International Journal of Artificial Intelligence, Data Science, and Machine Learning
Grace Horizon Publication | Volume 4, Issue 1, 40-50, 2023
ISSN: 3050-9262 | https://doi.org/10.63282/3050-9262.IJAIDSML-V4I1P105

Original Article

A Review of Machine Learning Techniques for Financial Stress Testing: Emerging Trends, Tools, and Challenges

Srikanth Reddy Vangala[1], Ram Mohan Polam[2], Bhavana Kamarthapu[3], Mitra Penmetsa[4], Jayakeshav Reddy Bhumireddy[5], Rajiv Chalasani[6]
[1]University of Bridgeport.
[2]University of Illinois at Springfield.
[3]Fairleigh Dickinson University.
[4]University of Illinois at Springfield.
[5]University of Houston.
[6]Sacred Heart University.

Abstract *- As the global economy becomes more uncertain and systemic vulnerabilities increase, financial institutions are growingly becoming resilient through the use of intelligent systems to assess resilience. Although it forms a basis of stress testing, traditional methods might not be sufficient to reflect the realities of contemporary financial settings. In this paper, a critical review of how the area of financial stress testing is changing towards machine learning (ML) technologies, such as supervised learning, unsupervised learning, reinforcement learning, and hybrid frameworks, is provided. In order to maximize model transparency and regulatory compliance, it goes into depth on how to include Explainable AI (XAI) approaches. Also, the paper provides the technological framework, including TensorFlow, Keras, and Apache Spark, which makes it possible to implement it on a large scale and in real-time. Important issues like data integrity, interpretability and model governance are also tackled. The paper also outlines the research gaps for the future and suggests a framework on how ML-based stress testing can be aligned with the global regulatory expectations. This review helps to orientate oneself in the future outlook of ML-based stress testing by mapping the major regulatory frameworks, practical challenges, and emerging tools through which ML-based stress testing can transform financial risk management and system-wide stability.*

Keywords *- Stress Testing, Scikit-learn, TensorFlow, Keras, SHAP, LIME, Apache Spark, Google Cloud Platform.*

1. Introduction

In this modern financial environment, financial institutions are under increased pressure to assess and strengthen their vulnerability to possible economic shocks. These shocks could be as a result of market turbulence, geopolitical conflicts, pandemics, or technological shocks which can disrupt the financial systems. Stress testing has become an important tool used in evaluating the capacity of an institution to survive under unpleasant conditions [1]. However, the traditional stress testing models may rely on linear, scenario-based models that have pre-determined assumptions and as such, they may not be suitable in projecting outcomes in dynamic and nonlinear environment. The emergence of ML provides a revolutionary change in the arena of financial risk analysis. ML methods make it possible to automatically learn from large, high-dimensional financial data [2][3], which can then be used to more accurately determine risk factors, quicker detect vulnerabilities, and more realistically generate scenarios.

The default prediction and credit risk assessment are applied on supervised models (such as LR, SVM, RF, etc.), whereas unsupervised methods (k-means, DBSCAN, etc.) reveal latent patterns and systematic anomalies. Reinforcement learning plays a role in tuning long-term choice of decision-making strategy in stressful situations, and ensembles of methods perform better than individual ones.Besides, active research in Explainable AI (XAI) tools, including SHAP and LIME, ensures the important issue of interpretability is considered, allowing financial analysts and regulators to gain insights into the rationale behind ML-based predictions. Predictive performance is also boosted by the availability of alternative data sources, like social media sentiment, macroeconomic indicators and transactional data [4], especially in real-time uses.

Recent frameworks, such as TensorFlow, scikit-learn, Keras, XGBoost, and cloud computing platforms, such as Google Cloud and Apache Spark, offer the infrastructure required to develop at scale and robust ML-based stress testing systems. Such technological innovations can not only provide quicker processing of sophisticated data, but can also be built into the regulatory process, which will lead to better transparency, compliance and resilience of the financial system. With financial institutions still braving uncertainty, the presence of smart models in stress tests becomes more and more inevitable.

