonds but allowing purchases in any relevant market segment. The ECB's principle of proportionality guides these interventions, considering criteria such as effectiveness, efficiency, and potential side effects like moral hazard and balance sheet risks. However, the ECB is limited to dealing with credit institutions, which may hinder its response to crises involving NBFIs, where banks may hesitate to provide liquidity or the ECB may be reluctant to acquire certain assets. Therefore, the ECB should establish conditions for temporarily expanding the counterparty framework during crises while identifying constraints to such expansion.

54. The FSAP reiterates the 2018 recommendation to centralize emergency liquidity assistance (ELA) at the ECB. Noting the need for a Treaty amendment, centralizing ELA at the ECB would align with its role as the direct supervisor for all SIs, enhance policy consistency within the banking union and financial integration, improve coordination for cross-border support, reduce the sovereign-bank nexus (as risks are shared), and minimize interference with other Eurosystem tasks.

55. Steps should also be taken to support ELA provision to systemically important NBFIs. Further steps are needed to extend ELA to systemically important NBFIs. Although two CCPs are banks with access to standard ECB operations and recent modifications have improved access to overnight liquidity for eligible CCPs, significant constraints exist for broader ELA provision to the NBFIs due to legal and regulatory hurdles faced by ten NCBs. To address growing activity outside the banking sector, these constraints should be resolved, and operational capacity developed to mitigate the risk of liquidity stress in NBFIs, ensuring ELA availability is paired with robust oversight, enhanced monitoring, transparency and clear communication to contain moral hazard.

AUTHORITIES' VIEWS

56. The authorities appreciated the comprehensive and constructive nature of the FSAP, welcomed the exchange of views, and valued the FSAP team's insights into financial system resilience. They noted the team's insights and discussions of policy responses were valuable and broadly aligned with their own assessment of risks and vulnerabilities. They concurred that the use

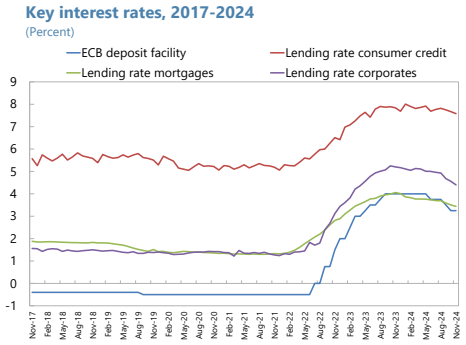
of multiple scenarios in bank stress testing allowed for a more thorough assessment of risks and vulnerabilities. However, they also recognized the institutional constraints that limit the feasibility of conducting such exercises. Regarding the system-wide liquidity stress test, they emphasized the ongoing efforts and methodological enhancements aimed at capturing interactions and spillovers between banks and non-banks, as well as the impact on core markets. They also agreed on the need to strengthen efforts to assess systemic risks and vulnerabilities across the entire financial system, focusing on cross-sectoral and cross-border risks. They broadly supported the team's concerns with data gaps, access, and sharing while noting the legal challenges for cross border sharing at the national level.

57. The authorities welcomed the assessment of the regulatory and supervisory framework, including recognition of significant progress since the last FSAP, but had different views on the materiality of some findings. The authorities generally welcomed recommendations regarding supervisory processes and methods. They also welcomed the positive assessment of the SSM's supervisory performance in the risk areas for which the revised Basel Core Principles raised the bar, including climate-related financial risks and nature risks, business model sustainability and operational risk and resilience, also demonstrated in the recent turbulences. However, they noted that the methodology did not fully capture the impact of the Banking Package published in June 2024. They also highlighted that while some divergence from international standards exists, the application of the Basel capital requirements to all EU credit institutions helps strengthen banks' safety and soundness and financial stability and eliminates the potential for regulatory arbitrage between banks. In addition, they noted that most deviations are temporary, and they should be placed in the context of the overall EU regulatory framework for banks and of the delays in other jurisdictions as regards Basel III. The authorities also discussed the timing and relevance of some recommendations, which would involve changes in the EU legal framework. Authorities welcomed the assessment of the insurance supervisory framework, including the overall view that Solvency II is a well-functioning prudential framework, while noting they have a different view of the impact of changes introduced into the Solvency II Review. One authority stressed the importance of implementing a minimum harmonization framework for insurance guarantee schemes across member states.

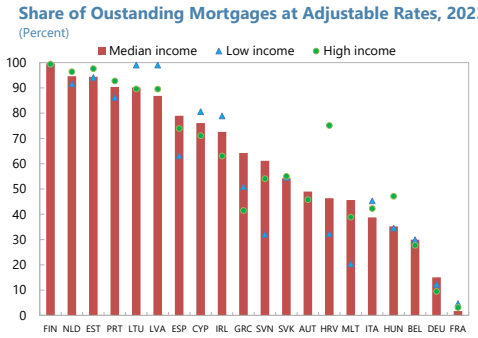
58. The authorities agreed on the importance of completing the banking and capital markets union and stressed the need to take sequential steps. The authorities highlighted the importance of the IMF support in the FSAP for the ongoing reforms in the Crisis Management and Deposit Insurance (CMDI) framework. They generally noted that a future European deposit insurance system (EDIS) should build on the recent developments in the single market for banking and aim to strengthen financial stability, while acknowledging that political challenges remain. The authorities agreed on the need to further address the issue of liquidity in resolution, with adequate safeguards. Finally, the authorities welcomed the assessment of the progress in the capital markets union and were overall supportive of the recommendations to ensure that the regulatory and supervisory framework adapts to the needs of deeper and more integrated capital markets, as envisaged under the savings and investment union initiative.

Figure 3. Euro Area: Macrofinancial Conditions

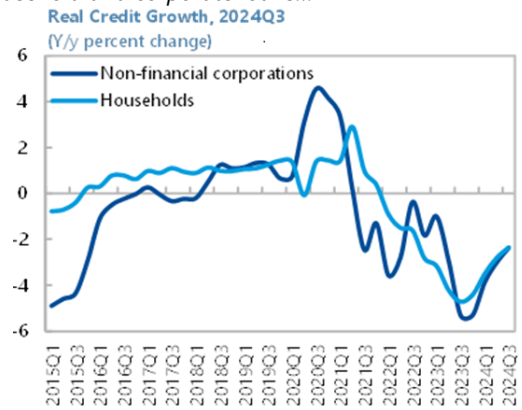
The steep rise in ECB policy rates that started in mid-2022 has sharply tightened financial conditions…



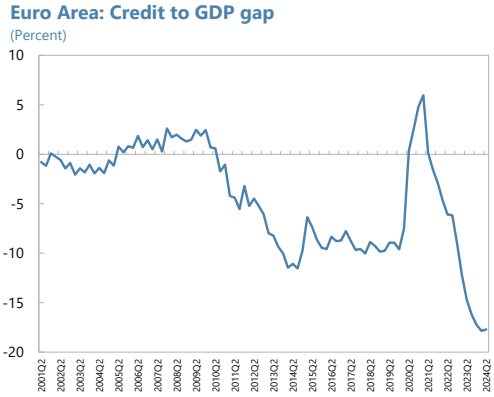
…increasing debt servicing payments for new borrowers and outstanding borrowers with adjustable-rate loans.



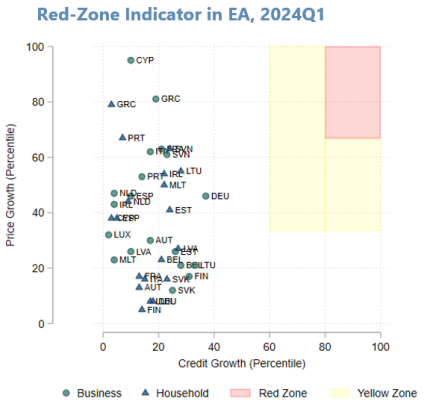
Real credit growth has posted negative rates for both household and corporate loans…



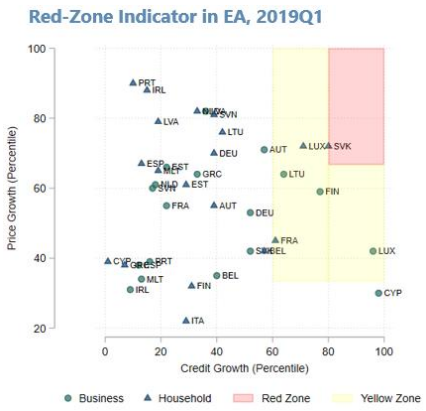
…triggering a significant widening of the negative credit-to-GDP gap…



…signaling a decrease in financial exuberance…



…relative to pre-COVID levels.



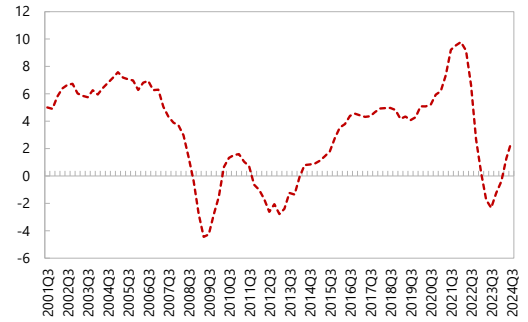
Sources: ECB; Haver; OECD; 2023 Household and Financial Consumption Survey (HFCS); Greenwood et al. 2022, Hennig et al. 2023, and IMF staff calculations.

The top right panel shows the share of adjustable mortgages on the household's main residence, i.e., for which the interest rate can vary during the life of the contract. The bottom panels show the credit and asset price growth percentiles for the EA economies (2019:Q1 and 2024:Q1). The x-axis is the three-year change in (business or household) credit-to-GDP ratio and the y-axis is the three-year real (equity or house) price growth in percentiles. A country is defined to be in the "Red-Zone" if the three-year change in the (business or household) credit-to-GDP ratio is above 80th percentile and the three-year change in the log (equity or house) price to is above 66.7th percentile. Percentiles are computed at the income group level (advanced economies) over the sample period 1995–2024.

Figure 4. Euro Area: The Real Estate Market

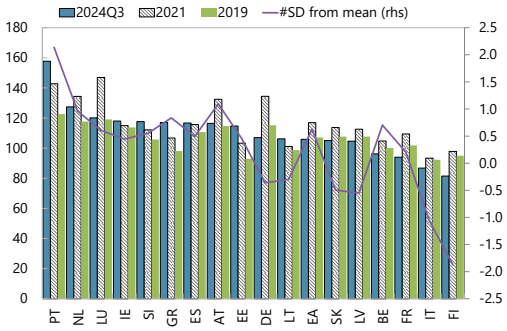
Despite some correction in housing prices…

Property Transaction Values in the housing market in the euro area
(Percent; Year-on-Year)



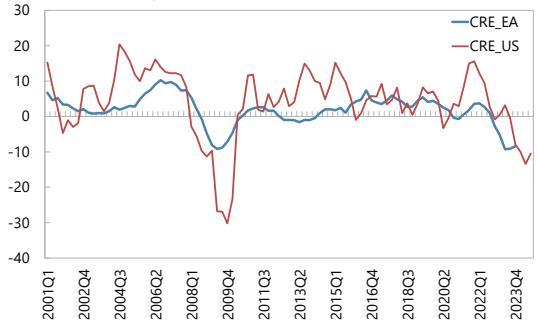
…housing affordability remains a concern in Europe, weighing on households' ability to service their debt.

Price-to-Income in the euro area
(Index; 2015=100; number of SD from mean)



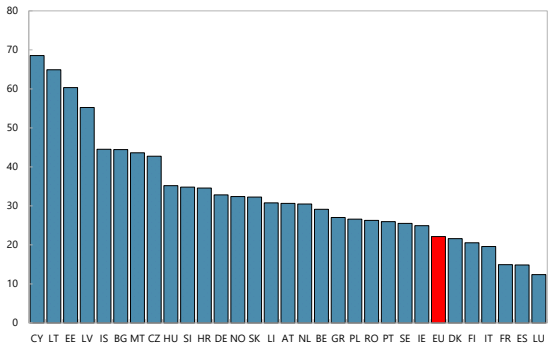
Monetary tightening and structural changes have triggered a turnaround in the CRE segment in the EA and the United States…

Property Transaction Values in CRE in EA and US
(Percent; Year-on-Year)



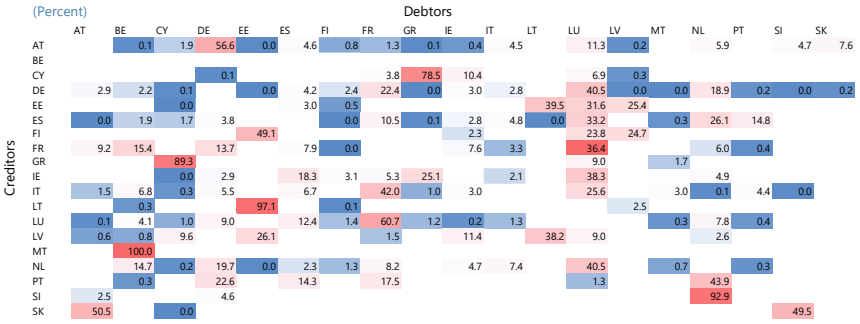
…which accounts for over 20 percent of corporate loans in the EU, doubling that share in eight countries.

CRE Loans, December 2023
(Percent of corporate loans)



The CRE segment is characterized by significant cross-border linkages, particularly to Cyprus, Finland, France, Germany, Luxembourg, and Netherlands, amplifying potential spillovers from a sudden CRE price correction in these debtor countries across the EA.

Commercial Real Estate, Share of Cross-Border Exposures
(Percent)

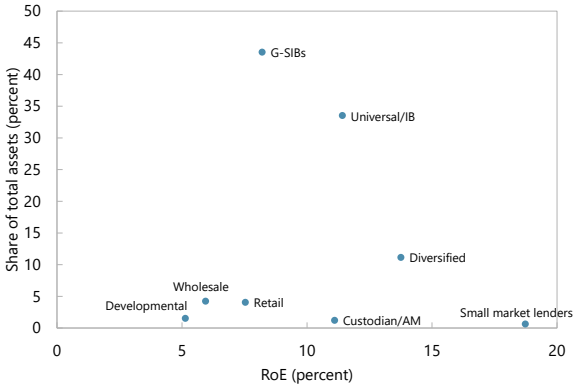


Sources: OECD; ECB; FRB; ESRB based on AnaCredit; EBA; and IMF staff calculations.
Note: The top-right panel shows loans at amortized cost by banks reporting to the EBA.
The bottom panel shows creditor countries in rows and debtor countries in columns, as of March 2024 (except FR, Sep 2023). The chart shows the breakdown of cross-border exposures to EA destinations. For instance, AT is heavily exposed to DE (accounting for over half of its cross-border exposures). This means that a negative development in DE could affect AT banks.
The share of CRE loans in banks' assets varies across countries, ranging between 18 percent in Estonia to 3 percent in Spain, France, Luxembourg and Ireland. On average CRE accounts for 5 percent of total assets in EU as of end-2024.

Figure 5. Euro Area: A Diverse Risk Profile of Significant Institutions

Profitability varies widely across business models, with G-SIBs posting lower RoE than diversified banks…

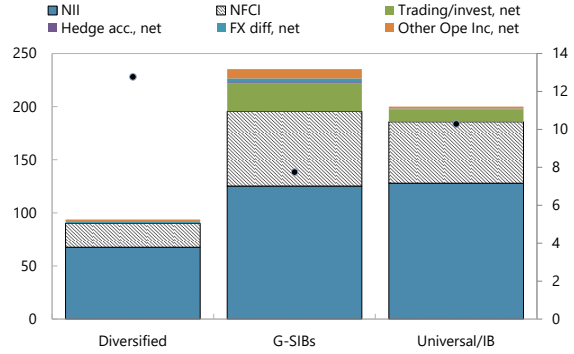
Size and profitability by business model, 2024Q2



…and showing higher reliance on fees and commissions and trading revenue income.

Sources of Profitability by Business Model, Dec 2023

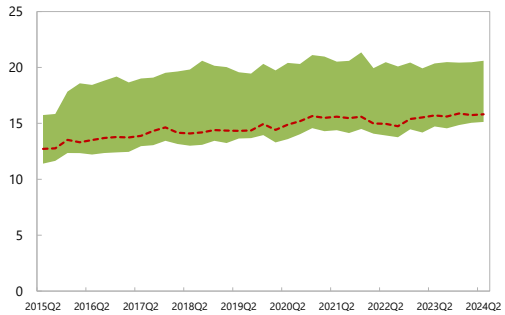
(Billion euros, percent)



Banks' capital position has strengthened gradually with larger banks displaying lower capital ratios…

CET1 Ratio Distribution

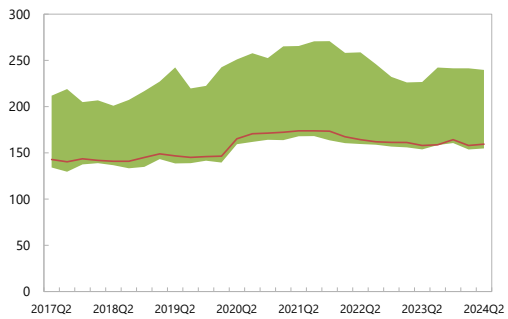
(Percent)



…while liquidity ratios have remained robust after peaking before the start of the tightening cycle.

LCR Ratio Distribution

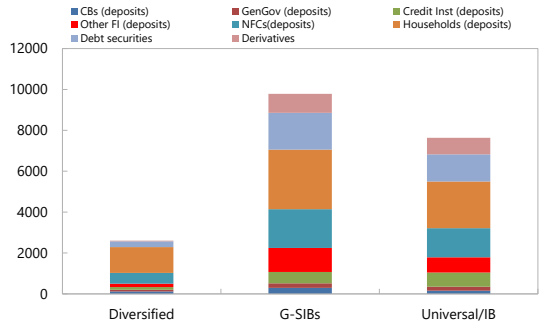
(Percent)



G-SIBs and universal/IBs are more exposed to liquidity risks in NBFIs and derivative markets than diversified lenders.

Liability structure by Business Model, 2023

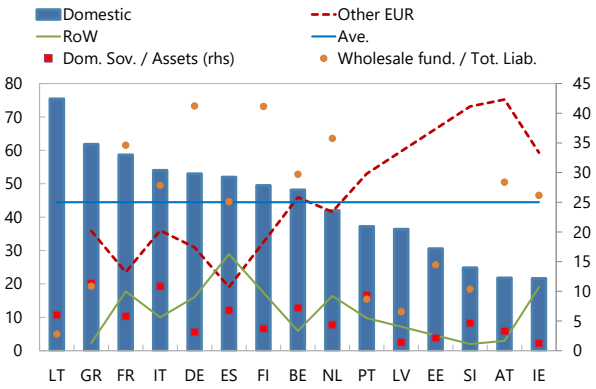
(Billion euros)



EA banks exhibit significant "home bias" in their government exposures; some of which are also highly exposed in terms of total assets.

General Government Exposure by Geography, 2024Q2

(Percent)

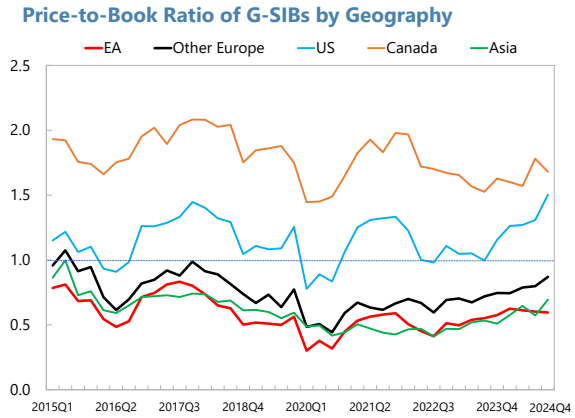


Sources: ECB; IMF staff calculations.

