Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

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Dear Members,

We would like to provide you with an overall view of the results of the recently published EBA stress test 2025 exercise.

The EBA sample includes the largest EU/EEA banks (while ECB stress test includes medium-sized euro area banks directly supervised by the ECB but outside the EBA sample). There has been no Luxembourg bank directly covered, however several Luxembourg subsidiaries of banks with head office in another EU country have been indirectly covered.

The 2025 EBA exercise includes a sample of 64 banks 4, 51 of which are from the euro area, representing about 75% of the total assets of EU banks.

The headline is very reassuring as the results indicate that the largest EU banks would be resilient to a severe hypothetical - but still plausible - stress scenario that combines a severe recession with escalating geopolitical tensions and a rise in protectionist trade policies worldwide, including tariffs.

Despite bearing combined losses of EUR 547 bn during the 3-year horizon, EU banks show strong income generation during the exercise. This results in an aggregate capital depletion of 370 bps, lower than in the 2023 EU-wide stress test, despite the overall severity of the scenario being broadly similar. EU banks finish the exercise at the end of the scenario with an aggregate CET1 ratio above 12%.

The EU banking sector has also further improved in terms of profitability and capital ratios in the past two years, which has cushioned the impact of the severe scenario. While banks are more risk-sensitive to changes in the scenario demonstrating higher nominal losses, they have a better loss absorption capacity through income generation.

Furthermore, the integration of the CRR III into banks' starting points and projections has been the biggest innovation of the 2025 stress test. The regulator underlines that the stress test continue to be a risk exercise, and not an exercise that assess the regulators change, but still, it gives a good indication to the market.

It appears that the impact of the revised rules on EU banks' aggregate CET1 ratio at year-end 2024 is negligible on a transitional basis, the reduction of the aggregate capital ratio is 129 bps on a "fully loaded" basis, but the latter is applicable only in 2033. As the CRR3 is progressively implemented over eight years, institutions have room to continue adjusting their policies and portfolios towards the full implementation. Still, even if the fully loaded ratios would be applicable today, the EU banking system would finish the exercise with an aggregate CET1 fully loaded ratio above 11%, which is notably higher compared to previous stress tests.

Few attention points still emerge from the report:

- Stress testing capabilities are sometimes impacted by improvable internal organization and systems. Banks should further develop their statistical capabilities to project sectoral losses and enhance their risk management to better capture vulnerabilities that may hide in parts of their corporate portfolios.

- It is expected that, going forward, the loss absorption capacity coming from Net Interest Income (NII) will decline as banks net interest margins will normalise from high levels. Stress tests over the past three cycles show that persistently low interest rates are more damaging to banks' NII than sharp rate hikes.

- Banks are more vulnerable in certain risk areas. Not surprisingly, the largest losses come from credit risk. However, in this year's exercise they are notably higher compared to the 2023 exercise. Similarly, losses from market activities are much higher compared to the previous stress test

On credit risk, we also refer to the counterparty credit risk (CCR) exploratory scenario analysis recently published by the ECB.
This exploratory analysis is separate from the 2025 EU-wide stress test coordinated by the EBA and investigates additional hypothetical adverse scenarios relevant for CCR. The 15 participating banks were selected based on quantitative criteria derived from the 2023 EBA stress test and on supervisory judgement.

It examined how selected banks model CCR under diverse stress conditions and also aimed at better understanding the vulnerabilities stemming from interlinkages between the banking sector and non-bank financial institutions (NBFIs).

The analysis suggests that banks’ stressed CCR exposures net of collateral are particularly sizeable vis-à-vis non-financial corporations and US-based NBFIs. The level of collateralisation in stressed CCR portfolios varies considerably across the banks.

As in prior years, the stress test results influence banks’ SREP scores and supervisory capital requirements.

We hope this summary would be useful for your teams and we would be pleased to continue the conversation in our relevant committees.

Kind regards,

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You can view the details here:

https://abbl.lu/en/professionals/members/discussion/2791