1.1. Structure of the Paper

This paper is structured as follows: Section II invests into conceptual roots of financial stress testing. Section III reviews ML methodologies. Section IV discusses emerging trends and technological platforms. Section V presents a literature review. Section VI concludes with future directions.

2. Conceptual Foundations Of Financial Stress Testing

Financial stress testing is a proactive risk management tool employed by financial firms and regulators to analyze the resilience of financial systems under negative and unfavourable conditions; by creating plausible but extreme economic or financial event scenarios- such as liquidity crunch, market sell off, or macroeconomic recession this can evaluate the impact on a portfolio, balance sheet or other aspects of the firm or financial health [5]. Primarily, stress testing is useful for revealing vulnerabilities that are not apparent in normal situations, as well as ensuring entities have sufficient capital or risk mitigate strategies to withstand the implications of stress testing. historically, stress testing has relied on deterministic models where the organization develops test scenarios determined either by historic crises or expert judgment.

Although there is some value to these consumer use models, there are certainly challenges in capturing sometimes the rarer, and often more complicated, non-linear behaviours and interactions within and among financial variables are more often ignored or missed. As systems further develop into the more interconnected and modifications to real-time, growing flux operational forms and market contexts, financial stress testing now requires increased demand for more dynamic, adaptive and exploratory data-based alternatives [6]. Consequently, financial systems are incorporating machine learning (ML) approaches to stress testing, allowing exploration of additional types of predictive strength, more flexibility in target and scenario generation and the possible ability to find patterns and/or relationships existing in massive datasets previously hidden from view, while addressing complex data dependencies.

2.1. Regulatory Frameworks and Compliance Requirements

Regulatory frameworks for financial stress testing have evolved to ensure that institutions maintain resilience under adverse conditions and aid in maintaining a consistent financial system. Supervisory authorities have established detailed guidelines requiring banks, insurance companies, and other financial institutions to integrate stress testing into their internal risk management and capital planning processes. These frameworks are commonly risk-focused, and they focus on quantitative rigor as well as the relevance of the scenarios. Prudential regulations require stress testing, which is usually found in wider risk management standards and capital adequacy tests. Credit, market, operational, and liquidity risk assessments are required by banks on a regular basis [7]. The results of such tests should be recorded and analyzed by the top management and should be reflected in the strategy-making and capital allocation policy. In addition, firms should also be able to create institution-specific stress scenarios, taking into account their distinctive risk profiles and business models.

The regulatory demands also touch on the internal governance, model validation, and data integrity. To ensure the high quality of the stress testing process, institutions are supposed to have effective internal controls, such as independent validation of the models, good documentation standards [8], and an effective board-level oversight. Supervisory stress tests to examine system-wide vulnerabilities may also be performed by the regulatory bodies, and firms must engage in them with standardized assumptions and templates. Regulatory action, capital surcharges or limits on dividend payments may follow failure to match regulatory expectations. As a result, financial institutions have been ramping up investments in state-of-the-art modeling capacity, data systems, and risk analytics systems to achieve compliance requirements and to improve their risk culture across the board.

2.2. Conventional Methodologies in Stress Testing

The conventional methods of stress testing can be mainly divided into sensitivity analysis, scenario analysis and reverse stress testing. The said methodologies have already been the long-standing tools used in assessing how resilient financial institutions can be in unfavourable circumstances. Sensitivity analysis is concentrated on the assessment of the possible effects of the isolated changes of a single risk variable, e.g., interest rates, exchange rates, or credit spreads on a portfolio or balance sheet [9]. It is practical in the determination of vulnerability to particular risk exposures and does not put into consideration the interaction of risk factors. In comparison, scenario analysis evaluates the effect of a conjunction of unfavourable economic and financial variables, which are frequently characterized by macroeconomic declines or market interferences. They can be historically motivated or hypothetically built and may vary in their mild or extreme versions.