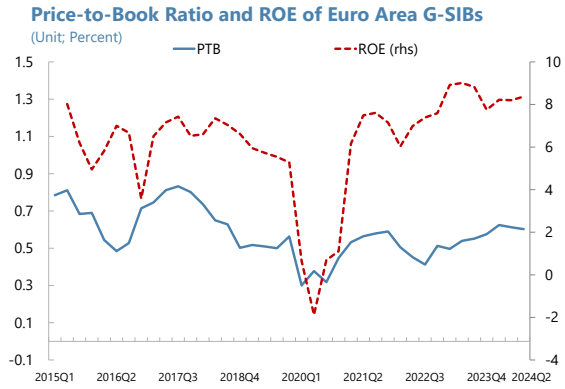
Note: The business model classification follows the ECB/SSM categories, which allow for peer group comparisons and analysis. For instance, "diversified lenders" have a balanced exposure to the retail and wholesale sector, while "universal and investment banks" engage in both lending and non-lending business like insurance, asset management, or trading activities. "G-SIBs" stand out due to their size and international focus. While some G-SIBs are focused on lending business, others are universal banks with more investment activities, in particular, trading business.

Figure 6. Euro Area: Bank Market Values and Performance of SIs vs. LSIs

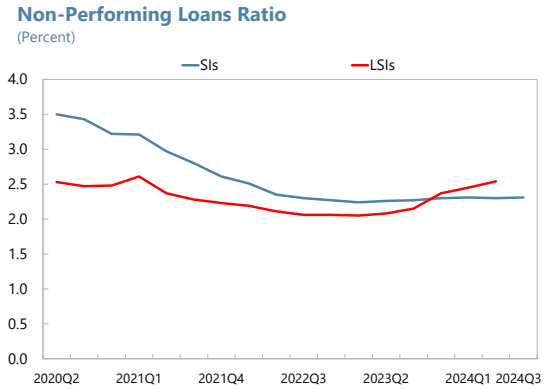
Bank market values for EA G-SIBs remain below book values and lower than those for peer banks…



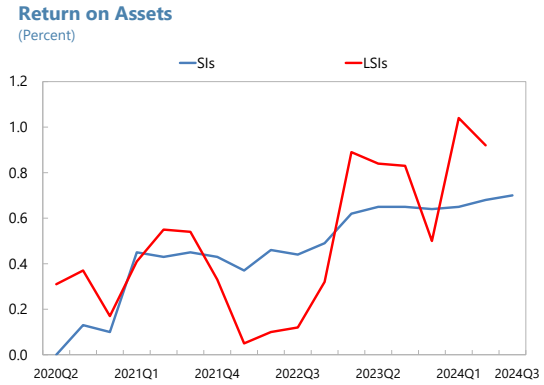
…despite their recent increase, supported by higher profits.



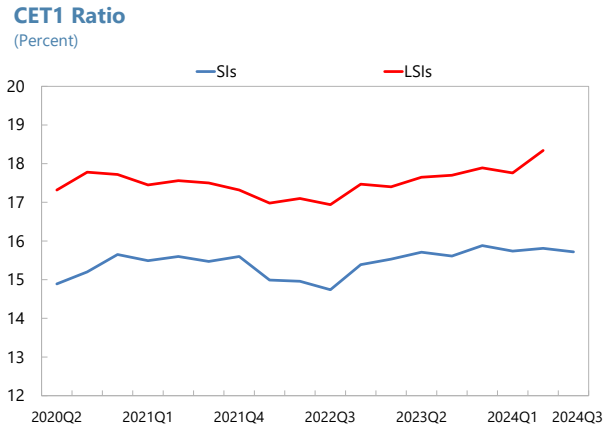
Asset quality remains comparable for SIs and LSIs…



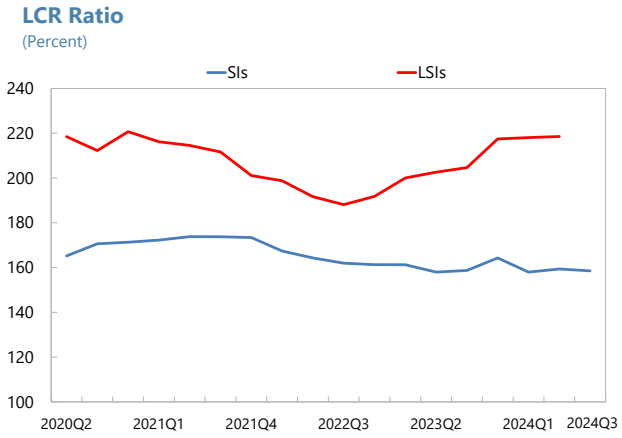
…while profitability is higher for LSIs.



LSIs post higher capital ratios than SIs…



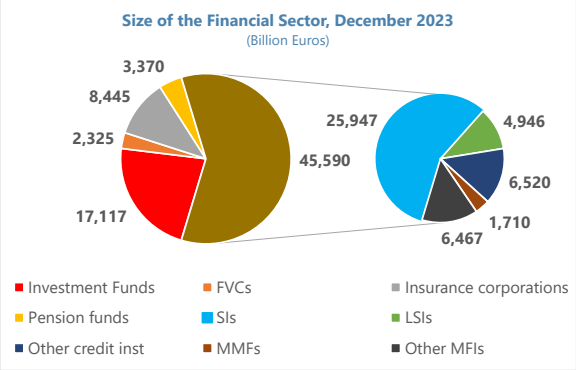
…and higher liquidity buffers.



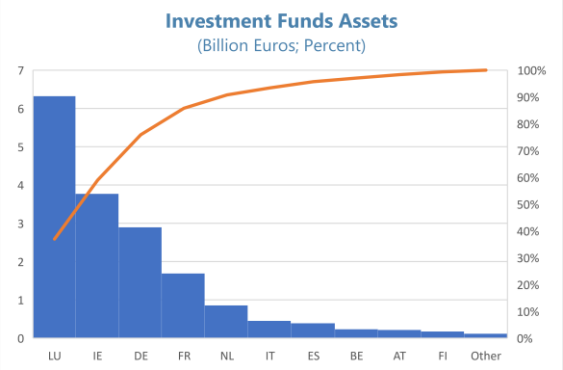
Sources: Bloomberg; ECB; IMF staff calculations.
Note: The top-left chart shows the average price-to-book ratio of the latest 29 G-SIBs (as of November 2024) grouped by geography. NPLs are computed excluding central bank balances. The CET1 ratio is based on the transitional definition of capital.

Figure 7. Euro Area: An Interconnected Investment Fund Sector

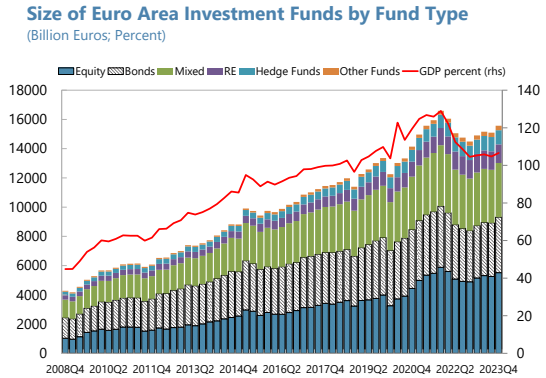
The IF sector accounts for over one-fifth of total financial system assets at 120 percent of EA GDP.



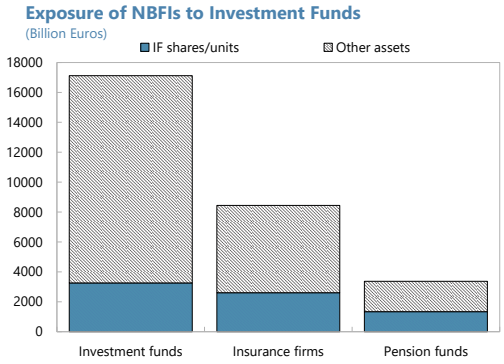
The sector is highly concentrated with LU, IE, DE, FR, and NL, accounting for 90 percent of assets.



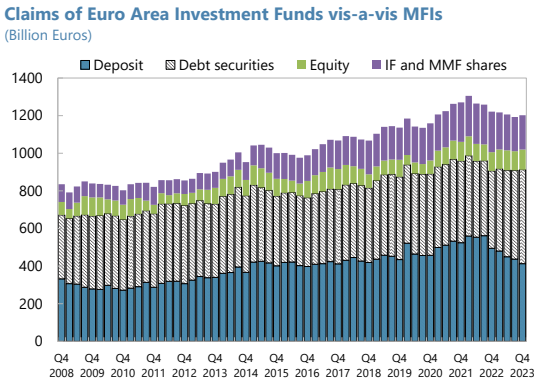
The IF sector tripled since the global financial crisis despite some valuation adjustments over the last two years.



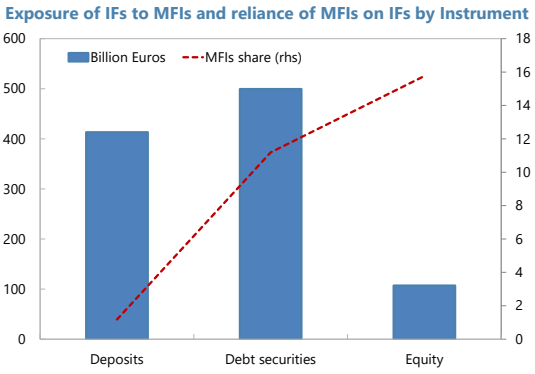
The IF sector exhibits significant intra-sectoral exposures as well as cross-sectoral exposures to insurers and pension funds.



IF exposure to MFIs takes mainly the form of deposits and debt securities…



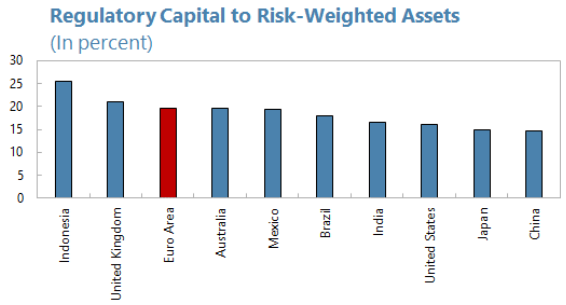
…but MFIs reliance on IF is highest through the equity channel, exposing banks to market valuation risks.



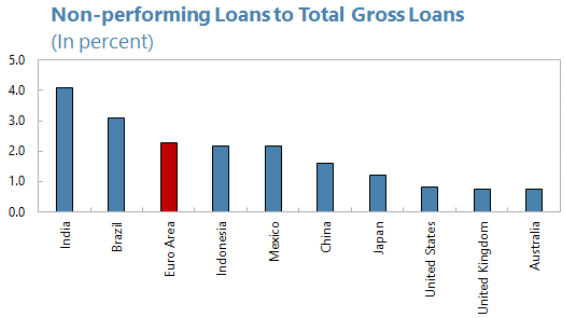
Sources: ECB; IMF staff calculations.
Note: The Investment Fund's figures exclude money market funds. The bottom right chart shows equity holdings held by investment funds in monetary financial institutions (MFIs) as a share of MFI's quoted shares.

Figure 8. Euro Area: FSIs of EA Banks in an International Perspective

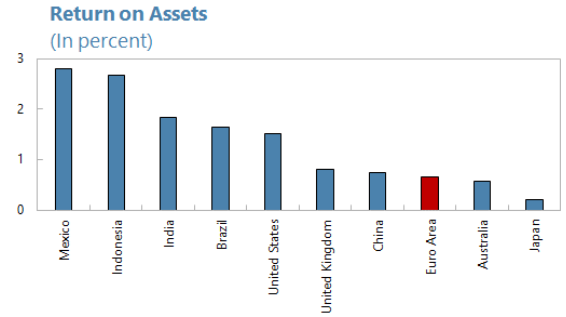
Bank solvency in the euro area remains healthy…



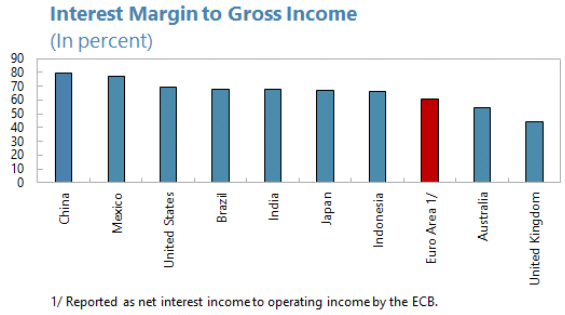
…supported by low NPL ratios.



European banks lag some of their peers in profitability…

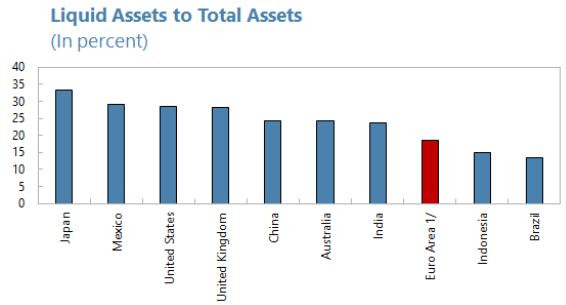


…and rely on interest income to a lower extent than most peer banks.



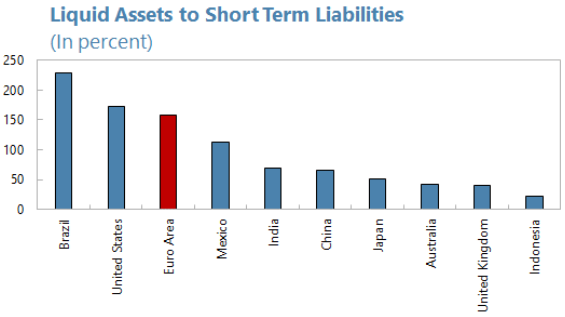
1/ Reported as net interest income to operating income by the ECB.

While the share of liquid assets in total assets is lower than in other advanced economies…



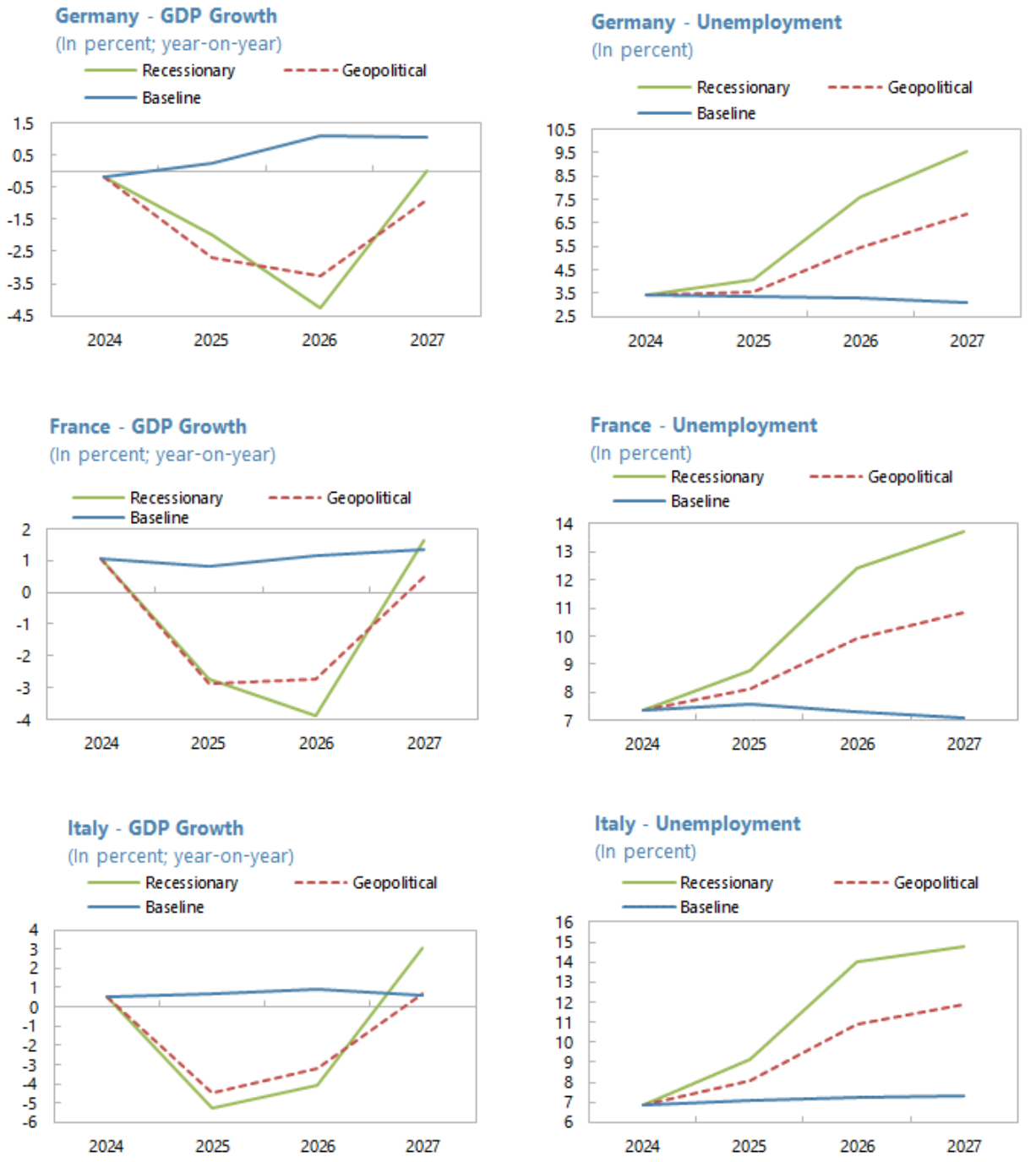
1/ Uses liquidity buffer in ECB Banking Supervisory Statistics report as the numerator, and total assets as denominator.

…it exceeds 150 percent of short-term liabilities.



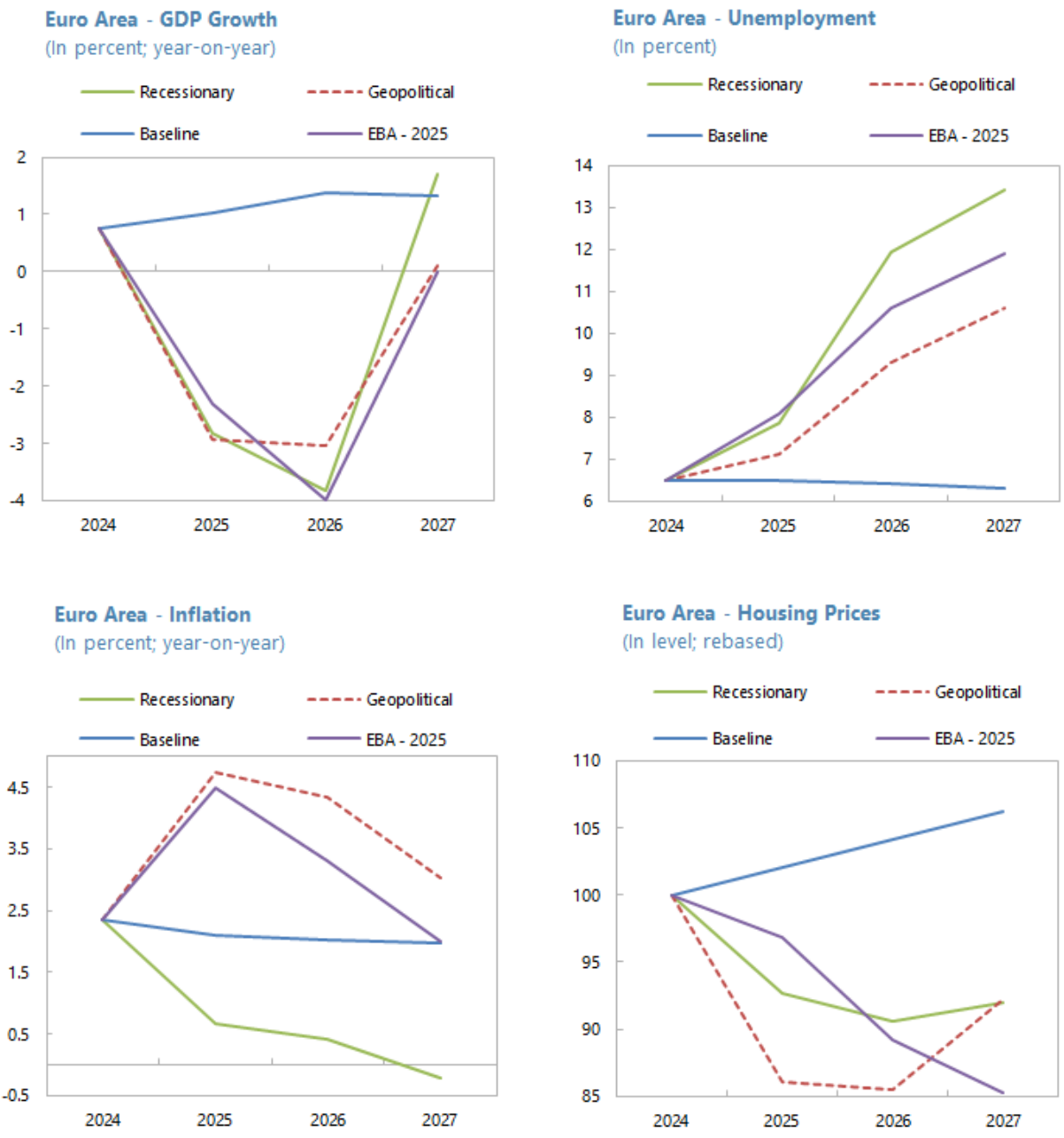
Sources: IMF's Financial Stability Indicators database, Haver, and ECB's Banking Supervisory Statistics database.
Note: Shows latest available data for each country. Data for the United Kingdom and India is as of 2023:Q2; data for Australia and Japan is as of 2023:Q1. For all other countries, data is as of 2023:Q3. There are two exceptions: charts 4 and 5 for China and chart 4 for Australia both show 2022:Q4 data due to data gaps.

