



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Written overview for the exchange of views of the Chair of the Supervisory Board of the ECB with the Eurogroup on 4 May 2026

At the current juncture, Europe's banking sector remains resilient, which is a testament to the significant progress made since the global financial crisis and the European sovereign debt crisis. Strong capital and liquidity positions are allowing the sector to provide services to the economy. But this resilience may be tested. The ongoing war in the Middle East is a stark reminder of how quickly geopolitical shocks can affect the economy and change the risk environment for banks.

Geopolitical risk and its impact on banks

The conflict in the Middle East is adding to an already challenging geopolitical environment, with implications for energy prices, inflation and growth. Financial conditions have tightened, reflecting lower equity prices and higher risk premia. This could weigh on investment, stretch borrowers' capacity to repay loans and ultimately affect banks through three main channels.

First, credit risk may increase. Euro area banks have relatively modest direct exposures to countries in the conflict region. However, the indirect effects of the war could be more substantial, and their severity very much depends on its duration. Credit quality may deteriorate in energy-intensive sectors such as manufacturing and transportation. In an adverse scenario, weaker growth and higher inflation could impair borrowers' debt servicing capacity, leading to a build-up of non-performing loans on banks' balance sheets.

Second, heightened geopolitical stress may trigger sharp price movements across asset classes and cause bouts of market illiquidity. For banks that rely heavily on wholesale funding, market volatility could become a source of vulnerability. More broadly, elevated uncertainty may increase counterparty credit risk, disrupt market functioning and tighten funding conditions for banks. Vulnerabilities in non-bank financial institutions and private credit markets that are interconnected with banks could further amplify these risks.

Third, modern conflicts have a cyber dimension, turning critical financial infrastructure and individual institutions into potential targets. Operational resilience is therefore crucial to the soundness of euro area banks.

For banks to manage these challenges effectively, they need strong financial and operational resilience, underpinned by effective liquidity management. This is reflected in our supervisory priorities, which focus among other things on ensuring prudent risk-taking and adequate capitalisation, as well as robust operational risk management frameworks and strong cyber risk mitigation capabilities.

The euro area banking sector remains well capitalised, with significant banks reporting an aggregate Common Equity Tier 1 ratio of around 16% and a leverage ratio slightly below 6% in 2025.¹ Banks are comfortably meeting the new capital rules under the revised Capital Requirements Regulation (CRR III), which implements Basel III and came into effect in 2025: thanks to phase-in arrangements, temporary provisions and banks' balance sheet adjustments, the shift to the new rules has left banks' capital requirements practically unchanged.² In addition, liquidity positions remain strong, exceeding regulatory minimum requirements.³

The European banking sector's operational resilience continues to be challenged by an elevated and evolving cyber threat environment arising from geopolitical developments and fast-paced technological change. Rapid advances in AI-enabled vulnerability identification and attack capabilities may increase the likelihood of successful cyberattacks. Requirements under the Digital Operational Resilience Act (DORA) relating to third-party outsourcing, together with other supervisory initiatives such as the 2024 cyber resilience stress test, have helped banks to prepare. However, banks need to continue strengthening their vulnerability management processes and bolster their detection and response capabilities.

Safeguarding banks' resilience

Safeguarding the resilience of banks is key. So far, the effects of the geopolitical disruptions have not yet materialised on banks' balance sheets, and non-performing loans remain relatively low. But the favourable conditions in the banking sector are no grounds for complacency. Banks must remain prepared for scenarios in which the environment deteriorates abruptly, particularly since fiscal policy has limited capacity to buffer shocks and thus protect banks' balance sheets.

¹ Profitability remained robust throughout 2025, with return on equity standing at around 10%.

² See EBA (2024), [Basel III monitoring exercise results based on data as of 31 December 2023](#), October. The EBA's impact assessment finds that the average increase in Tier 1 requirements resulting from the European implementation of the Basel package is below 4% until 2030, and below 8% in 2033, when transitional provisions are lifted. This estimate is an upper bound as it is based on static balance sheet assumptions, whereas in reality banks dynamically adjust their exposures over time. Other recent contributions suggest that the impact of Basel III is shrinking. See, for instance, Esho, N. (2025), "[Just get it done](#)", remarks at the 20th high-level meeting on financial stability and regulatory and supervisory priorities, 10 December.

³ The liquidity coverage ratio and the net stable funding ratio for significant institutions stood at 159% and 127% respectively at an aggregate level in 2025.

The 2025 EU-wide stress test exercise, which assessed euro area banks' preparedness to cope with geopolitical risks, showed that the euro area banking sector is sufficiently capitalised to absorb losses occurring in a common adverse scenario triggered by geopolitical events. This year, we are asking banks to identify a scenario that could lead to a pre-determined capital depletion. We will also ask them to describe how they would act to mitigate the impact of adverse shocks using their risk management capabilities and contingency planning.

Well-capitalised, well-managed and well-governed banks are better placed to absorb shocks and support the economy – whether these shocks originate in financial markets, the macroeconomy or geopolitics. This benefits households and firms.

Promoting fair competition and integration

Differences in the implementation of Basel III across jurisdictions have led the banking industry to renew its calls for lower capital requirements in Europe, arguing that a level playing field is needed to preserve banks' competitiveness and free up balance sheet capacity for banks to lend to the economy. But lower capital requirements would not achieve either of these objectives. Instead, they would increase fragility.

Lower capital requirements would reduce the scope for international cooperation. The Group of Central Bank Governors and Heads of Supervision overseeing the Basel Committee's work on regulatory standards and policy has recently confirmed its commitment to implementing the Basel rules. This international coordination has always been central to our supervisory approach. Global standards, agreed under the aegis of international standard-setting bodies, are – and will remain – a cornerstone of our work. We need to preserve a strong and proportionate framework that safeguards financial stability and protects European banks from potential spillovers originating outside the European Union or outside the banking sector.