The approach gives a wider picture of how the risks can develop jointly and the overall impact on capital adequacy and liquidity [10]. Reverse stress testing works backwards by determining the kind of extreme yet realistic events that may jeopardize the solvency of a firm or cause violation of regulations. It is constructed to reveal unfitness behind the scenes and condition institutions against worst-case scenarios. These traditional approaches are mostly deterministic and based on stationary assumptions, past data trends and expert opinion. They are useful in control amplification and internal risk analysis but fail to capture much of the interaction structure, feedback loops and time-varying dynamics of financial systems. They consequently wear out in very dynamic market conditions or in unprecedented market situations.

2.3.Challenges and Opportunities in Stress Testing

- **Technological Complexity and Costs:** Advanced stress testing models cannot be implemented without heavy investments into advanced IT infrastructure. Financial institutions have to invest enormous resources not only in the purchase of hardware, but also in the creation and support of sophisticated analytical models [11], which require very specialized technical skills.
- **Data Management Requirements:** Stress testing requires the ability to manipulate large and diverse data. Institutions are struggling to develop powerful data management systems that can guarantee data quality, consistency and security which are key elements in ensuring that models give the right output.
- **Regulatory Adaptability:** The regulatory framework involving financial stress testing is constantly changing in accordance with the developments in the global economic environment and risk scenario. One way is to ensure that the models used by the institution are up to date with the changing requirements, as in the case of transition between the previous regulatory standards and the stricter ones, models would have to be continuously modified.
- **Compliance and Future-Proofing:** In addition to the existing requirements, banks are expected to look into the future of regulation. This vision is essential to remain compliant in the long run, prevent the expensive model re-designs, and make the stress testing an efficient risk managing tool despite the fluidity of regulations.

2.4. Opportunities

- **Bridging Technology and Regulation:** The technology planning professionals are especially placed in bridging the gap between innovative technological solutions and the regulatory requirements. They are able to spearhead the implementation of advance tools and techniques and at the same time ensure that such approaches satisfy compliance requirements, thereby enhancing innovation and risk management.
- **Enhanced Predictive Analytics:** Improved data analytics and machine learning techniques allow for the development of stress testing models with higher predicted accuracy. This enhancement will allow the financial institutions to detect the possible weaknesses in advance and plan better to face the unfavourable economic conditions.
- **Improved Transparency and Trust:** Distributed ledger technologies present viable opportunities to increase transparency and integrity of the stress testing processes and reporting. This greater visibility can help build more confidence with the regulators and investors and other stakeholders.
- **Development of Dynamic Models:** The shift of the scenario-based, formerly used testing methods, towards the dynamic models of stress testing enables real-time adjustments to the changing economic environments. These models allow a more realistic and opportune evaluation of the financial risks, thus enhancing the decision-making and resilience.
- **Collaboration with Regulators:** Continued engagement between technology planners and regulators will affirm that new stress testing practices can be executed in line with standards and be appropriately assimilated into regulatory frameworks so that implementation and acceptance become easier.

3. Machine Learning Methodologies For Financial Stress Testing

In financial supervision, machine learning (ML) provides a versatile toolbox of algorithms which can be fruitfully used in stress testing and systemic risk analysis [12]. These models are different in terms of complexity, interpretability and computation needs and have particular advantages in modelling capital stress scenarios and also present detailed comparative table, using Table II below to compare and contrast supervised, unsupervised, and reinforcement learning approaches as they pertain to financial stress testing:

3.1. Supervised Learning Techniques

Financial stress testing heavily relies on supervised learning methods to model input-output relationships on historical data that can then be used to correctly predict and measure risk in stressed conditions.

Three popular models of supervised learning that are frequently used in this field are mentioned below:

3.1.1. Logistic Regression

As a fundamental classification approach, LR finds widespread use in financial risk modelling. Through the use of a number of explanatory factors, it attempts to estimate the probability of a binary result, such as default or non-default. Its interpretability and statistical robustness make it suitable for regulatory environments where transparency is essential [13].