Figure 9. Euro Area: Projected GDP Growth and Unemployment Rates in Major Countries



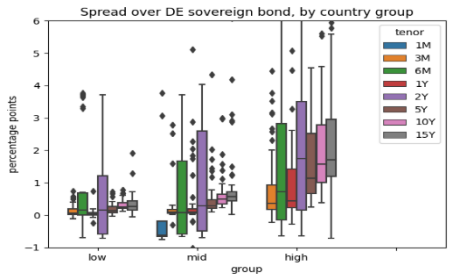
Sources: EBA, IMF, and IMF staff calculations. Baseline projections are based on January 2025 WEO.

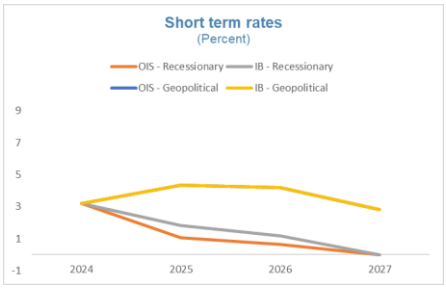
Figure 10. Euro Area: Projected Core Variables in the Euro Area

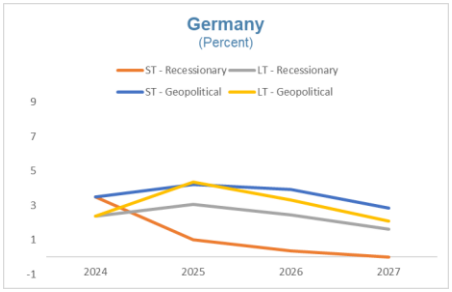


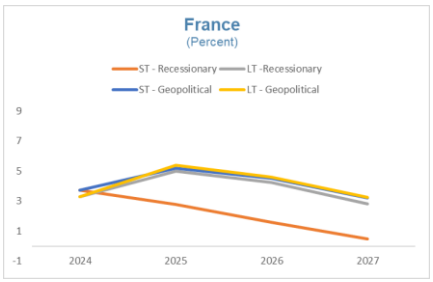
Sources: EBA, IMF, and IMF staff calculations.
Note: The figure shows the path of key variables for the euro area under the FSAP stress test scenarios. Baseline projections for GDP growth, unemployment and inflation are based on January 2025 WEO. EBA – 2025 is the scenario used by the EBA for its 2025 stress test.

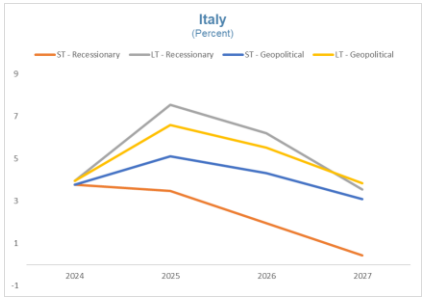
Figure 11. Euro Area: Projected Interest Rates Across Scenarios

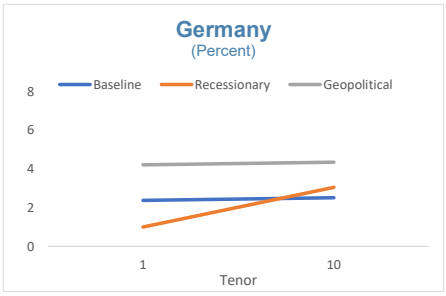


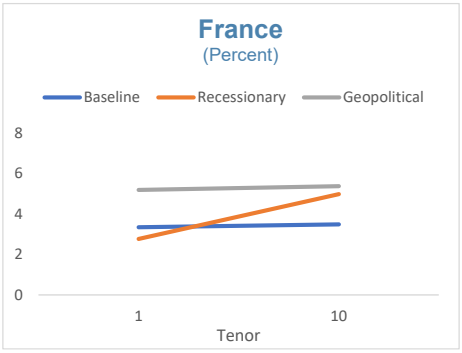


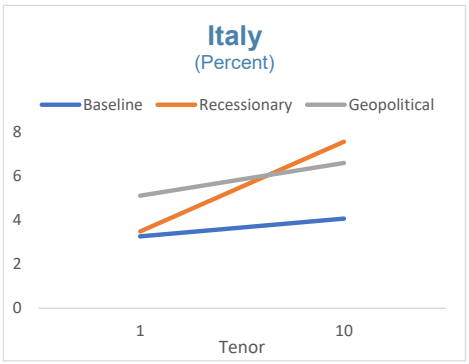






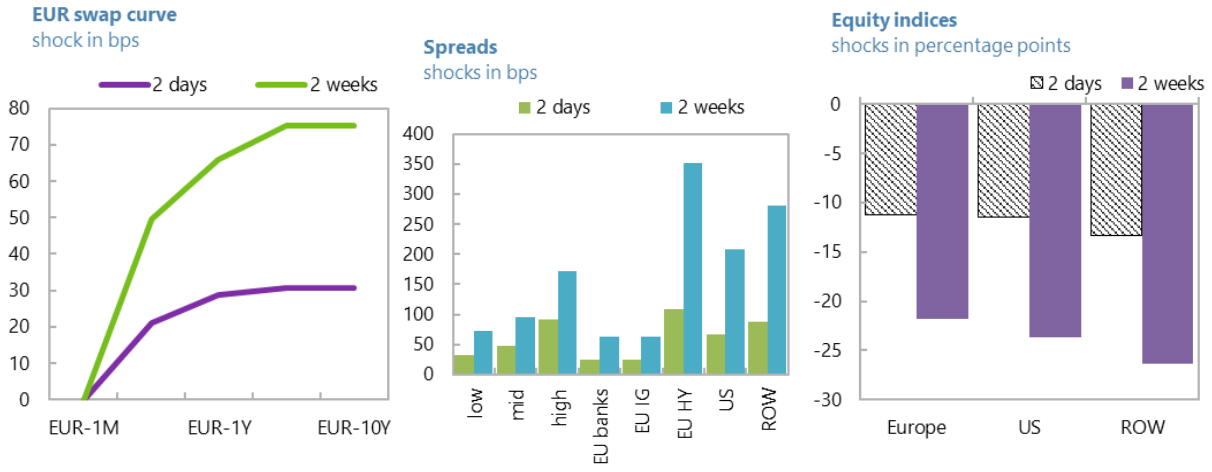






Source: Bloomberg, IMF, and IMF staff calculations.
Note: The top panel shows the average spread of yields relative to Bunds for euro area countries grouped into three risk buckets: low (AT, NL, FI); mid (BE, FR, IE), and high (IT, ES, GR, PT) in terms of debt sustainability risks. Short-term (ST) rates are 1-year bank rates; long-term (LT) rates are 10-year government yields. OIS stands for overnight index swap and IB stands for interbank rate. The top right channel shows the interest rate paths under the two adverse scenarios, using forward curves for OIS baseline projections (WEO does not produce forecast of country policy rates, and adverse interest paths are projected as deviations from baseline). Monetary policy is endogenously determined in the Global Macrofinancial Model used to generate the stress scenarios (i.e., central banks adjust policy rates using a Taylor rule), but unconventional monetary policies (e.g., QE) are excluded.

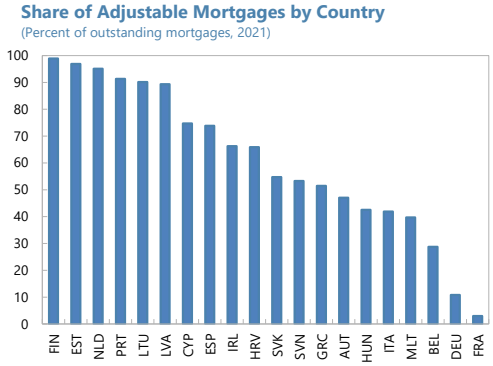
Figure 12. Euro Area: Market Scenario and Assumptions for System-Wide Analysis



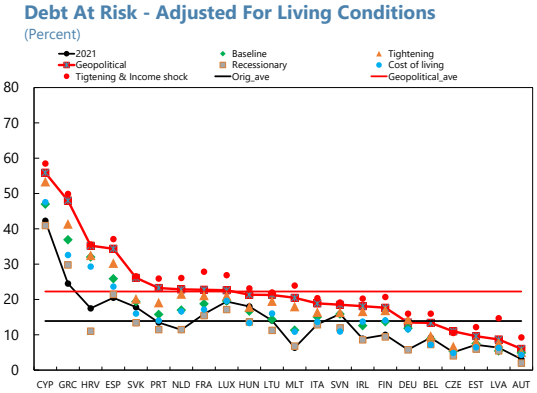
Source: Bloomberg, IMF, and IMF staff calculations.
Note: In the spread charts, "low," "'mid," and "high" refer to the bucketing of countries as in the macro scenario. "IG" stands for Investment Grade, "HY" for High Yield, "ROW" for Rest of the World. For redemption shocks, we employ a flow-performance calibration approach, which estimates the expected outflow of funds given the projected fall in a fund's NAV following the market scenarios.

Figure 13. Euro Area: Households at Risk Across Scenarios

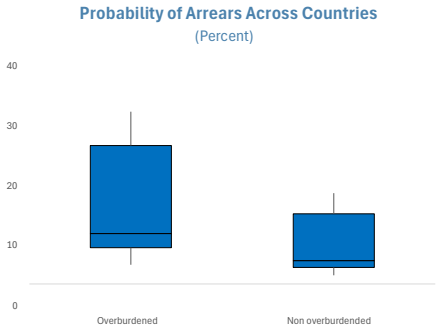
The share of adjustable mortgages is highly heterogenous across countries



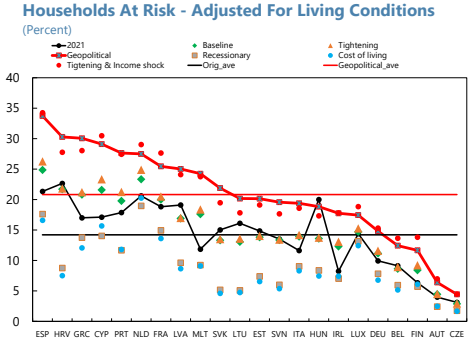
...while the share of debt at risk could exceed 22 percent.



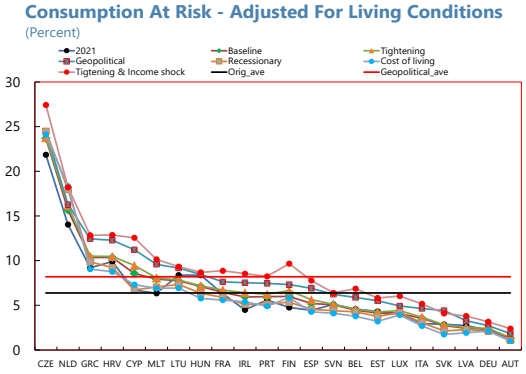
Overburdened households are more likely to miss payments when they become due...



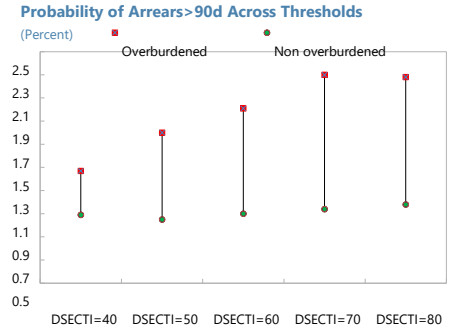
Under the geopolitical scenario, the share of vulnerable households could rise from 14 percent to over 20 percent...



The geopolitical scenario could affect the affordability of goods and services bought by households.



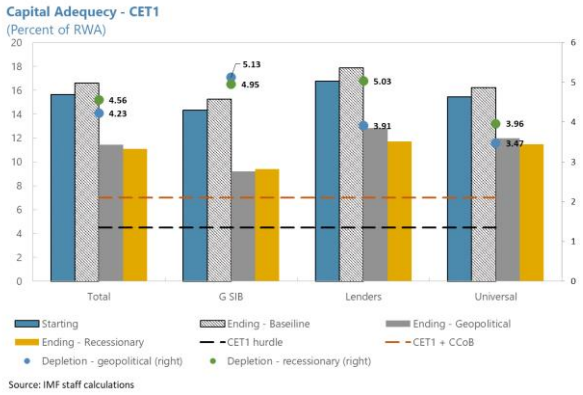
....and to be on arrears on debt payments more than 90 days

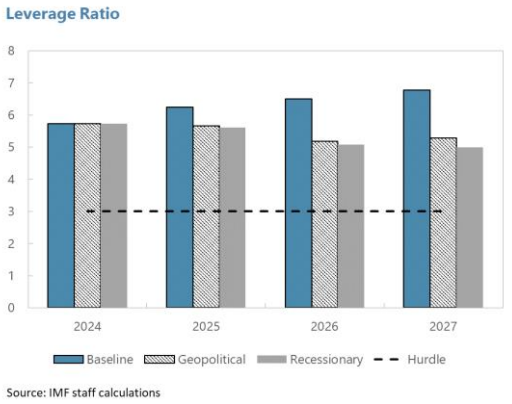


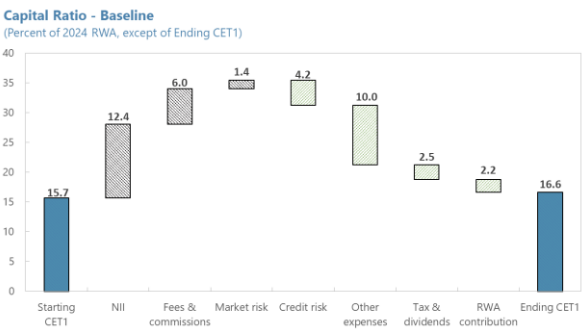
Sources: HFCS microdata and IMF staff calculations.

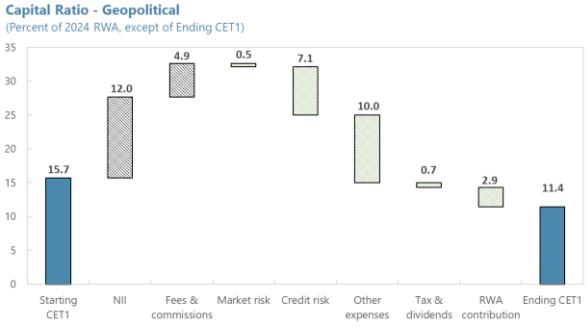
Note: The model is based on Valderrama et al (2023). A household is considered vulnerable if essential payments (including housing costs, debt repayments, and basis expenses) exceed 70 percent of gross income. Debt at risk is the share of bank debt held by vulnerable households. Consumption at risk is the share of consumption that needs to be cut back by vulnerable households to avoid breaching their income constraint. The top left panel shows the share of adjustable mortgages on the household's main residence, i.e., for which the interest rate can vary during the life of the contract. The top right and middle panels show the share of financial distress under the stress test scenarios (baseline, geopolitical, and recessionary) as well as three stylized scenarios: "tightening" (with lending rates raising 200 bps over baseline); "cost of living" (combining tightening financial conditions and a 20 percent increase in food and energy costs); and "tightening and income shock" (combining tightening financial conditions, 10 percent reduction of income relative to baseline, and 5 percentage point increase in unemployment relative to baseline). The bottom left chart shows the probability of being on arrears for overburdened households (with debt service and essential consumption payments exceeding 70 percent of their income), and the bottom right chart shows the probability of being on arrears over 90 days for different overburden ratios.

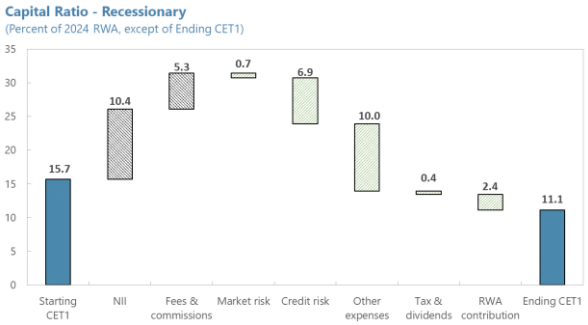
Figure 14. Euro Area: Results for Solvency Analysis

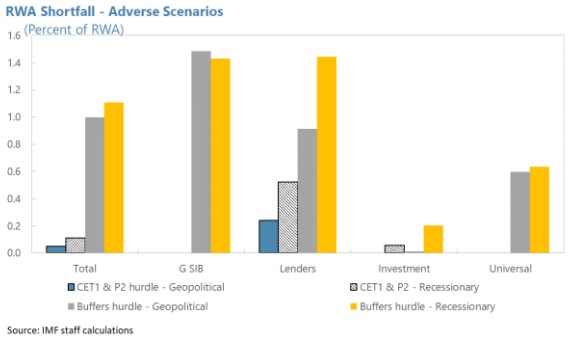








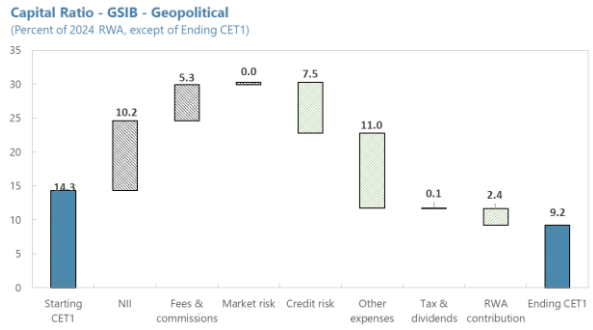


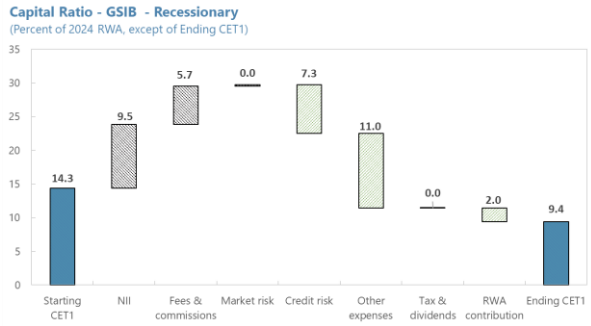


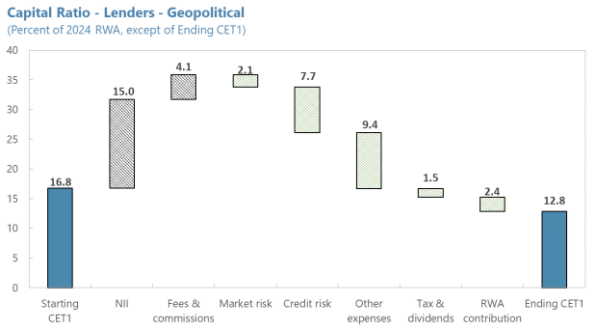
Source: IMF staff calculations.