What is more, lower capital requirements would put the resilience of the euro area banking sector at risk. Banks need to be sufficiently capitalised to lend to the economy and absorb potential losses without disrupting the flow of credit. Lowering capital requirements would not guarantee more lending. Rather, it would weaken banks' ability to keep credit flowing in times of stress, precisely when support for the economy is needed most. Banks currently have sufficient capital to lend to the economy, but elevated risks, lower risk tolerance and weak demand for loans are preventing the supply of credit from expanding more quickly. In this situation, lowering capital requirements may simply result in higher distributions to shareholders rather than more lending to firms and households.

This brings me to the debate on competitiveness, which is often framed too narrowly with the focus on banks' short-term profitability or share price performance. But competitiveness has a broader meaning. It is not about banking systems competing against one another. It is about how banks perform individually – their productivity, efficiency and ability to innovate and provide services of better quality or at a lower cost than others.

Banks' contribution to welfare should be assessed more broadly, taking into account the safety of deposits, financial stability and services provided to customers.

Against this background, I would like to highlight three key actions to ensure banks can develop sustainable business models that will enable them to compete successfully in the future while maintaining resilience.

The first action is to complete the implementation of Basel III in the respective legislation. This will promote fair international competition and strengthen financial stability – ensuring that banks can continue delivering their services to the economy even in times of distress.

Second, banks' must adapt their business models to the digital transition and technological innovation. Investments in technology can help banks integrate innovation into core processes and deploy strategies to address competition from new digital market participants. Banks currently enjoy good levels of profitability, which means they are in a position to make these investments. Supervisors assess banks' digital maturity both in terms of IT resilience and strategic impact on business models, focusing in particular on generative AI and digital assets.

Third, banking markets across Europe remain fragmented, and local market power has even increased in some countries. Promoting competition and integration can thus improve the provision of financial services and give banks an incentive to become more competitive.

From the supervisory side, we reduce unnecessary complexity and compliance costs while addressing relevant risks. We are making supervision more efficient, effective and risk-based – which includes standardising key processes for reaching decisions on internal models, capital, stress testing, reporting and on-site inspections. And we are fostering a more unified supervisory culture across the Single Supervisory Mechanism that directs supervisory efforts to where they matter most.⁴

Strengthening the Single Market

A deeper and more integrated Single Market remains the essential foundation for a competitive European banking sector, but it is still incomplete. Although we have made significant strides towards banking union, practical progress on integration of European banking markets has been limited over the past decade. The cross-border provision of services remains relatively low, and cross-border merger activity has been weak. This is why the banking union should be regarded as a single European jurisdiction for the purpose of financial regulation.

European banks continue to operate in a more fragmented market than their US counterparts, with activities still largely organised along national lines. This fragmentation limits banks' ability to reap economies of scale and serve a broader, integrated client base. It constrains risk diversification. What

⁴ See ECB (2025), [Simplification of the European prudential regulatory, supervisory and reporting framework](#), December; and ECB (2025), [Streamlining supervision, safeguarding resilience: the ECB's agenda for more effective, efficient and risk-based European banking supervision](#), December.

is more, the lack of harmonisation in areas such as insolvency legislation, mortgage market regulation and corporate law creates undue complexities which may discourage banks from operating across borders. Insolvency rules are a prominent example: the time needed to enforce claims and complete recovery procedures differs significantly across EU countries.

A true single market for banks should be accompanied by a mature capital markets union to boost innovation financing through equity and long-term risk capital. Bank and market-based finance complement each other. Banks play a central role in underwriting, securitisation, risk-sharing and advisory activities. In this context, we welcome the European Commission's package on market integration⁵, including its proposals to step up the centralised supervision of significant capital market participants, as this is a necessary pre-condition for fostering capital market integration.

The main obstacle to genuine cross-border banking integration is the persistence of differences in national legal and regulatory frameworks. From a supervisory perspective, we treat cross-border and domestic mergers alike when assessing their prudential implications.⁶ In addition, we believe capital and liquidity should be allowed to flow freely within cross-border banking groups in the banking union, provided supervisory requirements are met.

Completing the banking union by establishing a European deposit insurance scheme (EDIS) should be a priority. A collective effort is needed to arrive at a clear timetable for implementation. EDIS would improve crisis management, reduce the bank-sovereign nexus and ensure equally strong depositor protection regardless of individual Member States' fiscal capacity. It may additionally provide an incentive for cross-border consolidation. Alongside EDIS, a strong EU framework for liquidity in resolution is crucial for successful bank crisis management.⁷

Summing Up

Geopolitical risks have materialised, not least because of the ongoing war in the Middle East. The effect on energy markets has been very sudden, but the full impact of the shock on the global economy and financial system will be revealed only over time. Uncertainty over the duration, intensity and propagation of the shock is high. In such a fragmented and unpredictable global environment, Europe's strength lies in its ability to promote integration while safeguarding resilience, at the same time reaffirming its commitment to international standards and regulatory certainty. Developing a true single market in Europe – for consumers, non-financial firms and financial institutions – is key to supporting innovation, investment and growth. This is crucial for maintaining financial stability.

⁵ See European Commission's [Market integration and supervision package](#)

⁶ See ECB (2021), [Guide on the supervisory approach to consolidation in the banking sector](#), January.

⁷ See ECB (2026), [Eurosystem response to the EU Commission's targeted consultation on the competitiveness of the EU banking sector](#), April.