3.1.2. Random Forest

In order to generate more accurate and resilient classifications, RF use an ensemble learning technique that combines the predictions of several decision trees. Compared to individual DT, it is less likely to overfit and works well with nonlinear and high-dimensional data. Stable out-of-sample forecasts, identification of the most important risk factors, and modelling of complicated interconnections are all tasks performed by random forests in financial stress testing.

3.1.3. Support Vector Machine (SVM)

In high-dimensional domains, SVMs perform exceptionally well as classifiers, particularly in stress testing, separating data points into distinct categories and modelling non-linear decision boundaries using kernel functions.

3.2. Unsupervised Learning Techniques

The clustering technique is the foundation of most unsupervised classification systems. Within the provided feature space, clustering algorithms identify the most appropriate natural groupings. As a feature vector, this study takes into account the subjects' stress and non-stress sensor data.

Chapters that follow provide an overview of the study's most popular unsupervised classifiers:

3.2.1. K-Mean Classifier

An unsupervised learning classifier that sees a lot of action is the K-mean classifier. Each data point is assigned a group label by the algorithm in order to minimise the total variance of each cluster [14]. By treating each centroid as a cluster, the method begins with a randomly selected set of centroids and iteratively adjusts their positions through computations.

3.2.2. DBSCAN

DBSCAN can detect outliers and find clusters of any shape since it is a density-based clustering method that organizes data points according to the density of their geographical distribution. As an alternative to centroid-based approaches like k-means, DBSCAN is able to handle datasets with varying degrees of noise and abnormalities without requiring a predetermined number of clusters.

3.2.3. T-Distributed Stochastic Neighbor Embedding (T-SNE)

T-SNE is a nonlinear method for cluster identification, local structure preservation, and high-dimensional data visualisation. It aids in detecting risk clusters and anomalous behaviour, and supports exploratory analysis, aiding analysts and regulators in understanding systemic interactions and latent structures in financial data.

3.3. Reinforcement Learning and Its Applications

A subfield of ML known as Reinforcement Learning (RL) teaches agents to maximize their cumulative rewards through sequential decision-making in response to environmental cues. Random forest (RL) is useful for complicated and dynamic decision-making situations because, unlike supervised learning, it learns optimal policies by trial and error rather than assuming labelled input-output pairings.

3.3.1. Deterministic Policy Gradient (DPG)

In high-dimensional continuous action spaces, the Deterministic Policy Gradient (DPG) technique improves convergence and performance by directly learning a deterministic policy[15]. Such extensions as Deep Deterministic Policy Gradient (DDPG) and Neural Fitted Q Iteration with Continuous Actions (NFQCA) apply function approximation to enhance the stability of training.

3.3.2. Stochastic Policy Gradient (SPG)

Stochastic Policy Gradient algorithms approximate the gradient of the anticipated benefit via a random policy gradient through sampling. The policy emits a distribution over actions, which permits exploration and resilience in doubtful settings. The likelihood ratio trick is used to obtain the gradient estimate, and makes it possible to optimize efficiently using algorithms such as REINFORCE[16]. A large degree of variability is possible with this straightforward approach, although it is typically manageable with the help of variance reduction techniques.

3.3.3. Q-Learning

Q-learning is a pioneer value-based reinforcement learning algorithm, which aims at approximating the optimal action-value function Q*(s,a)Q^*(s,a)Q∗(s,a), the maximum expected future reward attainable in states by executing action a. It iteratively updates the Q-values with Bellman equation, and this makes the agents to obtain optimal policies in unknown dynamic environments.

3.3.4. Deep Q-Networks (DQN)

To handle complicated settings, DQN integrate Q-learning with deep neural networks; these networks have learnt control strategies for ATARI games; and deep Q-Networks incorporate experience replay and target networks.