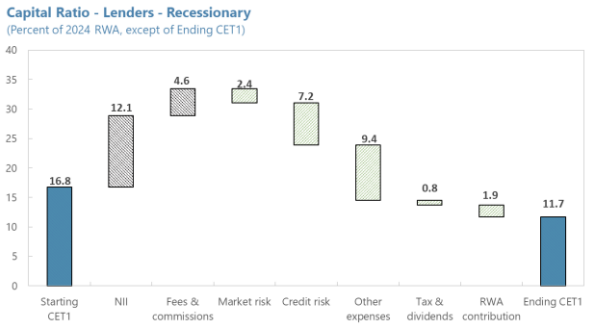
Note: Bank classification draws on SSM's reporting for significant institutions based on business model. "G-SIBs" follow FSB designation; "Lenders" include diversified lenders, corporate/wholesale lenders, retail lenders and consumer credit lenders, and small market lenders. "Universal" include banks engaged both in lending activities and non-lending business like insurance, asset management, and trading activities. The CET1 and P2 hurdle rate refer to SREP capital requirements, while the Buffers hurdle rate include SREP capital requirements, the capital conservation buffer, and the systemic risk buffer. See Technical Note on Systemic Risk Assessment for a detailed description of the stress testing methodology.

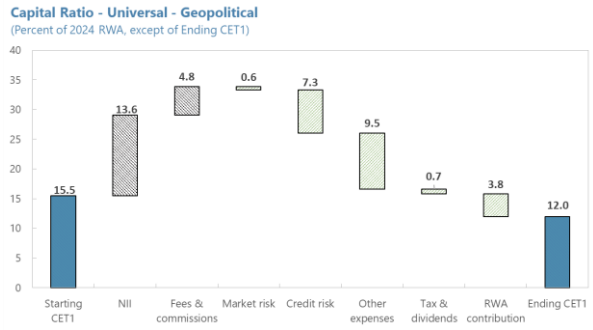
Figure 15. Euro Area: CET1 Depletion Drivers by Business Model and Scenario

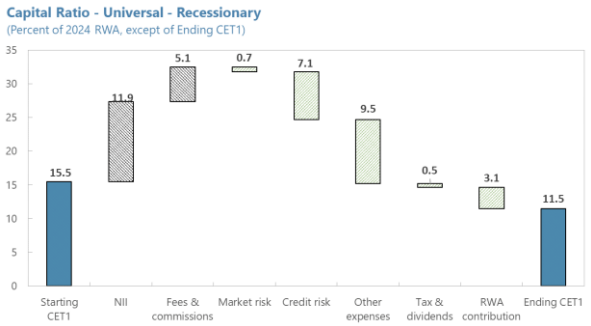








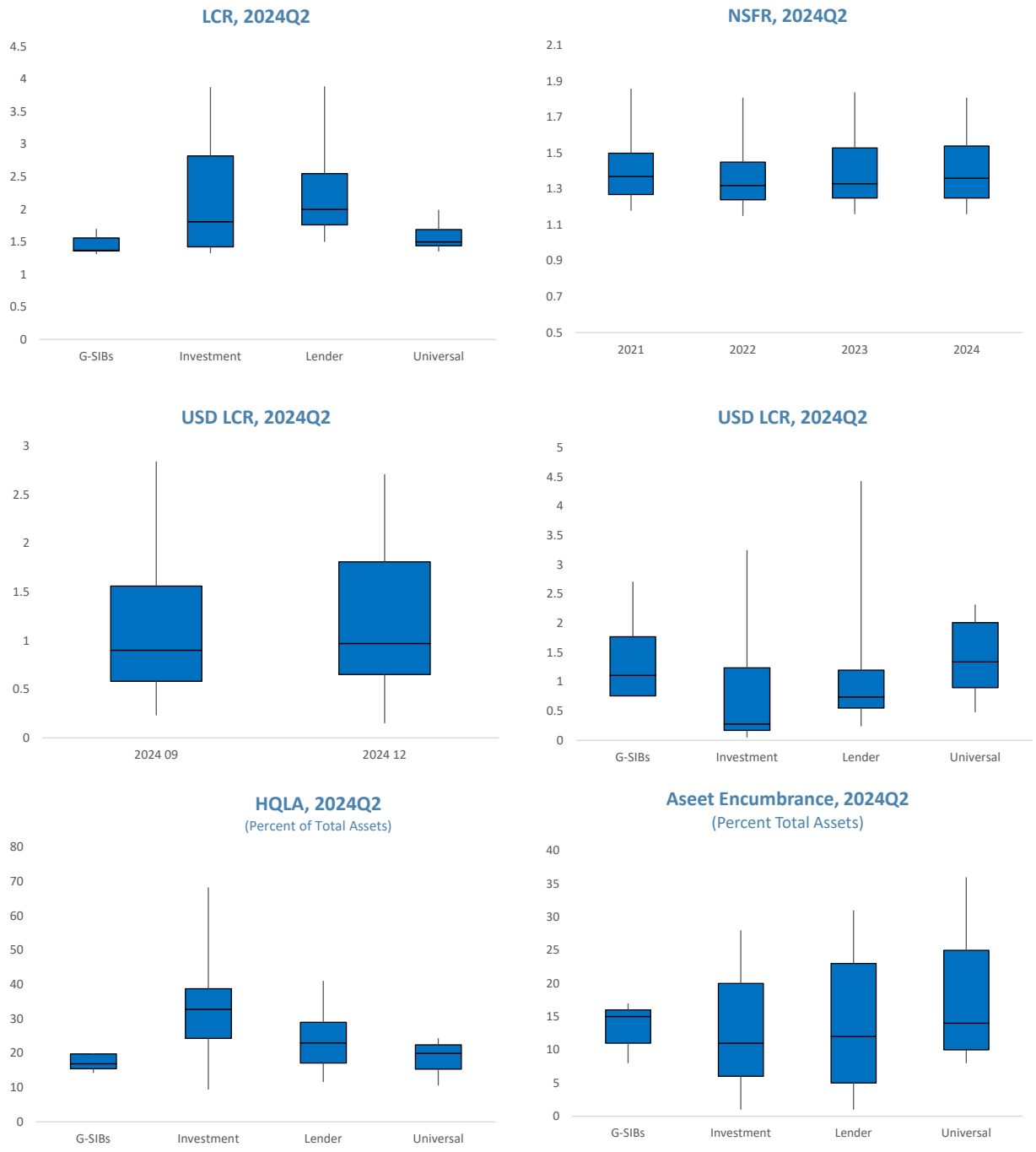




Source: IMF staff calculations.

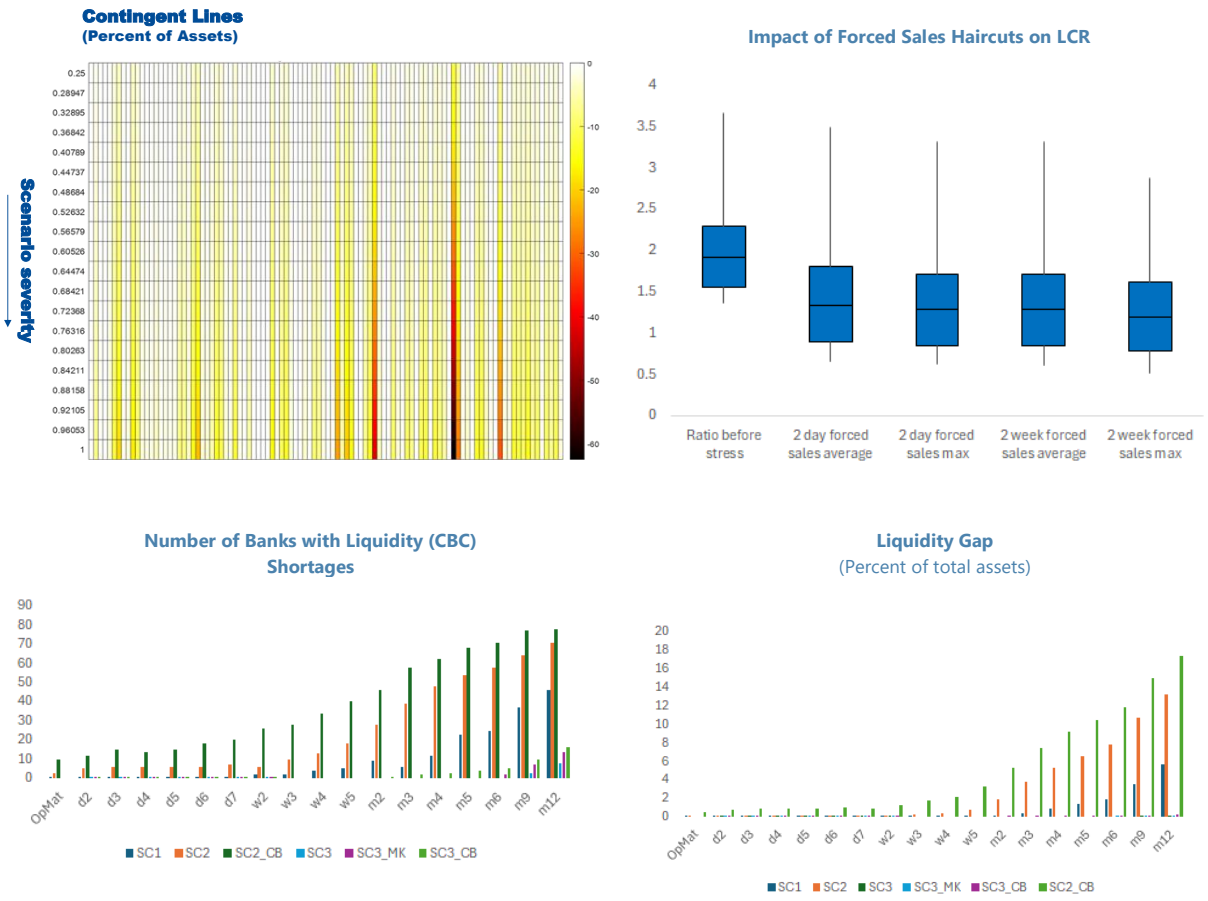
Note: Bank classification draws on SSM's reporting for significant institutions based on business model. "G-SIBs" follow FSB designation; "Lenders" include diversified lenders, corporate/wholesale lenders, retail lenders and consumer credit lenders, and small market lenders. "Universal" include banks engaged both in lending activities and non-lending business like insurance, asset management, and trading activities. See Technical Note on Systemic Risk Assessment for a detailed description of the stress testing methodology.

Figure 16. Euro Area: Liquidity Risk Metrics



Source: IMF staff calculations.
Note: Bank classification draws on SSM's reporting for significant institutions based on business model. "G-SIBs" follow FSB designation; "Investment" includes investment banks and asset managers; "Lenders" include diversified lenders, corporate/wholesale lenders, retail lenders and consumer credit lenders, and small market lenders. "Universal" include banks engaged both in lending activities and non-lending business like insurance, asset management, and trading activities.

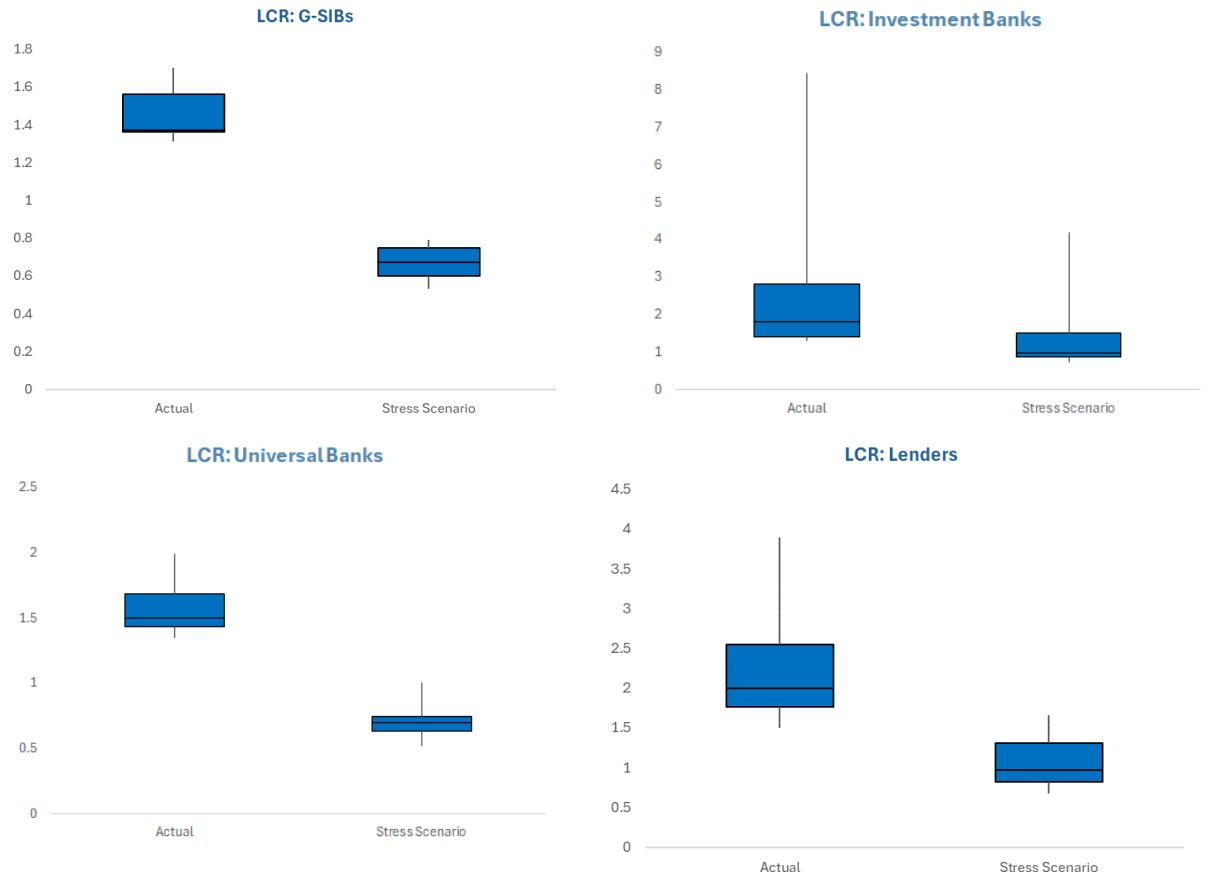
Figure 17. Euro Area: Liquidity Stress Test Results



Source: IMF staff calculations.

Note: The top left panel shows the share of contingent lines relative to assets (right Y-axis) when the scenario severity is increased gradually in 20 stepwise increments with a value of 1 denoting twice the magnitude of the contingent lines reported in the LCR (left Y-axis), and the X axis denotes each individual bank in a random order. The top right panel shows the impact of forced sales by funds under a market stress scenario on LCR over a 2-day and 2-week stress horizon, with a value of 1 denoting 100 percent LCR. Scenarios distinguish between average haircuts across securities included in HQLA and maximum haircuts (most conservative approach due to lack of granular security level data on banks' HQLA composition). The bottom panels show the results of a cash-flow stress test under six scenarios: SC1 ("systemic – mild": recession without sovereign distress), SC2 ("idiosyncratic" confidence shock), SC2_CB (SC2 excluding non-high quality liquid assets), SC3 ("systemic – severe": recession with sovereign distress), SC3_MK (SC2 excluding non-marketable assets), and SC3_CB (SC2 excluding non-high quality liquid assets).

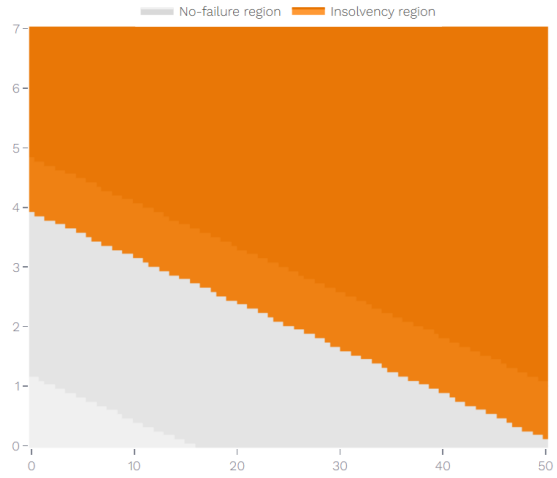
Figure 18. Euro Area: LCR Scenario based Stress Test Results



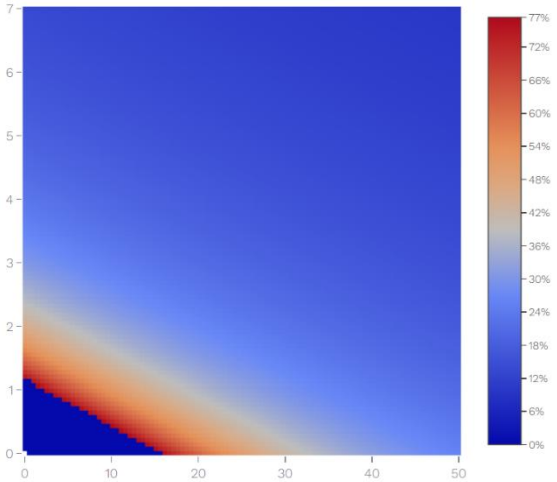
Source: IMF staff calculations.

Figure 19. Euro Area: Joint Solvency – Liquidity (2 weeks): Reference Scenario

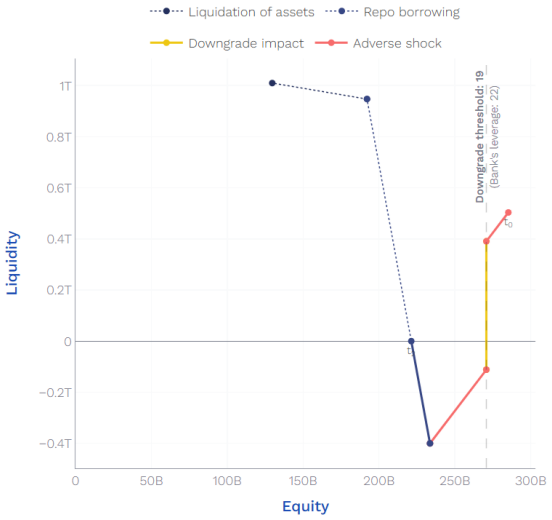
In a stress scenario, banks could be insolvent due to borrowing costs for severe but plausible combination of shocks (light orange region).



The loss amplification increases around the downgrade event.



Repo borrowing would allow banks to mitigate liquidity pressures…



…but it would erode capital buffers:

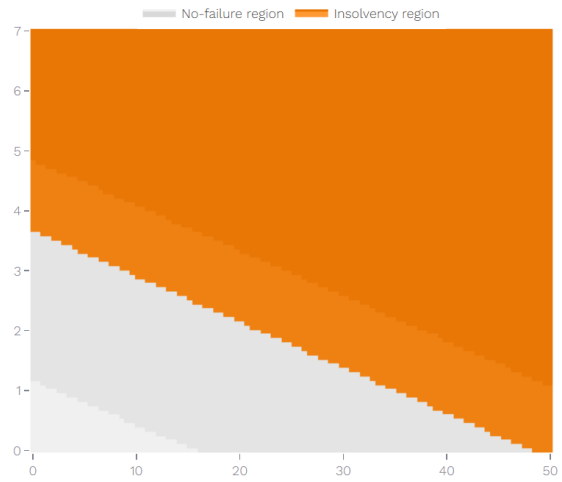
- *Under the market risk scenario, equity drops from EUR 285.3 billion to EUR 221.3 billion;*
- *Liquidity at risk stands at EUR 903.7 billion;*
- *The amount of liquidity borrowed reaches EUR 400 billion.*

Sources: IMF staff calculations.

