THE SUPERVISION BLOG

Navigating the risk landscape: supervisory priorities 2025-27

14 January 2025

By Sharon Donnery and Mario Quagliariello

Our supervisory priorities for 2025-27 focus on strengthening banks' ability to withstand macro-financial and geopolitical shocks, and on ensuring that banks remediate material and persistent shortcomings in a timely manner and address emerging challenges. In this blog post, we explain how these priorities will help European supervisors navigate the evolving risk landscape.

European banks are operating in a world of mounting challenges. Escalating geopolitical tensions, rapid technological change and the visible impact of climate change are significantly reshaping the risk environment. With finite resources and an evolving risk landscape, European banking supervision needs to focus on the most pressing challenges and concentrate efforts where they will have the greatest impact. Against this backdrop, the Supervisory Board has defined three key priorities that will guide our work over the next three years. First, our actions aim to improve banks' capacity to assess and manage macro-financial threats and geopolitical risks in particular. Second, we want banks to remediate persistent and material shortcomings in areas subject to intense supervisory scrutiny. This remediation needs to be both timely and effective. And third, we expect banks to address challenges arising from digitalisation and the use of new technologies. By focusing on these critical areas, we aim to ensure that Europe's banking sector remains resilient, sound and stable. This will also enable banks to stay competitive and be ready to support the economy through whatever challenges lie ahead.

Incorporating geopolitical risks into our supervisory priorities

Geopolitical risk has become a defining challenge for the global economy. In an era marked by rising protectionism, heightened uncertainty and the erosion of multilateral cooperation, financial systems face a more volatile and unpredictable environment than ever before. It is becoming increasingly difficult to identify the potential shocks that could trigger a crisis, to assess the potential spillovers across sectors and intermediaries and to predict the overall impact on banks and the economy. These risks, which are often complex and interconnected, require a new level of vigilance from banks and supervisors alike.

The focus needs to shift to the adequacy of risk controls and mitigation measures to ensure resilience in an uncertain environment.

In their interactions with banks, supervisors will use the framework we have developed to understand how geopolitical risks affect banks through various channels. Whether it is through volatile financial markets, disrupted trade and supply chains or direct threats to operations and security, geopolitical events can ripple across every aspect of a bank's business. By mapping these transmission channels we are promoting a better understanding of how geopolitical risk affects more traditional risk categories such as credit, market, operational, liquidity and funding risks.[1] As geopolitical risks cut across these traditional risk types, we address them as part of supervisory activities that are already ongoing, while also taking a holistic approach. Banks' management bodies are responsible for proactively managing these risks, with a robust risk culture that incorporates uncertainties in a holistic risk management strategy.

Our work on how banks manage credit and operational risk is a case in point. Supervisors are looking closely at how banks identify signs of weakening asset quality and whether they have sufficient provisions to cover potential losses, including those linked to geopolitical risks.[2] At the same time, the growing dependence on third-party providers and escalating geopolitical tensions have led to heightened cyber threats, making robust risk controls essential. This is particularly relevant in the context of our third supervisory priority – digitalisation and the increasing use of new technologies – as banks may be exposed to new challenges.

This year, geopolitical risks will feature prominently in the EU-wide stress test. In parallel, an exploratory scenario analysis will assess how well banks can model counterparty credit risk under stress. Alongside this work, we will also review how banks approach geopolitical risks in their risk management frameworks, capital and liquidity planning and internal stress testing, in order to identify sound practices and further clarify our supervisory expectations.

From risk identification to remediation

Our second priority is ensuring that banks remedy persistent material shortcomings promptly and effectively. In recent years supervisors have made a lot of progress in identifying banks' weaknesses in areas such as climate-related and environmental (C&E) risks and governance. We are very aware of where the shortcomings are. And while banks have been addressing our concerns and calls for improvements, sometimes remediation takes too long. This is why our focus is shifting to ensuring that identified weaknesses are resolved with clear and actionable remedial plans and within the agreed timelines.

Our supervisory work over the past few years has uncovered significant deficiencies in how banks approach C&E risks. Additionally, the risks themselves have continued to intensify, making them one of our top priorities. While many banks have made notable progress in this area, others are still lagging behind. This is why we have been stepping up enforcement – issuing binding decisions and using the full range of tools at our disposal to ensure these deficiencies are addressed.

The increasingly complex and uncertain environment requires banks' boards to make timely and informed decisions, to steer the business in the right direction, and to understand the risks and set appropriate limits. To achieve this, banks need to have adequate and effective risk data aggregation and risk reporting (RDARR) frameworks in place. But past supervisory work has revealed major shortcomings in banks' RDARR capabilities – the remediation process in this area remains incomplete, and banks need to make strong commitments and invest sufficient resources in order to complete it.

Importantly, risk data aggregation and risk reporting is just one area where we expect to see increasing awareness and material progress, and our supervisors will also step up their enforcement activities in other areas when appropriate.

Strengthening banks' digitalisation strategies

Third, rapid digitalisation provides banks with new business opportunities, but also challenges – banks need to prudently manage the risks stemming from new technologies and business practices. The evolving cyber threat landscape also plays a crucial role here, as digital advances might compromise banks' operational resilience. In the long run, digitalisation is expected to strengthen banks' resilience, but adequate safeguards and risk management are of paramount importance.

We therefore need a structured approach and targeted strategies to better understand the broad trends in the sector, such as the use of digital platforms, strategic partnerships and artificial intelligence. For several years now, supervisors have been emphasising the importance of managing the risks associated with digitalisation by adopting industry best practices. We will continue to assess the impact of digital activities on banks' business models and the risks stemming from the use of innovative technologies.

Conclusion

Alongside our supervisory priorities, we want to emphasise that strong governance and strategic steering are crucial for banks' resilience against current and future threats. Sound risk controls and effective risk management are essential foundations for navigating the evolving, uncertain risk landscape.

Many of our supervisory activities have a multi-year horizon and we understand that banks may need time to remedy shortcomings. At the same time, we need to adjust our focus and adapt to capture emerging risks. The update of the supervisory priorities ensures the right balance between continuity, predictability and agility in our medium-term strategy. We will continue monitoring developments in the risk outlook for banks, and we stand ready to adjust our focus if warranted.

The views expressed in each blog entry are those of the author(s) and do not necessarily represent the views of the European Central Bank and the Eurosystem.

Check out The Supervision Blog for future posts.

For topics relating to central banking, why not have a look at The ECB Blog?

1.

Buch, C. (2024), "Global rifts and financial shifts: supervising banks in an era of geopolitical instability", keynote speech at the eighth European Systemic Risk Board (ESRB) annual conference on "New Frontiers in Macroprudential Policy", 26 September.

2.

ECB (2024), *IFRS 9 overlays and model improvements for novel risks – identifying best practices for capturing novel risks in loan loss provisions*, July.

Whistleblowing