Principal points outlining RL applications:

- **Adaptive Risk Management:** The RL models have the ability to learn optimal hedging and risk mitigation strategies which are dynamically adapted to the changing market stress scenarios.
- **Portfolio Optimization Under Stress:** By simulating sequential decision-making under uncertainty, RL allows designing investment strategies that maximize the returns and minimize losses during bad economic times.
- **Regulatory Policy Simulation:** RL frameworks have the ability to assess the effects of various regulatory interventions by simulating the process by which financial institutions adjust their behaviors towards the new stress-testing regulations.
- **Systemic Risk Monitoring:** By modeling agent interaction and contagion dynamics on financial networks amid stress RL can locate the harmful nodes of systematic vulnerability.
- **Early Warning Systems:** RL models can identify the precursors of financial distress and issue an early warning by learning the past crisis data.
- **Scenario Generation:** RL can be used to generate realistic stress scenarios, by searching a large number of potential future states, even rare, but significant events.

Table 1: Supervised vs. Unsupervised vs. Reinforcement Learning in Financial Stress Testing

Criteria	Supervised Learning	Unsupervised Learning	Reinforcement Learning
Primary Objective	Predict outcomes based on labeled historical data	Discover hidden patterns or groupings in unlabeled data	Find the best policies for making decisions by making mistakes.
Input Data	Labeled (input-output pairs)	Unlabeled	Environment with states, actions, rewards
Learning Approach	Transferring data from one set of inputs to another	Identifying structure within data	Achieving maximum benefit through environmental interaction
Common Algorithms	Logistic Regression, Random Forest, SVM	K-Means, DBSCAN, T-SNE	Q-Learning, Deep Q-Network (DQN), DDPG, SPG
Output Type	Predictive (classification or regression)	Descriptive or visual patterns	Policy or action strategy
Application in Stress Testing	Default prediction, risk scoring, scenario classification	Risk clustering, anomaly detection, exploratory analysis	Adaptive stress management, scenario generation, systemic risk simulation
Data Requirements	Requires large, clean, and labeled datasets	Requires sufficient variance and meaningful patterns in unlabeled data	Requires simulation environment and iterative interaction
Strengths	High accuracy, interpretability, regulatory acceptance	No need for labeled data, effective for exploratory insights	Dynamic learning, handles sequential decision-making, adapts to changing environments
Limitations	Limited by availability and quality of labeled data	May produce ambiguous or hard-to-interpret clusters	High computational cost, sensitive to hyperparameters, may suffer from convergence instability
Use Case Example	Predicting bank default probability during economic downturns	Detecting hidden stress patterns among financial institutions	Designing investment strategies under hypothetical stress events

3.4. Hybrid Approaches

The possibility for hybrid approaches to improve forecasting accuracy and stability by combining several learning algorithms has piqued the curiosity of financial stress testers.

3.4.1. Genetic Algorithms (GA) in Hybrid Models

GA have also been used commonly to do feature selection and hyper-parameter optimization in hybrid models, i.e. using GA with neural networks MLP or SVM. These hybrids jointly optimize the model structure and parameters, and they show better prediction of the financial distress or bankruptcy.

3.4.2. Rough Sets for Feature Selection

The rough set theory can also be effectively used to reduce the dimensionality via dimensionality before model training [17]. Rough sets can be used to improve the accuracy and interpretability of models when used with classifiers such as SVM or fuzzy k-nearest neighbours; this is important in stress-testing situations where model transparency is needed to meet regulatory requirements.

3.4.3. Improving Model Transparency with Fuzzy Systems and SOM

The stakeholders and regulatory oversight require the transparency of financial stress testing models. The hybrid methods combine fuzzy rule-based systems or neuro-fuzzy models to produce explainable decision rules to interpret financial distress predictions.

3.5. Ensemble Modelling Methods

High volatility and non-linearity of the financial systems make these approaches especially useful in stress testing. Ensemble models have the advantage of combining the decisions of many different learners, and hence reducing the effects of any single bias, and of picking up a wider variety of patterns.