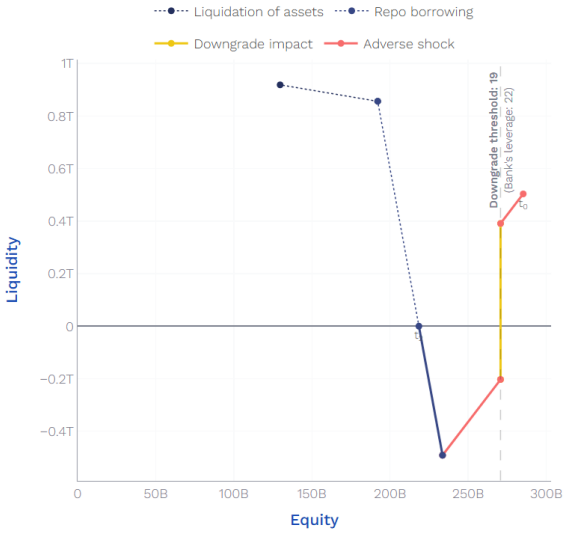
Note: Results are aggregated for selected G-SIBs. The top left panel shows the bank failure regions for shocks to the benchmark market rate ranging between 0 and 7 percent (EUR 1 year OIS; y axis) and between 0 and 50 percent for the reference equity index (EQ-Europe; x axis). The colored areas show four regions of bank performance: the light grey region implies "bank solvent, liquid, with no borrowing action", the dark grey region shows "bank solvent, liquid, with borrowing action", the light orange region depicts "bank liquid, insolvent, due to borrowing costs," and the dark orange region denotes "bank liquid, insolvent, due to the size of the shock". The top right chart shows a heatmap of amplification effects due to *endogenous* liquidity shocks on bank capital relative to the initial solvency shock. The bottom left chart illustrates solvency-liquidity diagrams for the market shock scenario described in the "reference" scenario (TN Stress Testing the Banking Sector) with t (in the x axis) denoting the final point of the simulation. The remaining liquidity that can be monetized is depicted by the two dashed lines: the steeper dashed line represents "Repo borrowing" while the flatter dashed line represents "Liquidation of assets".

Figure 20. Euro Area: Joint Solvency – Liquidity (2 weeks): "Credit Sensitive" Flows vs. "Business as Usual"

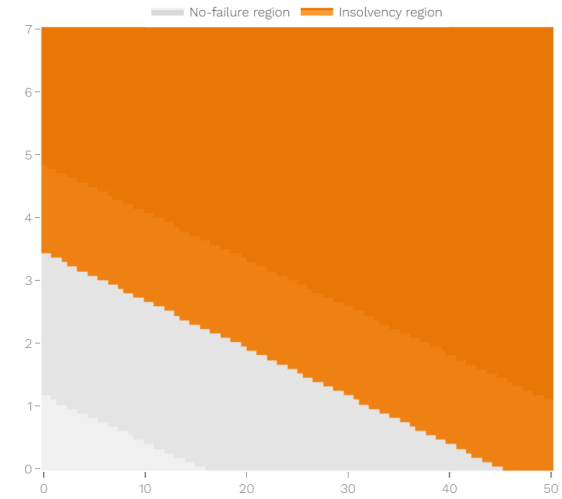
Higher outflows from credit sensitive depositors and higher IM in derivative transactions ("credit sensitive" scenario) expand the region of insolvency…



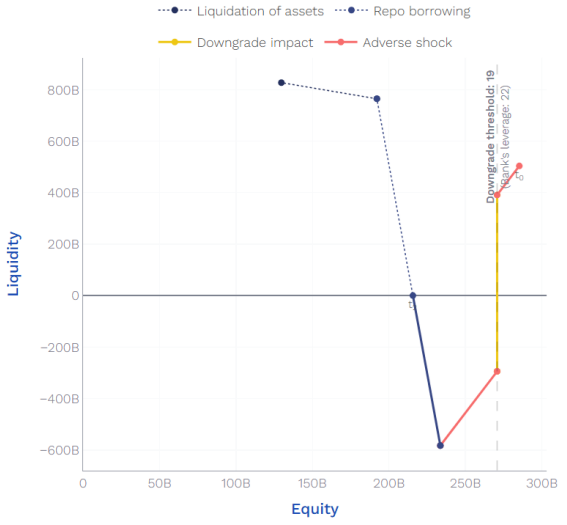
…and reduce the amount of liquidity that can be monetized.



Rolling over maturing loans ("business as usual") would increase the likelihood of insolvency…



…and constrain further the amount of cash that can be mobilized.

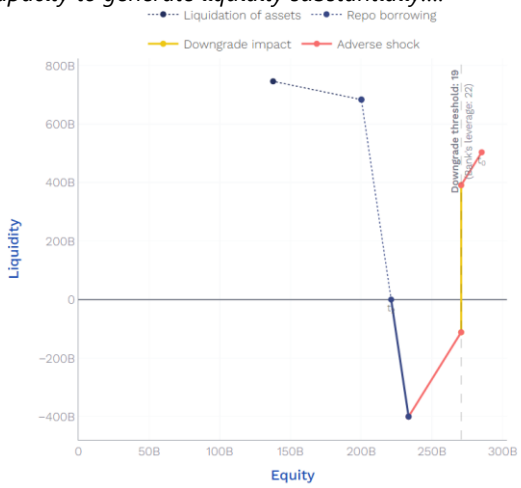


Sources: IMF staff calculations.

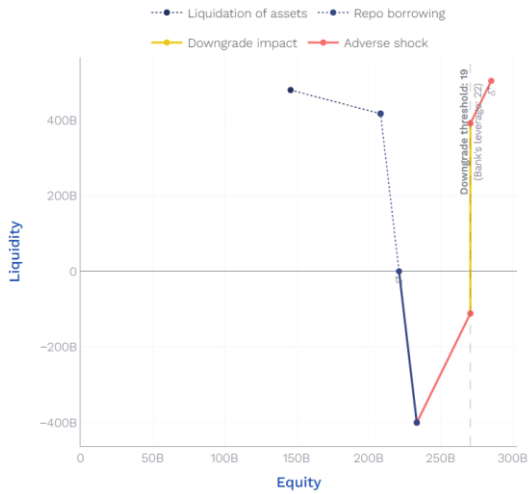
Note: Results are aggregated for selected G-SIBs. In the 'credit sensitive' scenario: (i) the run-off rate of category 1 and 2 deposits increases to 20 percent (from 13, and 18, percent in the regulatory framework, respectively); (ii) operational deposits not covered by DGS are subject to a 40 percent (rather than 25 percent) run-off rate; and, (iii) IM on collateral posted in margined transactions increases by 20 percent. In a 'business-as-usual' scenario, maturing loans are rolled over. The left panels show the bank failure regions for the "credit sensitivity" and "business as usual" scenario, respectively, for shocks to the benchmark market rate ranging between 0 and 7 percent (EUR 1 year OIS; y axis) and between 0 and 50 percent for the reference equity index (EQ-Europe; x axis). The colored areas show four regions of bank performance: the light grey region implies "bank solvent, liquid, with no borrowing action", the dark grey region shows "bank solvent, liquid, with borrowing action", the light orange region depicts "bank liquid, insolvent, due to borrowing costs," and the dark orange region denotes "bank liquid, insolvent, due to the size of the shock". The right panels depict the corresponding solvency-liquidity diagrams for each scenario with t (in the x axis) denoting the final point of the simulation. The remaining liquidity that can be monetized is depicted by the two dashed lines: the steeper dashed line represents "Repo borrowing" while the flatter dashed line represents "Liquidation of assets".

Figure 21. Euro Area: Joint Solvency – Liquidity (2 weeks): Narrower Collateral Framework, "Trapped Liquidity", and Business Risk

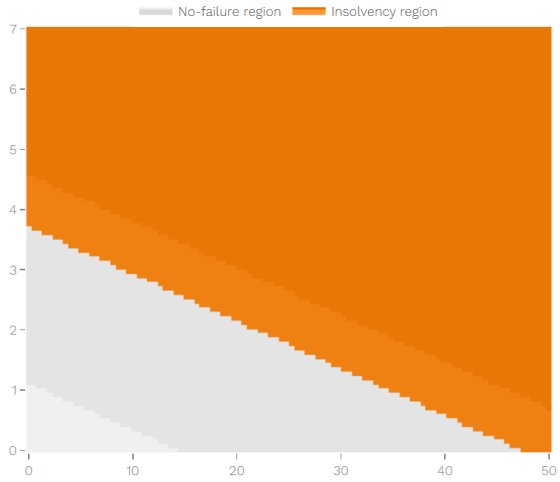
A narrower collateral framework would limit banks' capacity to generate liquidity substantially….



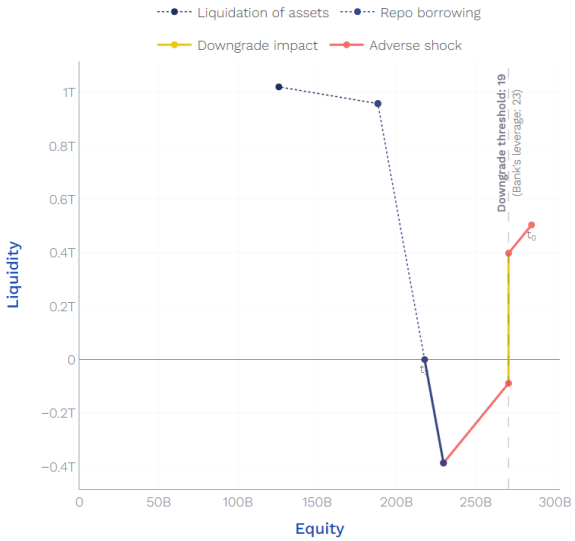
…but "trapped liquidity" in foreign currency would be more material.



A reduction of fee and commission income from capital-based and asset management activities would increase the likelihood of insolvency…



…and contribute to banks' capital depletion.

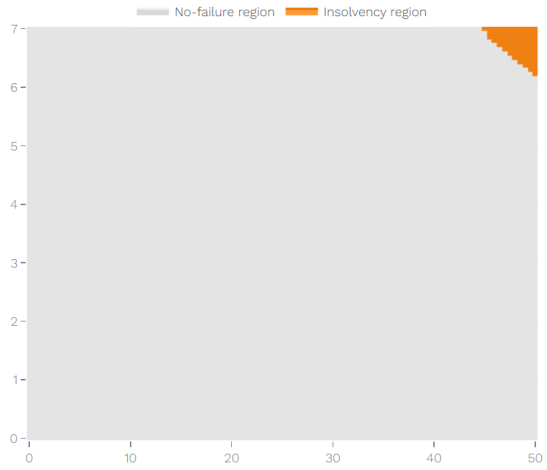


Sources: IMF staff calculations.

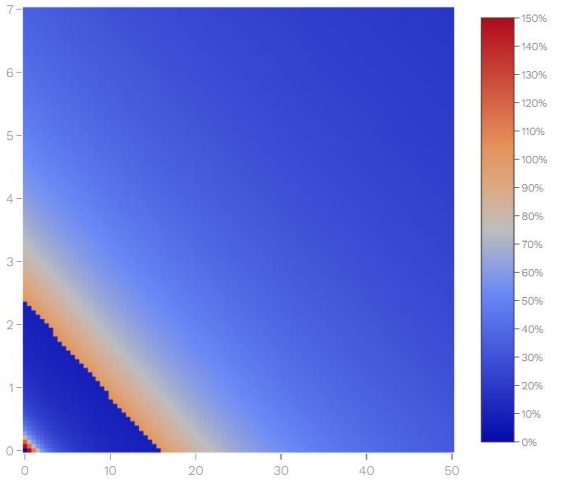
Note: Results are aggregated for selected G-SIBs. In the 'narrow collateral' scenario, credit claims and own issuances eligible for central bank credit operations become ineligible. In the 'trapped liquidity' scenario, collateral in FX becomes unavailable conditional on a credit downgrade. In a 'business risk" scenario, client attrition in investment banking and asset management activities reduce fee and commission income by 30 percent, conditional on a credit downgrade. The top panels show the solvency-liquidity diagrams under a narrow collateral framework (left panel) and a "trapped liquidity" scenario (right panel) with t (in the x axis) denoting the final point of the simulation. The remaining liquidity that can be monetized is depicted by the two dashed lines: the steeper dashed line represents "Repo borrowing" while the flatter dashed line represents "Liquidation of assets". The bottom left panel shows the bank failure regions for the "business risk" scenario for shocks to the benchmark market rate ranging between 0 and 7 percent (EUR 1 year OIS; y axis) and between 0 and 50 percent for the reference equity index (EQ-Europe; x axis). The colored areas in the bottom left chart show four regions of bank performance: the light grey region implies "bank solvent, liquid, with no borrowing action", the dark grey region shows "bank solvent, liquid, with borrowing action", the light orange region depicts "bank liquid, insolvent, due to borrowing costs," and the dark orange region denotes "bank liquid, insolvent, due to the size of the shock". The bottom right panel depicts the solvency-liquidity diagram for the "business risk" scenario.

Figure 22. Euro Area: Joint Solvency – Liquidity (2-days): The Role of Counterparty Credit Risk

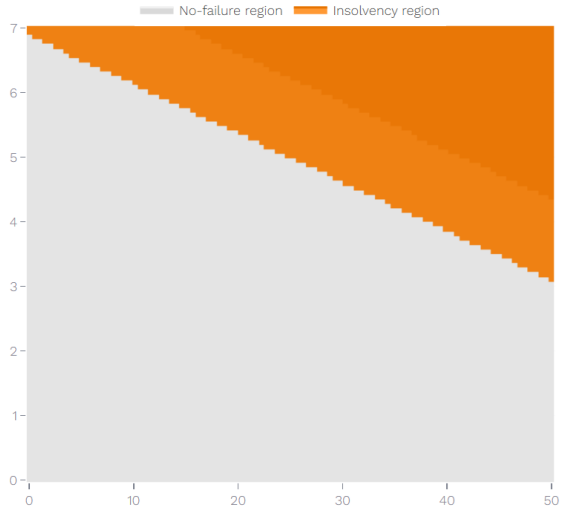
Banks are very resilient in the absence of CCR losses…



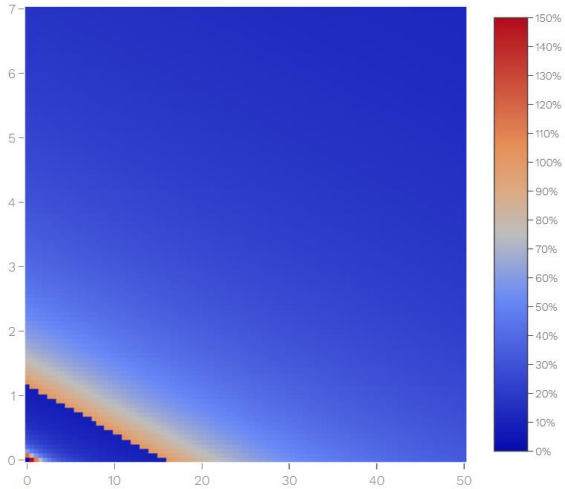
…although liquidity costs could amplify the initial market shock up to 150 percent.



CCR (default of three most vulnerable exposures among the largest twenty counterparties) could increase solvency risk significantly…



…with large amplification effects observed for small market shocks.

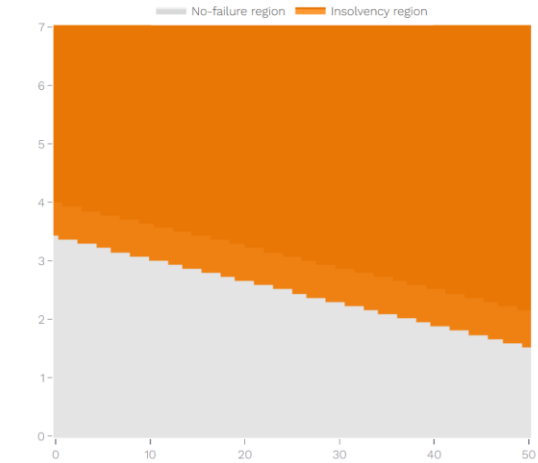


Sources: IMF staff calculations.

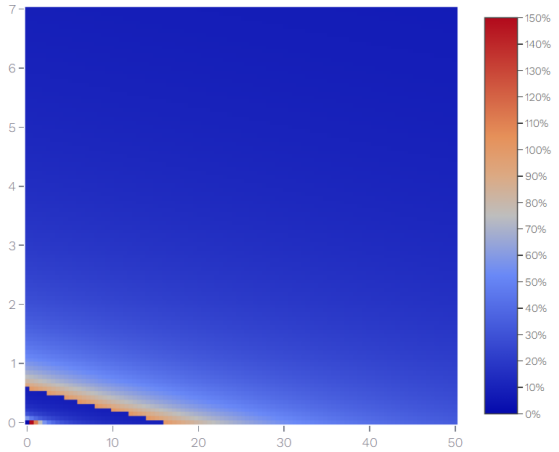
Note: Results are aggregated for selected G-SIBs. In the "No CCR" scenario (top panels), the market shock triggers portfolio valuation losses but CCR losses are excluded. In the "CCR – outright defaults" scenario (bottom panels), the three most vulnerable counterparties among the 20 largest exposures in derivatives, default (losses are net of credit risk mitigation). The left panels show the bank failure regions for shocks to the benchmark market rate ranging between 0 and 7 percent (EUR 1 year OIS; y axis) and between 0 and 50 percent for the reference equity index (EQ-Europe; x axis). The colored areas in the reverse stress testing panels show three regions of bank performance: the dark grey region shows "bank solvent, liquid, with borrowing action", the light orange region depicts "bank liquid, insolvent, due to borrowing costs," and the dark orange region denotes "bank liquid, insolvent, due to the size of the shock". The right panels show a heatmap of amplification effects measured by the ratio of the capital depletion due to funding costs to the initial shock to equity multiplied by 100.

Figure 23. Euro Area: Joint Solvency – Liquidity (2-days): The Role of NBFIs and Market Volatility

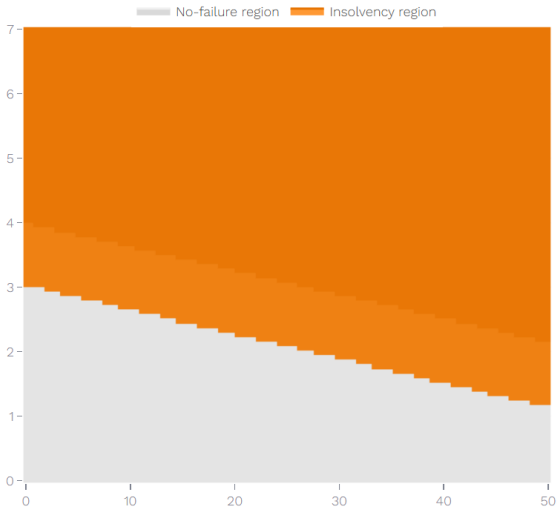
CCR losses from NBFIs (estimated in the system-wide liquidity stress test) could push banks into insolvency for moderate shocks…



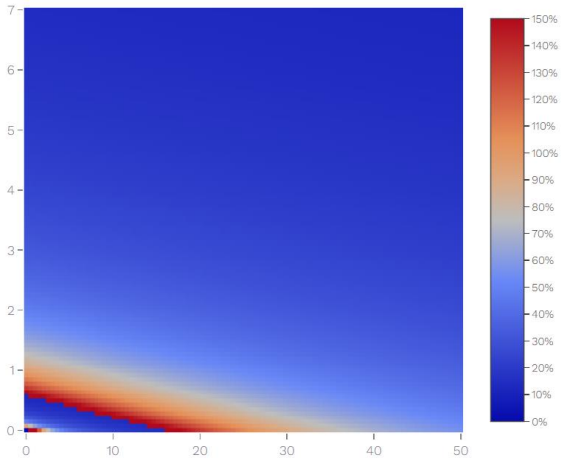
…and create significant amplification effects.



Adding wider credit spreads (two percentage points) from heightened market volatility could significantly increase credit risk…



…and create higher amplification effects for moderate shocks.