- **Bagging (Bootstrap Aggregating):** Bagging, or training many models on bootstrapped data, helps reduce variance and overfitting, so it can be effective with financial data which contains noise.
- **Boosting:** Sequential models such as AdaBoost and Gradient Boosting Machines algorithms are boosting algorithms that have shown to outperform other algorithms in financial default prediction and systemic risk assessment [18].
- **Stacking:** Stacked generalization involves training many base learners and then relying on a meta-learner to aggregate outputs to enhance robustness and accuracy in financial stress testing by assembling a variety of model types.

4. Emerging Trends, Technological Tools And Platforms

The Future trends of financial stress testing lie in the use of advanced analytical techniques, greater automation, real-time stress testing, and elastic infrastructures, to make the process of risk analysis more accurate, efficient, and flexible to operate within the dynamic and complex financial conditions.

4.1. Explainable Artificial Intelligence and Model Interpretability

As the use of ML methods in financial stress testing grows, it is crucial to focus on the transparency and interpretability of those models in parallel. State-of-the-art ML models (e.g., ensemble methods and DNN) are sometimes referred to as black boxes, which makes them less useful in regulated financial settings. A recent development that may be of critical importance [19] is XAI, which provides methods like SHAP and LIME to explain the behaviour of complex models [20]. The techniques allow stakeholders to determine the most significant variables during stressed conditions, thus assisting regulatory compliance and model governance.

4.2. Incorporation of Alternative Data Sources

Incorporation of alternative data sources into financial stress testing systems is also an upcoming topic of study, with the aim of making the ML models deeper and more predictive. Alongside traditional financial information, e.g., macroeconomic variables, market returns, and balance sheets of Institutional investors, practitioners and researchers have started to investigate unconventional sources of data. These are social media sentiment, news analytics, internet search trends, and satellite imagery. Conventional metrics may miss this type of data's real-time insights into customer behaviour, market sentiment, and external risk factors. ML models are specifically well aligned to work with high dimensionality and unstructured format of such dataset, capable of detecting high-order, non-linear patterns of interest in stressful situations.

4.3. Advancements in Real-Time and Dynamic Stress Testing

Advances in data processing power and machine learning methods have helped make such a transition, which aims to better reflect the dynamics of the real world. Conventional methods. Sometimes, stress testing is based on predetermined scenarios and regular assessments, which could not be sufficient to reflect the dynamic nature of financial markets. By contrast, dynamic stress testing uses continuously refreshed data feeds, such as market volatility indices, macroeconomic variables and transaction histories to flexible models that react to evolving risk factors. Stress testing in real-time helps financial institutions to track exposures and systemic weaknesses as situations develop, which enhances risk forecasting and decision-making. This evolution is backed by machine learning models that allow quicker data absorption[21], automatic identification of patterns, and the creation of future stress scenarios using real-time inputs.

4.4. Integration of Macroprudential and Microprudential Stress Testing

A combination of the macroprudential and macroprudential stress testing systems is an important innovation in financial risk management. Conventionally, macroprudential stress tests are concerned with the health of individual financial institutions and conducted by testing the capital adequacy of financial institutions in bad scenarios, however, macroprudential stress tests look at systemic risks and overall financial system stability [22]. Having noticed the linkage between the institutional weakness and the overall economic state, the tendency has been to integrate these approaches to include feedback loop and contagion effects.

4.5. Transfer Learning and Domain Adaptation Strategies

As a result of data scarcity and distributional variations, domain adaptation and transfer learning have been suggested as potential remedies. Challenges associated with financial stress tests. Conventional machine learning models, to be trained successfully, need large quantities of high-quality labeled data, which may be restricted in stress testing situations by the rare incidence of extreme stress occasions. Transfer learning alleviates this by using the knowledge acquired on related tasks or domains, like in other markets or other institutions or other economic conditions, etc, and transferring it to target stress testing models [23].

4.6. Machine Learning Frameworks, Tools, and Analytical Platforms

The development of robust frameworks, tools, and analytical platforms has significantly facilitated the application of ML in financial stress testing. These resources support the entire ML pipeline from data pre-processing and model training to evaluation, deployment, and monitoring enabling more efficient and scalable risk modelling practices. Eminent machine learning libraries offer a wide variety of algorithms and tools for applying ensemble learning, classification, and regression methods. Scikit-learn, TensorFlow, Keras, and XGBoost are just a few examples. These frameworks are widely used for building interpretable and high-performing models tailored to the complex and high-dimensional datasets found in financial systems[24]. In addition to algorithmic development, modern ML platforms often incorporate automated machine learning (AutoML) capabilities, facilitating model selection, hyperparameter tuning, and performance benchmarking with minimal manual intervention.

Integration with big data processing tools like Apache Spark, Hadoop, and SQL-based data warehouses allows institutions to process large volumes of structured and unstructured data efficiently. Analytical platforms also increasingly emphasize model governance, version control, and explainability, integrating with tools for visualization (e.g., Matplotlib, Seaborn, Tableau) and interpretability (e.g., SHAP, LIME) to ensure transparency and regulatory compliance. These components are essential for documenting assumptions, validating model outputs, and communicating results to stakeholders, including regulators and risk committees.

5. Literature of Review

This review examines short-term and long-term risk assessment using machine learning in financial stress testing. It shows how advanced models capture complex temporal, macroeconomic, and financial information to improve prediction accuracy and risk management and regulatory compliance.

5.1. Reviewing several studies:

Brummelhuis and Luo (2019) this research looks into NIM forecasting using non-linear ML and linear regression at the level of individual banks. They look at 162 models employing 11 distinct regression approaches to compare the accuracy of NIM forecasts. The results disprove the usefulness of stress testing by demonstrating that some linear and Machine Learning methods may outperform the random-walk benchmark in terms of accuracy. This study demonstrates a multi-step forecasting process employing iterative forecasting, rolling-origins, and recalibration to predict bank-specific NIM. It is the first systematic study of its kind. When dealing with outliers in forecasts, robust regression was useful [25].

Finck, (2019) study on stress testing in bank risk management reveals a methodical strategy for uncovering novel, intense situations. A Vector-Autoregressive time series model is used to get the necessary scenario distribution from historical time series. With elliptic constraints and box constraints on scenario variables, the worst-case search is an optimisation issue. Applying the Evolution Strategy, they consider the optimisation issue as a black-box optimisation problem. The paper delves into various algorithm design options and provides an explanation of the necessary algorithm changes. The findings are proven to be satisfactory when using a straightforward approach to addressing box constraints and fixing improbable circumstances [26].

Gramlich (2018) highlights the importance of incorporating sustainability risks into stress testing models for financial systems to assess their exposure to these risks and explore risk mitigation strategies. The major challenges in conceptualizing an SST framework include modelling sustainability stress factors, their propagation within the system, and the system's response. The architectural form and the dynamic behaviour of the financial system have to be viewed as forward-looking in order to sufficiently model the SST framework [27].

Jacobs Jr (2018) study presents one of the models in machine learning is the multivariate adaptive regression splines approach. This model outperforms a VAR model and is more accurate when estimated using Fed Y-9 filings and macroeconomic factors, leading to more sensible forecasts regarding quality and conservatism [28].

Gao, Mishra and Ramazzotti (2017) proposed a novel approach to stress testing financial portfolios using traditional machine learning classification algorithms in conjunction with Suppes-Bayes Causal Networks (SBCNs). This method outperforms the conventional Monte Carlo Simulations in terms of accuracy and computing simplicity when simulating stress testing situations, and it can pinpoint the interdependencies among the financial factors impacting portfolios. The approach here answers the call of verisimilar financial stress tests, where it centers on probabilistic causation and extreme rare cases of generating financial stress scenarios [29].