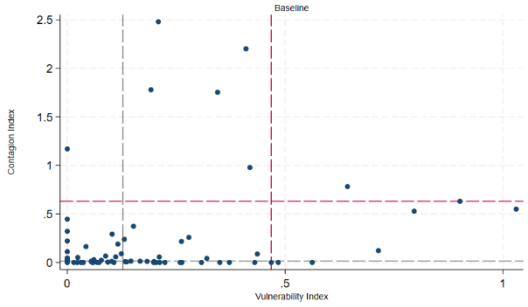


Sources: IMF staff calculations.

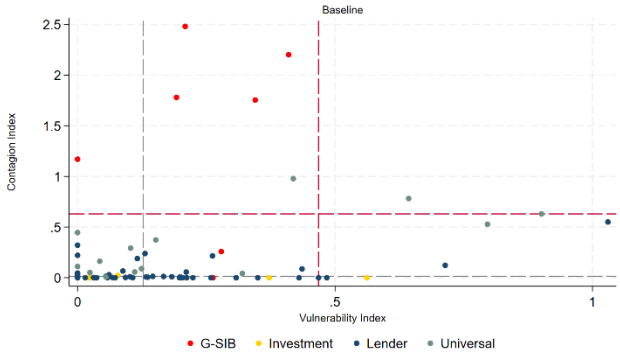
Note: Results are aggregated for selected G-SIBs. This scenario applies a bank-specific default rate to margined transactions drawing on the NBFI default rate projected in the system-wide stress test (Section E). The top panels show the bank failure regions and heatmap of amplification effects for the two-day scenario, while the bottom panels combine this scenario with higher funding costs from heightened market volatility, adding two percentage points to the funding rates observed in 2024. The left panels show the bank failure regions for shocks to the benchmark market rate ranging between 0 and 7 percent (EUR 1 year OIS; y axis) and between 0 and 50 percent for the reference equity index (EQ-Europe; x axis). The colored areas in the reverse stress testing panels show three regions of bank performance: the dark grey region shows "bank solvent, liquid, with borrowing action", the light orange region depicts "bank liquid, insolvent, due to borrowing costs," and the dark orange region denotes "bank liquid, insolvent, due to the size of the shock". The right panels show amplification effects quantified by the ratio of capital depletion due to funding costs to the initial shock to equity multiplied by 100. CCR losses could be partly mitigated by the initial margin posted by NBFIs.

Figure 24. Euro Area: Results of Network Analysis

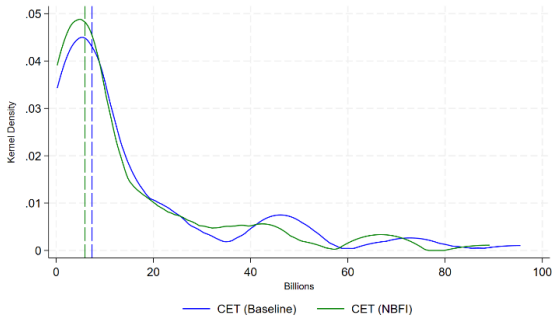
While the risk of contagion through interbank exposures within the EA is currently low in the baseline scenario, it identifies two banks with the potential to amplify spillovers.



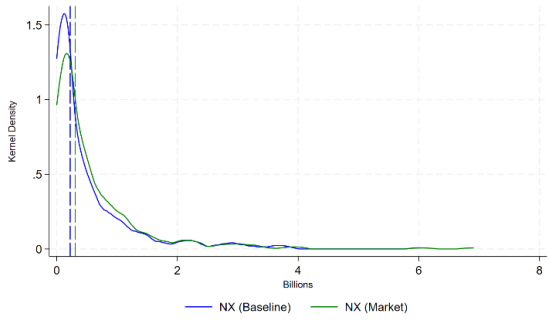
G-SIBs have the potential to induce high system wide losses but do not appear vulnerable to shocks within the EA banking system.



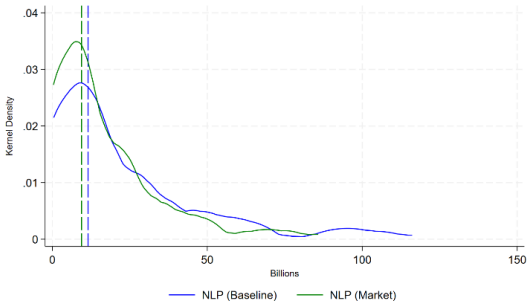
A severe scenario was calibrated to reflect lower initial capital due to largest five NBFI counterparties default.



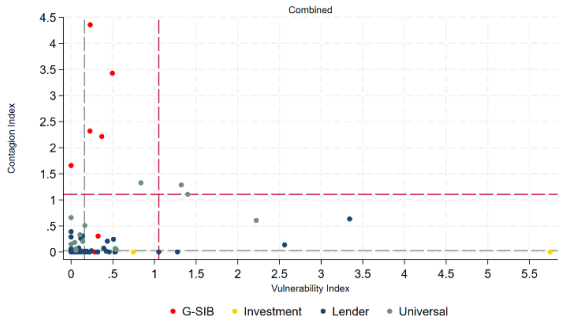
A combined scenario was calibrated to reflect additional risks from financial markets resulting in higher net exposures …



…and lower net liquidity positions.



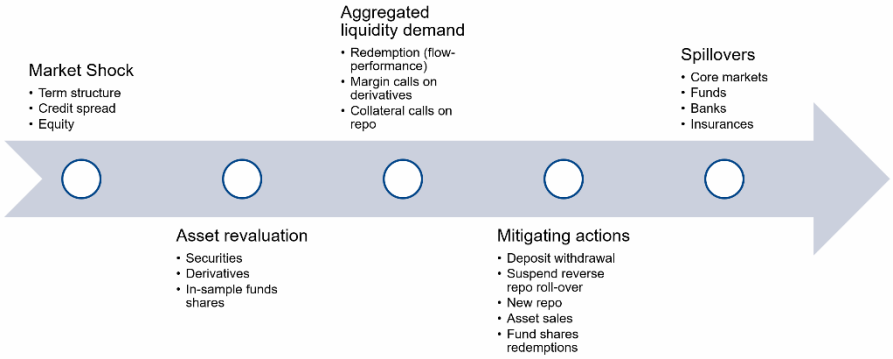
The results from the combined NBFI and market risks scenario suggest that the risk of contagion could be material.



Sources: ECB and IMF staff calculations.
Note: The panels show the Contagion and Vulnerability Indices obtained from a network analysis following Covi, Gorpe, and Kok (2021). The analysis quantifies the potential knock-on effects from the hypothetical default of a bank in the EA throughout the network of exposures. The baseline analysis is calibrated in line with Covi, Gorpe, and Kok (2021).

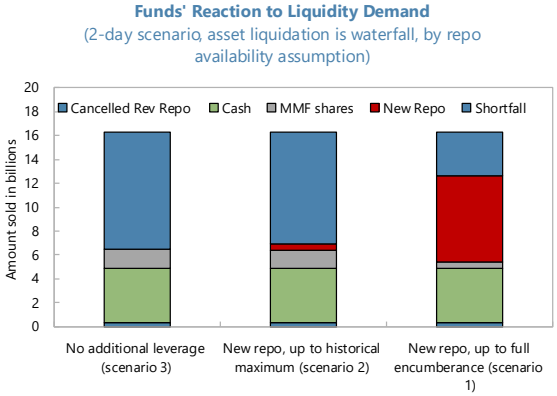
Figure 25. Euro Area: NBFIs Risk Analysis

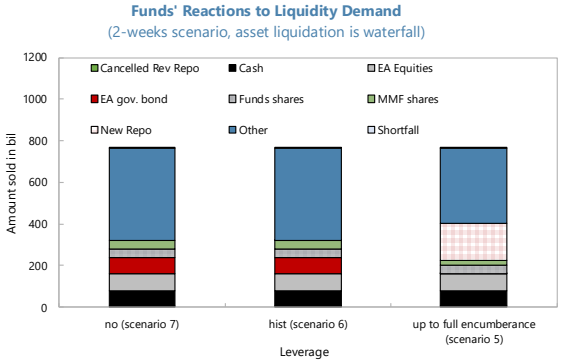
The stress test on system-wide liquidity spillovers from fund distress followed a five-step procedure, which initiates the stress through a market shock and associated asset revaluations, which entails additional liquidity demanded from funds…



On a two-day horizon, some funds experience a liquidity shortfall, which they can reduce significantly through repo borrowing.

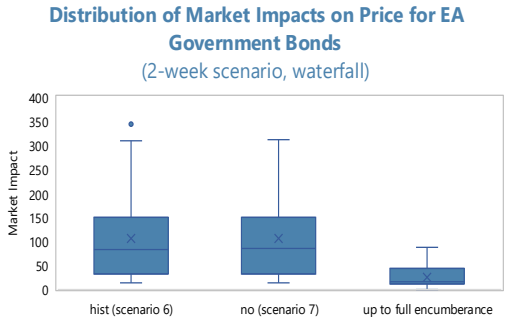
On a two-week horizon, funds sell assets after using their liquidity buffers and borrowing to the extent possible.

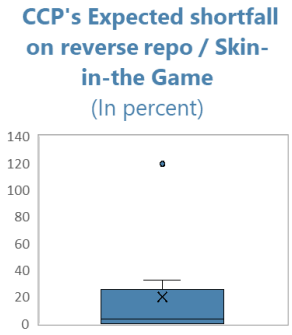




The more assets are being sold, the higher the observed market impact on sovereign bond markets, with repo borrowing mitigating the impact of funds sales.

Stress test of reverse repos found losses potentially comparable to some CCPs' own resources.





Source: Bloomberg, ESMA, IMF, Lipper, and ESMA and IMF staff calculations.

Table 2. Euro Area: Main Economic Indicators, 2021-2030

(Year-on-year percent change, unless otherwise specified)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
				Est.	*Proj.*	*Proj.*	*Proj.*	*Proj.*	*Proj.*	*Proj.*
Demand and Supply										
Real GDP	6.3	3.5	0.4	0.9	0.8	1.2	1.3	1.3	1.2	1.1
Private consumption	4.7	5.0	0.5	1.0	1.0	1.2	1.4	1.3	1.2	1.1
Public consumption	4.4	1.1	1.4	2.8	1.7	1.4	1.0	1.0	1.0	1.1
Gross fixed investment	3.8	2.0	1.7	-1.9	1.4	1.6	1.6	1.8	1.5	1.3
Final domestic demand	4.4	3.4	1.0	0.8	1.2	1.3	1.4	1.3	1.2	1.2
Stockbuilding 2/	0.7	0.5	-0.9	-0.3	0.1	0.0	0.0	0.0	0.0	0.0
Domestic demand	5.1	3.8	0.1	0.5	1.3	1.3	1.4	1.3	1.2	1.2
Foreign balance 2/	1.4	-0.2	0.3	0.4	-0.4	-0.1	0.0	0.0	0.0	0.0
Exports 3/	11.4	7.3	-0.8	1.0	0.0	1.4	2.2	2.6	2.5	2.5
Imports 3/	9.0	8.3	-1.4	0.2	1.0	1.8	2.4	2.8	2.7	2.7
Resource Utilization										
Potential GDP	2.3	1.2	1.0	1.1	1.0	1.1	1.1	1.2	1.1	1.1
Output gap 4/	-1.6	0.6	0.1	-0.2	-0.4	-0.3	-0.1	0.0	0.1	0.1
Employment growth	1.6	2.4	1.4	1.0	0.3	0.2	0.2	0.1	0.1	0.0
Unemployment rate 5/	7.8	6.7	6.6	6.4	6.4	6.3	6.2	6.2	6.2	6.2
Prices										
GDP deflator	2.1	5.1	5.9	2.9	2.2	2.0	2.1	2.1	2.1	2.1
Consumer prices	2.6	8.4	5.4	2.4	2.1	1.9	2.0	2.0	2.0	2.0
Public Finance (percent of GDP)										
Overall fiscal balance	-5.1	-3.5	-3.6	-3.1	-3.2	-3.4	-3.5	-3.5	-3.6	-3.7
Primary balance	-3.8	-1.9	-2.1	-1.5	-1.5	-1.6	-1.5	-1.4	-1.3	-1.3
Structural balance 4/	-4.0	-3.6	-3.6	-3.1	-3.0	-3.3	-3.5	-3.7	-3.8	-3.8
Structural primary balance 4/	-2.7	-2.1	-2.2	-1.5	-1.3	-1.4	-1.5	-1.5	-1.5	-1.4
Gross public debt	93.9	89.5	87.4	87.7	88.7	89.7	90.4	91.1	91.9	92.9
External Sector (percent of GDP) 6/										
Current account balance	2.7	-0.1	1.7	2.8	2.3	2.1	2.1	2.0	2.1	2.1
Interest Rates (percent, end of period) 7/										
Euro short-term rate (€STR)	-0.6	1.9	3.9	2.9	2.2	...	...	...	...	...
10-year government benchmark bond yield	0.3	3.0	2.9	2.8	3.1	...	...	...	...	...
Exchange Rates (end of period) 7/										
U.S. dollar per euro	1.1	1.1	1.1	1.0	1.1	...	...	...	...	...
Nominal effective rate (2005=100)	96.5	96.2	97.7	96.4	99.9	...	...	...	...	...
Real effective rate (2005=100, ULC based)	86.6	84.4	88.5	88.0	85.4	...	...	...	...	...

Sources: IMF staff estimates; and European Central Bank.

1/ Projections for 2025-30 are based on aggregation of the latest projections by IMF country teams, unless otherwise indicated.

2/ Contribution to growth.

3/ Includes intra-euro area trade.

4/ In percent of potential GDP.

5/ In percent.

6/ Projections are based on member countries' current account aggregations excluding intra-euro flows and corrected for aggregation discrepancy over the projection period.

7/ Latest monthly available data for 2025.

Table 3. Euro Area: Structure of Financial System

	2024			2023		
	In billion euros	In percent of assets	In percent of GDP	In billion euros	In percent of assets	In percent of GDP
Monetary Financial Institutions (MFIs)	46,030	57.0	303.7	45,411	59.1	311.0
Deposit-taking excluding central banks						
o/w: Credit institutions	38,559	47.8	254.4	37,406	48.7	256.2
o/w: Significant Institutions	26,837	33.3	177.1	25,944	33.8	177.7
o/w: Less Significant Institutions	4,948	6.1	32.6	4,952	6.4	33.9
o/w: Third Country Branches	6,774	8.4	44.7	6,510	8.5	44.6
Money Market Funds (MMFs)	1,996	2.5	13.2	1,710	2.2	11.7
Other MFIs	5,475	6.8	36.1	6,295	8.2	43.1
Investment Funds	19,730	24.4	130.2	17,186	22.4	117.7
Financial Vehicle Corporations (FVCs)	2,502	3.1	16.5	2,354	3.1	16.1
Insurance corporations	8,845	11.0	58.4	8,469	11.0	58.0
Pension funds	3,587	4.4	23.7	3,367	4.4	23.1
Total financial system assets	80,694	100.0	532.4	76,787	100.0	526.0
Memo: Eurosystem central banks	6,357	7.9	41.9	6,891	9.0	47.2

Source: ECB; Haver; IMF staff calculations. Note: Other MFIs include central banks in the Eurosystem, electronic money institutions and other financial intermediaries.

Table 4. Euro Area: Recent MCM Technical Assistance Activities

Start Date	End Date	Authority	Title
3/1/2021	1/31/2022	EBA	Implementation of TD solvency stress testing models and framework

Table 5. Euro Area: Financial Soundness Indicators for Significant Institutions

(In percent, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024
Capital adequacy						
Common Equity Tier 1 ratio	14.9	15.7	15.6	15.4	15.9	15.9
Tier 1 ratio	16.1	17	16.9	16.7	17.3	17.3
Total capital ratio	18.6	19.5	19.6	19.4	19.8	20.0
Leverage ratio (fully phased-in definition)	5.6	5.8	5.9	5.5	5.8	5.9
Leverage ratio (transitional definition)	5.7	6	6	5.6	5.8	5.9
Asset quality						
Loans and advances (in billions of euros) 1/	15,698	16,890	18,138	18,477	18,344	18,468
Stage 1 ratio		87.5	88.3	88.2	87.9	87.8
Stage 2 ratio		9.3	9.2	9.6	9.7	9.9
Stage 3 ratio		3.2	2.5	2.2	2.3	2.3
Nonperforming exposures ratio		3.2	2.6	2.3	2.2	2.1
Nonperforming exposures coverage ratio	46.0	45.1	44.6	43.6	42.6	42.1
Earnings and profitability						
Return on equity	5.2	1.5	6.7	7.7	9.3	9.5
Return on assets	0.4	0.1	0.4	0.5	0.6	0.7
Funding and liquidity						
Loan-to-deposit ratio	116	106.8	104.4	103.5	102.7	100.4
Liquidity coverage ratio	145.9	171.3	173.4	161.3	164.3	158.0
Assets						
Total assets (in billions of euros)	22,185	24,176	25,092	25,822	25,944	26,837
Total assets (in percent of GDP)	184.2	209.9	201.1	191.2	165.6	179.2
CB assets (in percent of total assets)				0.08	0.04	0.02
Loans to households and NFCs (in percent)	74.6	75	75.7	75.9	74.4	73.4
Significant institutions by size (number of) 2/						
Total	113	112	113	110	107	109
Banks with total assets						
Less than EUR 30 billion						18
Bw/ EUR 30 billion and EUR 100 billion						44
Bw/ EUR 100 billion and EUR 200 billion						20
More than EUR 200 billion						20
Global systemically important banks						7

Sources: ECB; and IMF staff calculations.
1/ Loans and advances in the asset quality tables are displayed at gross carrying amount, excluding central bank exposures.
2/ The number of SIs for which common reporting (COREP) and financial reporting (FINREP) is available is 109 in 2024.

Table 6. Euro Area: Risk Assessment Matrix			
Sources of Risk	**Likelihood of Risk** (High, Medium, Low)	**Expected Impact of Risk** (High, Medium, Low)	**Policy Responses**
Global Risks			
Trade policy and investment shocks	**High** Higher trade barriers or sanctions reduce external trade, disrupt FDI and supply chains, and trigger further U.S. dollar appreciation, tighter financial conditions, and higher inflation.	**High** Weaker export growth, combined with higher uncertainty and weaker consumer and business confidence, weighs on the corporate sector and results in lower investment and a slower recovery in private consumption, ultimately undermining productivity and lowering potential output.	• Continue advocating for a stable, rules-based global trading system and pursuing constructive engagement. • Ensure consistency with WTO principles in the use of targeted instruments (e.g., safeguard procedures and anti-dumping, anti-subsidy, and anti-coercion measures). • Diversify global partnerships and advance new free trade agreements. • Deepen single market and avoid industrial policy that creates distortions or provokes retaliation.
Deepening Geoeconomic Fragmentation	**High** Persistent conflicts, inward-oriented policies, protectionism, weaker international cooperation, labor mobility curbs, and fracturing technological and payments systems lead to higher input costs, hinder green transition, and lower trade and potential growth.	**High** Trade barriers and supply disruptions lead to shortages in crucial inputs, higher inflation and production bottlenecks that reduce economic activity and decrease confidence.	• Diversify energy production and secure supply chains to avoid shortages of critical raw materials. • Diversify global partnerships and advance new free trade agreements. • Continue advocating for a stable, rules-based global trading system and pursuing de-escalation and constructive engagement. • Ensure consistency with WTO principles in the use of targeted instruments (e.g., safeguard procedures and anti-dumping, anti-subsidy, and anti-coercion measures).

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Tighter financial conditions and systemic instability	**Medium** Higher-for-longer interest rates and term premia amid looser financial regulation, rising investments in cryptocurrencies, and higher trade barriers trigger asset repricing, market dislocations, weak bank and NBFI distress, and further U.S. dollar appreciation, which widens global imbalances and worsens debt affordability.	**Medium** Higher funding costs and a shift in risk sentiment lead to bond repricing and financial tightening, reducing credit growth. Insolvencies increase, resulting in deterioration of bank balance sheets and profitability. Rates staying high for longer will also lead to housing market corrections. Sovereign spreads increase, straining fiscal sustainability in high-debt countries.	• Enhance liquidity support to financial institutions and markets to avoid contagion and prevent liquidity shortages morph into insolvencies. • Ensure strong coordination between the ECB and the national authorities on financial stability risks. • Use countercyclical financial policy to support viable financial institutions.
Regional Conflict	**Medium** Intensification of conflicts (e.g., in the Middle East, Ukraine, Sahel, and East Africa) or terrorism disrupt trade in energy and food, tourism, supply chains, remittances, FDI and financial flows, payment systems, and increase refugee flows.	**Medium** Increased uncertainty weakens consumer and business confidence, reducing consumption and investment. Spikes in energy prices and supply disruption reduce competitiveness and the purchasing power of households.	• Accelerate the energy transition. • Provide targeted support to vulnerable households to mitigate the impact if risks materialize.
Commodity Price Volatility	**Medium** Supply and demand volatility (due to conflicts, trade restrictions, OPEC+ decisions, AE energy policies, or green transition) increases commodity price volatility, external and fiscal pressures, social discontent, and economic instability.	**Medium** Higher commodity import prices lead to higher energy prices that fuel inflationary pressures. Export competitiveness of European firms is adversely affected which in turn slows down activity. High energy prices have an adverse impact on households, leading to lower domestic demand.	• Maintain monetary policy flexibility. • Allow automatic stabilizers to operate and provide fiscal support to vulnerable households. • Safeguard energy security by accelerating the green transition and electricity market integration. • Provide targeted support to vulnerable households to mitigate the impact of higher energy prices.

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Cyberthreats	**Medium** Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets), technical failures, or misuse of AI technologies trigger financial and economic instability.	**Medium** Depending on the country level of digitalization and exposure to digital infrastructure, cyberattacks disrupt the financial system as well as the real economy.	• Advance crisis preparedness to cyberattacks. • Further strengthen coordination at the European/international level. • Strengthen the operational resilience of the financial system.
Climate Change	**Medium** Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, supply disruptions, lower growth, and financial instability.	**Medium** Productivity declines or shortages lead to price increases. EU members may receive migrants from economies facing severe climate disruptions.	• Build fiscal space that can be used in response to large climate shocks. • Enhance the EU budget to invest efficiently to mitigate climate risks and flexibly respond to extreme climate events. • Accelerate green transition.
Global growth acceleration	**Low** Easing of conflicts, positive supply-side surprises (e.g., oil production shocks), productivity gains from AI, or structural reforms raise global demand and trade.	**Medium** Higher export growth, combined with stronger consumer and business confidence, supports the corporate sector and results in higher investment, lower unemployment, and a faster recovery in private consumption. Higher growth leads to an improvement in public debt sustainability in some high-debt countries.	• Allow automatic stabilizers to operate and accelerate fiscal consolidation to rebuild buffer. • Promote high quality public investment in infrastructure, and advance structural reforms. • Diversify global partnerships and advance new free trade agreements.
Euro Area Domestic Risks			
Disorderly energy transition	**Medium** A disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	**Medium** Higher energy prices lead to higher inflation and decreased real incomes. Increased climate policy uncertainty lowers investments in green technology.	• Provide temporary, targeted fiscal policy support to households and businesses severely affected by energy transition. • Promote public investment and accelerate structural reforms to improve energy efficiency and facilitate labor reallocation with active labor market policies.

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Higher defense spending	**Medium** New NATO commitments or a lower-than-expected efficiency of additional defense spending could result in higher than anticipated defense spending.	**Medium** Higher defense spending supports growth but raises concerns about public sector debt sustainability and raises interest rates.	• Limit the use of the national escape of the EU fiscal rules clause to the initial phase of scaling up defense investment expenditures. • Assess the consequence of increased defense spending on debt sustainability. • Closely monitor efficiency of additional defense spending.
Populism and Polarization	**Medium** Real income loss, spillovers from conflicts, dissatisfaction with migration, and worsening inequality ignite populism, polarization, and resistance to reforms.	**Medium** Delayed and suboptimal policies weaken confidence and raise uncertainty, lowering growth and leading to market repricing. Delayed fiscal adjustment weakens fiscal sustainability and increases sovereign risks.	• Increase growth and productivity, and ensure benefits are shared widely. • Ensure that increased defense spending and fiscal consolidation do not undermine targeted social spending or exacerbate inequality. • Provide temporary support to vulnerable households if needed.
Realization of Financial Sector Vulnerabilities	**Low** A shift in market perception undermines the ability to roll over and service debt, re-igniting financial fragmentation and adversely affecting the banking system. NBFIs could amplify risk propagation in the banking sector and system-wide spillovers from investment fund distress	**High** Higher funding costs and a shift in risk sentiment lead to bond repricing and financial tightening, reducing credit growth. Insolvencies increase, resulting in deterioration of bank balance sheets and profitability.	• Enhance liquidity support to financial institutions and markets to avoid contagion and prevent liquidity shortages morph into insolvencies. • Ensure strong coordination between the ECB and the national authorities on financial stability risks. • Use countercyclical financial policy to support viable financial institutions. • Rely on bank resolution systems to address unsound banks. • Enhance system-wide monitoring and improving data sharing.

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Responses
Shifting sentiment on countries with high public debt	**Low** Policy slippages with weak growth outturns in some high-debt euro area countries, along with weak trust in the Governance Framework, could raise concerns over debt sustainability in high debt countries.	**High** Sharp increases in funding costs strain high-debt countries' ability to service their debt resulting in adverse real-financial feedback loops and financial fragmentation that weighs on economic activity and impairs monetary policy transmission.	• Activate EU support lines for high-debt countries under stress. • Make use of the transmission protection instrument (TPI) if higher spreads are not based on fundamentals. • Enhance liquidity support to financial institutions and markets with strong coordination between the ECB and the national authorities on financial stability risks.

Table 7. Euro Area: Stress Testing Matrix (STeM)		
A. Banking Sector: Solvency Stress Test		
Top-down by IMF		
1. Institutional Perimeter	Institutions included	• 95 SIs (out of 109 SIs), of which 7 are G-SIBs.
	Market share	• About 99 percent of the banking sector assets.
	Data and baseline date	• Data vintage: 2024:Q4. • Supervisory data: Bank balance sheet and supervisory statistics (including FINREP and COREP), information on interest rate risk in the banking book (IRRBB), short-term exercise (STE), provided by the ECB. Expected Default Frequency sourced from Moody's. • Household analysis relies on household survey microdata from the 2021 (latest) HFCS survey, covering 83,000 households across 22 countries (EA, CZ, and HU) and 200,000 personal files. Montecarlo simulations of unemployment shocks at the person level. Projections of households' balance sheets, consumption, and debt repayments, allowing for new issuances of maturing loans. • Market and publicly available data, such as information from ECB statistical data warehouse on funding and lending rates for new business by type of asset and funding portfolios, complemented with commercial databases such as Capital IQ. Corporate sector analysis uses data from Orbis. • Scope of consolidation: banking activities of the consolidated banking group for banks having their headquarters in Euro Area. • Coverage of sovereign and non-sovereign securities exposures: debt securities measured through fair value (FVPL and FVOCI) and amortized cost (AC) account.

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
Banking Sector: Solvency Stress Test		
Top-down by IMF		
2. Channels of Risk Propagation	Methodology	• FSAP team satellite models and methodologies. • For internally modelled exposures (IRB), projection of PiT and TTC PDs, PiT and DT LGDs, EAD, and RWA. For SA exposures, Projection of new flows of defaulted exposures and RWA based on risk weights for performing and nonperforming loans separately. Provisioning for IRB and SA modeled using IFRS 9 transition matrix approach. • Static balance-sheet approach, allowing the re-issuance of maturing loans at current market rates. • Provisioning for IRB and SA are modeled using IFRS9 transition matrix approach. • Traded risk impact from the revaluation of instruments at fair value (FVPL and FVOCI, including hedging instruments) will be assessed using bank-specific sensitivities reported in COREP/Short-Term Exercise to market risk factors. The analysis will use one-off market stress scenarios that have a similar narrative to the macro scenarios but correspond to a shorter time horizon (e.g., in the geopolitical scenario, the one-off market stress event features higher interest rates and commodity prices, while the opposite occurs in the recessionary scenario). Risk factors include interest rate, commodity, equity, FX, and credit spread.
	Satellite models for macrofinancial linkages	• Models for credit losses, funding costs, lending rates • Within EA, for household and corporate, analysis of PD using micro-data at individual household (based on household survey, HFCS) and corporate (based on corporate databases Datastream and Capita IQ). Outside of EA, expected default frequency will be used as proxies for corporate PDs, while a panel model will be used for household PDs. LGD shocks for collateralized exposures will be linked to paths for real estate prices in the scenario using a smoothing factor to account for the TTC regulatory approach. • Interest income to be projected at geography-portfolio segment level using a structural approach applying interest rate shocks on new business and repricing of floating rate instruments. Funding costs to be projected at portfolio level using funding structure by product (retail and wholesale deposits, secured and unsecured debt securities, repo, etc.) and maturity bucket (overnight vs. term).

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
Banking Sector: Solvency Stress Test		
Top-down by IMF		
3. Tail Shocks	Stress test horizon	• 2025 – 2027 (three years)
	Scenario	Three scenarios: • A baseline scenario drawn from the January 2025 WEO macroeconomic projections. • Adverse scenario 1: A geopolitical scenario featuring an escalation of geopolitical conflicts. • Adverse scenario 2: A recessionary scenario showing a synchronized global slowdown amplified by sovereign debt distress in EA. • The two adverse scenarios rely on GFM, a structural macro econometric model of the world economy, disaggregated into 40 national economies, documented in Vitek (2015).
	Second-round effects and Sensitivity analysis	• Household 'consumption at risk,' defined as the consumption of "economically vulnerable households" (for which the sum of debt service and consumption exceeds gross income) as a share of aggregate consumption. The elasticity of unemployment to changes in consumption will be used to test second-round effects on default risk. • Solvency and liquidity risk interactions testing business risk will be assessed in April 2025 for the G-SIBs.
4. Risks and Buffers	Risk covered	• Risks covered include credit (on loans and debt securities), market (valuation impact of financial instruments with respect to market risk factors such as interest rates, foreign exchange, credit spread, equity prices) and interest rate risk.

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
Banking Sector: Solvency Stress Test		
Top-down by IMF		
	Behavioral Adjustment	• Static balance sheet approach: size of portfolios (gross of NPLs) remains constant throughout the stress testing horizon (with no write-offs allowed). • In projecting RWAs, standardized and IRB portfolios are differentiated. For the standardized portfolios, RWAs change due to the shift in the composition of performing and non-performing exposures, and a deterioration in creditworthiness is modeled as a credit rating downgrade linked to the initial rating of the exposure and the projected rise in loan losses. For the IRB portfolios, through-the-cycle-PDs, downturn LGDs and EAD for each asset class/industry are used to project risk weights. • Interest income from nonperforming loans is not accrued. • Dividends are paid out by banks that remain profitable and adequately capitalized. The tax rate and the dividend rate are both set at 30 percent.
5. Regulatory and Market-Based Standards and Parameters		• Consider two hurdle rates: (i)" Minimum capital hurdle" consists of regulatory minimum Pillar 1 capital requirements (4.5 percent for CET1 ratio) plus Pillar 2 requirements (P2R); (ii) "Breaching buffers hurdle" includes the SREP capital requirements and capital buffers (CCoB, max (G-SII, O-SII), and SyRB). The CCyB is assumed to be zero in the scenarios. Leverage ratio during the stress test horizon assessed against the 3 percent Basel III minimum requirement.
6. Reporting Form for Results	Output presentation	• Aggregate capital path for each scenario by groups of banks, categorized by business model. • Aggregate capital shortfall relative to RWAs. • Number of banks and percentage of banking assets in the system that fall below the hurdle rates. • Outputs also include information on impact of different result drivers, including profit components.

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
B. Banking Sector: Liquidity Stress Test		
Domain		**Framework**
		Top-Down by FSAP Team
1. Institutional perimeter	Institutions included	95 SIs (out of 109 SIs), of which 7 are G-SIBs.
	Market share	About 99 percent of the banking sector assets.
	Data and horizon	Data vintage: 2024: Q2 updated to 2024: Q4 in April/May 2025 Data: Supervisory data from ITS files (FINREP, COREP). Scope of consolidation: Consolidated group basis. Perimeter of the banking group (CRD V). Insurance activities are excluded; banking associates are included.
2. Channels and Risk Propagation	Methodology	Structural analysis: evolution of LCR, NSFR, Asset Encumbrance, Funding concentration and Collateral Swaps. Dynamic analysis: (i) LCR- stress tests, using more severe scenarios than regulatory ones. Breakdown by significant currency, where available. (ii) Cashflow-based stress test. Breakdown by significant currency, where available. (iii) Reverse stress test to imply under which outflows banks would not meet regulatory requirements (LCR) or become illiquid (negative CBC).
	Stress test horizon	30 days for LCR-based tests, and 1-day through 1-year for cashflow analysis.
3. Type of analyses	Scenario analysis	For cash flow liquidity stress tests. Various stress scenarios are considered, with varying intensity of adverse liquidity conditions. Main risks analyzed are: (i) idiosyncratic risk due to reputational risks/decline in CET1 capital; (ii) market upheaval and tightening of market liquidity conditions (linked to solvency adverse scenario, where possible), deposit run-offs, outflows from top funding sources.
4. Buffers	Behavioral adjustments	Different amounts of CBC using assumptions about ECB monetary policy (collateral) normalization. Liquidity from the central bank (except for the lender of the last resort measures) is considered under different assumptions about what type of collateral is included into CB eligible CBC
	Buffers	Capacity of banks to generate liquidity from inflows and from assets under stress (i.e., counter-balancing capacity).

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
B. Banking Sector: Liquidity Stress Test		
Domain		**Framework**
		Top-Down by FSAP Team
5. Regulatory standards	Regulatory/accounting and market-based standards	For the LCR, the hurdle rate is set at 100 percent at the aggregate currency level (per Basel III and domestic regulation). For cashflow analysis, the outcomes of interest are the Net Liquidity Position and the survival period.
6. Reporting format for results	Output presentation	Outputs include (1) Average LCR, Net Liquidity Position and survival period, (2) Number of institutions with LCR below regulatory limits, (3) Reverse stress tests.
C. CCP counterparty credit risk on reverse repo		
Top-down by IMF, in collaboration with ESMA staff		
Institutional Perimeter	Institutions included	• 14 EU CCPs + 2 Tier 2 CCPs
	Market share	• 100 percent
	Data and baseline date	• SFTR, CCP supervisory return, 2024:Q4
Methodology	• Type of exposures considered: bilateral reverse repo • Conditional loss based on stressed collateral value • Historical simulation over 5 years (2020-2024), Holding period of 5 days: based on portfolios at the cut-off, cumulative distribution function of conditional losses is computed for each CCPs by sampling from past 5 years market conditions, with equal weights for each day. Unlike a parametric set up, historical simulation does not assume a specific distribution of returns and correlations. The holding period of 5 days reflects common regulatory practice for VAR set up in risk management and represents the time it might take for the CCP to monetize the collateral after default of counterparty. • Total loss for each day in the historical simulation based on all possible combinations of conditionally independent defaults of counterparties. Probabilities of default for counterparties are based on National University of Singapore, Credit Research Initiative - https://nuscri.org/en/.	
Risks	• Counterparty credit risk	

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
CCP counterparty credit risk on reverse repo		
Top-down by IMF, in collaboration with ESMA staff		
Buffers	• Skin in the game and default fund	
Output presentation	• Expected shortfall at 0.1 percent • Cover 2	
D. Testing System-Wide Spillovers from NBFI Liquidity Distress		
Top-down by IMF, in collaboration with ESMA staff		
The scope of the analysis includes the liquidity demand from UCITS (using commercial Lipper data), AIF, and MMF (using AIFMD and MMF Regulation data, in cooperation with ESMA) as well as the interaction of their joint activities in the bond, repo and derivative markets. In the process, cooperation with ESMA also allows analyzing margin requirements using transaction-level derivatives and repo data. The analysis quantifies spillover effects on core funding markets, banks and other investment funds as well as money market funds. It further incorporates additional liquidity demand on these money market funds from insurance companies (using data provided by EIOPA). The scope of the analysis has been limited by the data access granted. For a fully-fledged system-wide liquidity stress test further channels and assets need to be incorporated. First, the system-wide analysis excludes certain types of interactions because data could not be accessed in one location and could not always be exported at the level of granularity required. Second, the analysis does not fully incorporate the interactions of funds and banks due to limited data availability, for example, the channel of credit line usage could not be analyzed because access to the AnaCredit credit registry was not granted. Third, the level of granularity in terms of asset holdings reported did not allow for the identification of cross-holdings in all cases.		
1. Institutional Perimeter	Institutions included	• 13,000 (EUR 7.1 trillion) UCITS funds with holdings data in Lipper, 19,000 (EUR 7.4 trillion) AIF and around 1,000 (EUR 1.5 trillion) MMF • EA insurance undertaking from a significant subset of EA jurisdictions, • Banks: 109 EA Significant institutions
	Market share	• Funds: 50 percent of assets under management of UCITS Funds, over 90 percent of open-ended AIF, and over 90 percent of MMF • Insurers: about 70 percent of EA insurers' total investment • Banks: About 99 percent of the banking sector assets
	Data and baseline date	• 2024: Q2 for stock • 2020-2024 for time series of market variables

Table 7. Euro Area: Stress Testing Matrix (STeM) (continued)		
Testing System-Wide Spillovers from NBFI Liquidity Distress		
Top-down by IMF, in collaboration with ESMA staff		
2. Channels of Risk Propagation	Methodology	• Liquidity measure based on cash and high-quality liquid assets • Models of market depth to integrate second round effect coming from sales of assets, considering illiquidity of assets - calibrated based on MIFID trading disclosures • Limited incorporation of intersectoral linkages via deposits
3. Risks and Buffers	Risks	• Severe redemption shock, with additional liquidity needs arising from margin calls on derivatives and collateral calls on repo • Funding liquidity (liquidity outflows) and inability to sell assets to cope with redemptions • Market liquidity leading to second round price effects • Margin calls leading to second round liquidity effects • Liquidity demand from funds to banking sector
	Buffers	• Stock of liquid assets, cash, and reverse repo positions
4. Tail shocks	Size of the shock	• Market scenario calibrated based on expected shortfall at 0.1 percent of market factors marginal distributions over the holding period of the scenario (i.e., 2 or 10 days). Historical data covered the period January 2008 - October 2024. • Redemption shock calibrated based on historical net flows and returns data and linked to the market scenario • Second round effects coming from price effects due to sales of assets
	Sensitivity Analysis	• Access to repo market

5. Reporting Format for Results	Output presentation	• Liquidity shortfall at Fund sector / strategy level, including:
		  ○ Number of funds with a redemption coverage ratio (ratio of highly liquid assets to redemptions) below one
		  ○ Total net assets of funds with RCR below one, as a percentage of aggregate total net assets
		  ○ Total liquidity shortfall in sector / strategy group
		• Distribution of bank liquidity pressures
		• Market impact for key segments
		• Net demand on repo market
		• Redemptions from other funds, especially MMF and Exchange Traded Funds

Appendix I. Recommendations on Enhancing Financial Stability Data Collection, Sharing, and Transparency in the EA

Data Recommendations	Timeline[1]	Authorities
Publish the individual insurance undertaking results of stress test exercises, starting from the 2024 Stress Test exercise.	ST	EIOPA, NCAs
Make EIOPA the recipient of supervisory data from insurance undertakings and groups with access to national authorities to facilitate sharing of data with other EU authorities.	ST	EC
Publish individual insurer statistics to contribute to market discipline.	ST	EIOPA, NCAs
Ensure new reporting framework under UCITS and AIFs collects instrument-level portfolio data and sufficient and comparable information on leverage across funds, to adequately monitor systemic risks and be able to conduct macroprudential/system-wide stress testing of funds.	MT	ESMA
Develop a harmonized approach for the measure and reporting of leverage across fund types.	ST	ESMA, EC
Enhance data collection and powers for automatic and timely sharing of financial stability data including for non-bank financial institutions and transaction-level data.	MT	EC
Introduce a single reporting mechanism for fund-level data and centralize data collection at ESMA. Specifically include information on: Liquidity Management Tools (LMTs), committed credit lines/temporary borrowing arrangements from banks.	MT	EC, ESMA
Close data gaps for Tier 2 CCP regarding investment positions, including on collateral received.	MT	ESMA
Ensure ECB's direct and complete access to data on UCITS, AIFMD and MiFID/MiFIR data from ESMA, primarily to be able to assess vulnerabilities arising from linkages between banks and investment funds	MT	EC, ESMA
Ensure ESRB's timely and automatic access to data on banks and non-banks alike to be able to deliver on its mandate for macroprudential oversight of the EU financial system.	MT	EC, EBA, EIOPA, ESMA

[1] I: Immediately; ST: short term = less than 1 year; MT: medium term = 1–5 years.

Appendix II. Status of Key Recommendations from the 2018 FSAP

Recommendation*	Timing**	Actions
Supervision		
Reduce the fragmentation of national legal frameworks for bank supervision (EU)	MT	**Status: Partially implemented.** The *Banking Package* (CRR 3 and CRD 6) includes measures designed to ensure more consistent supervision across the EU. CRD6 (i) harmonizes the provisions for the assessment of banks' directors and key function holders (fit-and-proper assessments); (ii) introduces a common set of rules for branches of third-country banking groups operating in member states will replace heterogeneous national approaches and strengthen the single market; (iii) and further harmonizes national powers related to the acquisition of qualifying holdings, transfers of assets or liabilities, and mergers or divisions. However, the ECB continues to exercise supervisory powers granted under national legislation and apply different national laws which, despite some progress, remain unharmonized in several areas (e.g., licensing criteria and governance of credit institutions.
Revise legal provisions to close regulatory gaps with international standards (EU)	MT	**Status: Not implemented.** Three of the deviation from Basel III capital standards identified in the 2014 Regulatory Consistency Assessment Program (RCAP) conducted by the Basel Committee have not been addressed (Danish compromise, limited scope of the Credit Valuation Adjustment capital charge, small and medium enterprise (SME) supporting factors for the part of exposures to non-retail SMS up to EUR 2,5 million, for retail SMEs and for IRB exposures to SMEs), while new deviations have been introduced permanently or temporarily in CRR 3 (lower risk weights for a specific subset of equity exposures under those national legislated programmes for which the only subsidies are guarantees with a guarantor that has a risk weight higher than 100 percent and specialised lending exposures in the form of project finance of physical structures or facilities, systems and networks that provide or support essential public services and meet conditions similar to those for high quality finance under Basel III revisions, lower input floors for exposures to regional governments and local authorities, transitional arrangements restricted to the calculation of the output floor for exposures to real estate and unrated corporates, as well as for securitisation and counterparty credit risk, to allow banks to apply reduced risk weights for these exposures but only when determining risk-weighted assets under the standardised approach as part of the calculation of the output floor), making the output floor less binding during the transition period. The impact of these deviations from Basel is material, as shown in the EBA impact study and further detailed in the ECB confidential impact analysis.
Improve planning of supervisory resources (SSM)	ST	**Status: Partially implemented.** ECB Banking Supervision was reorganized in October 2020, to make the structure more agile and integrated. The reorganization brought the creation of one new business area (D-SSR) with a focus on strategy, risk analysis, and a second line of defense. The D-SSR/Strategic Planning Office is responsible for the set-up, implementation, and continuous improvement of the SSM planning process and its monitoring, as well as for the development of a comprehensive overview of activities and resources vis-à-vis priorities. It also conducts the organizational readiness exercise for implementing SSM priorities and proposes the allocation of the SSM resource pool. The resources used for the ECB's supervisory tasks are financed via supervisory fees borne by the supervised entities (banking groups or stand-alone entities). The ECB in its annual budget planning exercise applies a lean process to cost

Recommendation*	Timing**	Actions
		allocation and provides an early estimation of the supervisory fees using a number of assumptions, including the full consumption of the allocated budget, while the cost metric types applied are based on latest available information (year-end metrics of the previous year). Several actions have been taken to integrate and simplify SSM processes. As regards staffing the NCA leg of Joint Supervisory Teams, several improvements were introduced in the annual staffing process. As part of the supervisory planning process, several tools have been introduced to support the organization's readiness for the implementation of priorities, including capacity building on critical areas. However, the dependency on NCA staff is both a strength but also an additional vulnerability which affects the planning and delivery of supervisory tasks, with more than half the NCAs not being able to meet their staffing commitments to the SSM. in addition, the ECB banking supervision business lines' consultation on the budget proposed by the ECB budgetary function is pro forma and late stage.
Raise standards for handling of loan classification and provisioning (SSM)	ST	**Status: Implemented.** There were developments in supervisory expectations on loan loss provisioning through: (i) the publication of the Addendum for new Non-Performing Exposures (NPEs) as of April 1, 2018; (ii) the SREP recommendations for the stock of NPEs as of March 31, 2018; and (iii) a new automatic Pillar 1 backstop for NPEs from newly originated loans as part of the EU Banking Reform package approved in 2019. In addition, at the onset of COVID-19 pandemic, "dear CEO" letters were published communicating supervisory expectations among others on classification and provisioning aspects. This was followed by extensive assessment of compliance at an individual bank level, issuance of specific recommendations to banks, and follow-up by offsite supervisory teams to ensure any gaps to supervisory expectations are closed. Deep dives in the areas of forbearance, UTP and IFRS 9 implementation were conducted over the last two years and will continue going forward. Lastly, training on these topics was provided to Joint Supervisory Teams (JSTs) and dashboards for the monitoring of asset quality and provisioning were enhanced.
Improve coordination and information sharing regarding AML/CFT (ECB, national authorities)	ST	**Status: Implemented.** At the end of 2018, ECB/SSM set up an AML Coordination Function (ALMCO) with responsibilities to: (i) act as a central point of contact for SIs; (ii) set up a network for achieving consistent SSM-wide prudential approach; and (iii) act as an internal center of expertise on prudential issues. In January 2019, the ECB also signed an agreement for information exchange with nearly 50 national AML/CFTs authorities in Europe as mandated by the 5th review of the AML Directive. Following the ESA review, the EBA is playing a coordinating role on AML/CFT supervision issues across sectors and the EU. The ECB/SSM have taken steps to streamline the information exchange process with AML/CFT authorities and implemented the changes coming from the EBA regulatory framework (EBA cooperation Guidelines, EBA database on material weaknesses). Based on recent external assessments (ECA report, SSM review by the EC), the information exchange process works well overall. The ECB/SSM enhanced the way ML/TF risks are reflected in prudential supervision for the SREP (implementation of the SREP Guidelines), authorizations, and fit-and-proper assessments.
Transfer supervision of systemic investment firms and third-country branches to the SSM (EU)	ST	**Status: Partially implemented.** The new Investment Firm Regulation and Directive—in force since June 2021—have introduced a multi-tiered regulatory regime for investment firms. They require that the largest and more systemic investment firms (above EUR 30 billion at solo- or group-level) and engaging in specific activities (dealing on own account or underwriting or placing financial instruments on a firm commitment basis) are authorized as credit institutions and,

Recommendation*	Timing**	Actions
		if the criteria for significance are met, fall under the direct supervision of the ECB. Although CRD 6 will improve the regulation and supervision of third-country branches, such branches will remain licensed and supervised by NCAs (outside the SSM) unless they are converted into subsidiaries and considered SIs. The process to require the establishment of subsidiaries is rather complicated and led by NCAs, without any possibility for the ECB to influence the outcome. There is also limited information available at the EU or EA level on the type and importance of activities of these branches, as well as on the risks taken and their booking models. It is also envisaged that CRD 6 will further enhance supervisory cooperation by including those TCBs with a larger EU footprint under EU supervisory colleges.
Ensure the availability of a full set of borrowers-based macroprudential instruments (EC, ESRB)	MT	**Status: Not implemented.** The ESRB has proposed the implementation of borrower-based measures (BBMs) in its responses to the European Commission's public consultations. To the consultation on banking sector macroprudential policy review in 2022 the ESRB has proposed the introduction of a common minimum set of BBMs in EU legislation for residential real estate loans. In the non-banking review, the ESRB called for the introduction of activity-based regulation into EU law, enabling national authorities to set BBMs and apply them to all types of lenders. In Recommendation ESRB/2022/9 the ESRB recommended that the EC assesses the current macroprudential framework in the EU and ensures that consistent rules for addressing risks related to CRE exposures are applied across all financial institutions when they perform the same activities, taking into account their specificities and specific risk profiles. In the 2024 report on the macroprudential review, the Commission identified BBMs as one of the key areas for further work for enhancing the framework's ability to tackle risks stemming from real estate markets. BBMs differ across the EU because the measures, where they exist, are exclusively governed by national law.
Preparations for the U.K. Exit from the EU		
Accelerate discussions on action to ensure continuity of service and data access (ECB, ESAs, SSM)	I	**Status: Implemented.** Cliff edge effects from derecognition of U.K. CCPs were avoided. Cooperative arrangements between the Eurosystem/ECB, the Bank of England, and the relevant U.K. CCPs were adopted due to the United Kingdom's withdrawal from the EU. U.K. CCPs were (temporarily, until June 2025) recognized for the purposes of providing clearing services in the EU. The EC adopted a decision (January 2025) to extend equivalence for UK CCPs framework for a further three years until 30 June 2028. This decision aims to ensure EU financial stability in the short-term and provide clarity to EU financial market participants. In March 2019, the ECB and the BoE announced the activation of the currency swap arrangement for the possible provision of euro to U.K. banks and of GBP to euro area banks. ECB Banking Supervision cooperates and exchanges confidential supervisory information with the U.K. prudential authorities on the basis of the Memorandum of Understanding (MoU) concluded in 2019 for the period after Brexit.
NPL Resolution		
Prescribe rules for valuation of immovable	MT	**Status: Implemented.** The 2017 EBA guidelines on PD and LGD estimation require some level of prudence for the purpose of LGD estimation, to reflect that the value of repossession does not always reflect accurately the market value of the asset. Banks are required to address this uncertainty by applying an appropriate

Recommendation*	Timing**	Actions
loan collateral, including repossessed collateral. (EU).		haircut to the value of repossession. The *Banking Package* contains requirements for determining the property value, a concept which is more prudent than the market value, and which should remove the divergence between jurisdictions using either market value or mortgage lending value. CRR 3 and EBA Guidelines on Loan origination and monitoring, NPL and FB, and SREP set out the requirements for banks' valuation of immovable and movable properties at origination, requiring banks to set out internal policies and procedures for the valuation of collateral; collateral valuation of immovable and movable properties pledged for nonperforming exposures , including the governance, procedures and controls in the collateral valuation; the frequency of the valuations; and the methodology for valuation of the collateral.
Set consistent NPL definitions and reporting standards (EC, EBA, SSM)	ST	**Status: Implemented.** Regulation (EU) No. 630/2019 amended Regulation (EU) No. 575/2013 and introduced a clear set of conditions for the classification of nonperforming exposures. EBA Guidelines on SREP, Loan Origination, Default, and NPLs set out requirements for the ongoing administration and monitoring of the various credit risk-bearing portfolios and banks' exposures, including identifying and managing problem credits and making adequate value adjustments and provisions. These guidelines set out: the definition of default; technical criteria for the identification of past-due borrowers; technical criteria for the identification of problem borrowers (e.g. unlikely-to-pay or UtP) and thus in default status; several possible triggers that banks could consider for classifying borrowers as UtP; and expectations with regard to the recognition of NPLs.
Establish minimum standards for insolvency and creditor rights regimes (EU)	MT	**Status: Partially implemented.** The 2019 Directive on Preventive Restructuring and Insolvency established minimum standards in certain areas, such as preventive restructuring mechanisms and debt discharge for entrepreneurs. In December 2022, the Commission proposed a Directive harmonizing certain aspects of insolvency law, which is still being negotiated. Critical issues, such as commencement standards for insolvency and the ranking of claims are outside the scope of the Directive.
Crisis Management and Financial Safety Nets		
Strengthen early action framework and advance resolution preparation (SRB, SSM, EC, NRAs)	I	**Status: Partially implemented.** Operational readiness at both the SSM and SRB has improved, with several initiatives to improve understanding of the practical steps needed to implement resolution completed or underway. There have been numerous incremental updates, including to the ECB's escalation procedures and the SSM-SRB MoU. The draft Crisis Management and Deposit Insurance (CMDI) legislation also includes reforms to the early intervention framework and the SRM's involvement earlier in potential resolution cases, but remains subject to negotiation.
Quickly buildup MREL and iMREL, prioritizing large banks (SRB)	I	**Status: Implemented.** The SRB reports that all significant institutions met their MREL targets as of January 1, 2024, with a few cases where a longer transition period was granted accounting for all of the remaining MREL shortfall. All EU G-SIIs still comply with TLAC.
Ensure availability of liquidity in resolution (SRB, EC, Eurosystem)	ST	**Status: Not implemented.** The SRB has stated publicly that the SRF can contribute to liquidity provision to institutions in resolution, but it should not be deemed as the only solution considering its capacity in case of liquidity needs post resolution for large banks. In addition, one member state has not yet ratified the ESM treaty changes to implement the ESM backstop. Recent crisis cases in

Recommendation*	Timing**	Actions
		other jurisdictions have required larger amounts of liquidity than the combined size of the SRF and ESM backstop.
Designate and make operational the SRF backstop (such as the ESM) (EU, SRB, ESM)	ST	**Status: Not implemented.** The establishment of the backstop is legally embedded in the revised ESM Treaty, with entry into force still pending ratification by one signatory. The backstop will have the form of a revolving credit facility initially amounting to EUR 68 billion.
Establish an EDIS with a backstop (EU)	ST	**Status: Not implemented.** Eurogroup-mandated work on EDIS has been suspended since 2022. The SRB has stated publicly that during the next legislature, the Council should decide to re-start discussions on EDIS.
Ensure consistency of triggers for action such as resolution, liquidity assistance, and precautionary recapitalization (EC, ECB, SRB)	ST	**Status: Partially implemented.** In 2018, ECB Banking Supervision has adopted a new definition of solvency to be used in the context of: (i) precautionary recapitalization; (ii) state guarantees on newly issue liabilities; and (iii) state guarantees to back central bank liquidity facilities. The new methodology is based on a forward-looking assessment of compliance with Pillar 1 and Pillar 2 capital requirements. It ensures alignment with the FOLTF assessment (which is one of the three conditions for resolution). The proposed CMDI reform would broadly improve the alignment of triggers for crisis management tools, including precautionary recapitalization, preventive measures, and resolution.
Align state- aid loss-sharing requirements (in resolution) with the BRRD/SRMR, while introducing flexibility through a financial stability exemption (EU)	ST	**Status: Not implemented.** The Commission is carrying out an evaluation of its state-aid framework for banks, which was expected to be completed in the first quarter of 2024 but has not yet been published. The outcome of this evaluation is expected to inform a subsequent potential review of the state-aid framework for banks.
Further harmonize the creditor hierarchy in bank insolvency (EU)	MT	**Status: Not implemented.** The proposed CMDI reform includes further harmonization of creditor claims as regards the ranking of depositors in insolvency (all depositors ranking in a single tier), but not other issues (e.g., treatment of post-default interest).
Introduce an administrative liquidation tool for the SRB (EU)	ST	**Status: Not implemented.** The approach taken with the proposed CMDI review is to facilitate the application of the already harmonized resolution framework to small- and middle-sized banks.
Pare back state-aid oversight of the use of the SRF and deposit insurance funding on a least-cost basis (EC)	ST	**Status: Not implemented.** The Commission's CMDI proposal envisages a targeted simplification of the process to be followed by the Commission and the SRB in case of use of Fund or State aid in resolution while maintaining the assessment of compatibility of such aid with the single market.
Buttress SRB independence and powers (for example, by granting permanent observer status at the SSM Supervisory Board) (SSM, EC)	I	**Status: Partially implemented.** The revised version of the SSM-SRB MoU signed in 2022 sets forth that "*the Supervisory Board will invite the Chair of the SRB to participate as an observer in its meetings for items relating to the tasks and responsibilities of the SRB*." Other changes to the SRB's status and powers have not been pursued.

Recommendation*	Timing**	Actions
Liquidity Management		
Articulate an explicit financial stability mandate for the ECB/Eurosystem (ECB)	MT	**Status: Not implemented.** The authorities consider that Article 127(5) of the Treaty of the Functioning of the European Union—*"The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system"*—and Article 25 of the ESCB Statute suffice. Following the latest Strategy Review, the ECB has taken steps to integrate financial stability analysis into the monetary policy-making process. These aim to preserve the focus on the primary objective to maintain price stability while taking into account any spillovers or interactions with financial stability matters.
Intensify "horizon scanning" involving supervisory and operational functions (ECB, SSM)	I	**Status: Partially Implemented.** The ECB had taken note of the recommendation regarding the "horizon scanning" arrangements to better detect emerging liquidity strains. Elements of horizon scanning are, however, already built into processes on the supervisory and monetary policy sides of the ECB. Additional elements will need to be considered in future work. With respect to the *euro area* CCPs' access to the Eurosystem facilities, there is ongoing work regarding the TARGET emergency credit facility, which covers, to the extent feasible, the possible harmonization of conditions across various credit facilities available to CCPs (with and without a banking license) as well as considering potential safeguards and enhancements of cooperation/information-exchanges (with relevant CCP supervisors).With respect to *non-euro area* CCPs, the internationally agreed "No Technical Obstacle" principles are considered to provide sufficient basis for possible establishment of arrangements between the ECB and non-euro area central banks.
Further harmonize and ultimately centralize ELA arrangements (ECB)	ST	**Status: partially implemented.** The ECB regularly reviews the rules and procedures surrounding the provision of ELA, as laid down in the ELA agreement (driven by transparency considerations, the ELA agreement was first published in June 2017; the last ELA review was finalized in 2020: Q4). The ELA framework has evolved and expanded over the last years with more elements being covered by the ELA agreement to ensure that the provision of ELA by NCBs does not interfere with the Eurosystem monetary policy. Moreover, and with a view towards a consistent approach within the euro area, topics related to communication and disclosure, solvency definition, or provision of foreign currency are also being looked at in the context of regular ELA reviews. Centralizing ELA would have substantial benefits, and should be pursued as a key element of completing the BU
Manage the transition from crisis-related policy settings and develop the future operational framework to reflect regulatory and market developments (ECB)	MT	**Status: Implemented** The ECB implemented changes to its operational framework for steering short-term interest rates in October 2024. The major changes are a narrowing of the corridor (to 15 bps) between the rates applied to the Main Refinancing Operation and the Deposit Facility, and the move to a demand driven approach where liquidity is provided on demand (weekly basis through the main refinancing operation) at a fixed rate. Also announced was the intention to construct a portfolio of long-term refinancing operations and securities with details to be announced at a later stage.

* In this table, EU will refer to the Council of the EU, the European Parliament, and the European Commission.
**I: Immediate, within 1 year; ST: short term, within 1 to 2 years; MT: medium term, within 2 to 5 years.

Appendix III. Forthcoming Roles and Responsibilities of AMLA

The AMLA will begin the direct supervision of high-risk financial institutions in 2028. AMLA's mandate calls for supervision of high-risk financial institutions (initially up to 40) in at least six member states through joint supervisory teams led by an AMLA staff member and supported by staff of the relevant national supervisors. AMLA is empowered to take various administrative measures and impose pecuniary sanctions for serious, repeated, or systematic breaches by obliged entities it directly supervises. Most financial institutions will still be supervised at the national level, with AMLA playing an indirect supervisory role to ensure consistency and quality across the EU. AMLA will only intervene and act in exceptional circumstances following indications of serious, repeated, or systematic breaches. In such cases it will request the supervisor to take specific actions or request the Commission to authorize a transfer of supervisory tasks and powers. It will also coordinate with national AML/CFT supervisors and Financial Intelligence Units (FIUs), manage a central AML/CFT database, develop and maintain a harmonized AML/CFT supervisory methodology, and enforce consistent AML/CFT supervisory approach across member states.