Hemakom et al. (2016) performed an investigation of the characteristics of financial stress indices in order to develop a robust indicator of financial stress levels. Under times of financial strain, they used intrinsic multiscale analysis to quantify the complexity loss hypothesis. The study looks at four major US stock indexes during the last quarter of a century: the Dow Jones Industrial Average, the NASDAQ Composite, the S&P 500, the Russell 2000, the FTSE 100, the CAC 40, and the exchange rates. High levels of stress were seen throughout the era of the subprime mortgage crisis and the fall of the Internet bubble, which is consistent with the EMH theory [30].

Table II provides an overview of the significant studies in the area of machine learning approaches to financial stress testing, revealing the type of models, issues, application scenarios, and perspectives on enhancing the predictive power of models and ensuring their use in sound financial risk management and regulatory decision-making.

Table 2: Summary of related work based on Machine Learning Techniques for Financial Stress Testing

Reference	Focus On	Approach	Key Findings	Challenges	Limitations/Gaps
Brummelhuis and Luo, (2019)	The prediction of net interest margins (NIMs) for individual banks	Analysis of 162 models using linear and non-linear ML regression methods	Some ML and linear models outperform random-walk benchmarks; robust regression beneficial with outliers	Forecasting individual bank NIM with sufficient accuracy; market confidence in stress-test models	Focus mostly on NIM forecasting accuracy, not direct stress-test integration; market confidence issues remain unresolved
Finck, (2019)	Stress test scenario generation and optimization	Vector-Autoregressive model for scenario distribution; Evolution Strategy optimization	Simple constraint handling combined with scenario repair yields good results in black-box optimization	High-dimensional constrained optimization in stress scenario search	Optimization focused on scenario generation, less on integration with broader risk assessment or ML techniques
Gramlich, (2018)	Incorporating sustainability risks into stress testing	Conceptual framework design for sustainability stress tests (SST)	Emphasizes systemic structure and behavioral dynamics; need for forward-looking modeling	Modeling propagation of socio-ecological risks through financial systems	Lacks concrete quantitative models or ML implementations; conceptual stage
Jacobs Jr, (2018)	CCAR stress testing segment-level modelling using macroeconomic data	Multivariate Adaptive Regression Splines (MARS) vs. Vector Autoregression (VAR) models	MARS outperforms VAR in accuracy and out-of-sample performance; provides more reasonable and conservative forecasts	Modelling complex, non-normal macroeconomic relationships; regulatory acceptance of newer models	Focus on CCAR modelling segments; adoption in practice still limited; requires further validation and regulatory buy-in

Gao, Mishra and Ramazzotti, (2017)	Financial portfolio stress testing via causation	Suppes-Bayes Causal Networks (SBCNs) with ML classifiers	SBCNs improve causal analysis and stress scenario simulation accuracy and computational efficiency	Discovering true causal relationships; scalability and complexity of models	Limited to portfolio stress testing; applicability to bank-wide or systemic stress testing unclear
Hemakom et al., (2016)	Financial stress measurement via market indices	Multiscale sample entropy; proposed ALIS metric	Validated analogy between market stress periods and physiological stress; supports Efficient Market Hypothesis (EMH)	Capturing complexity loss in financial stress indices	Focused on index-level stress detection, not predictive or bank-level stress testing; no ML model development

6. Conclusion And Future Work

The stress testing of financial institutions is a tool that forms the basis of testing the stability of the institutions in unfortunate economic circumstances, and its development is inextricably connected with the development of analytical techniques. ML has become an increasingly strong facilitator in this space in recent years, with the ability to turn the conventional stress testing structures into more dynamic and intelligent structures. Institutions can improve the accuracy and speed of risk detection, scenario generation and capital adequacy assessment by using supervised, unsupervised and reinforcement learning methods. Nevertheless, issues regarding interpretability of models, data quality, regulatory compliance and computational complexity represent an ongoing obstacle. Emphasis should be put on creating more explainable and auditable ML models, integration of real-time and alternative data sources, and creation of common frameworks which can meet the expectations of the global regulations. Also, the investigation of hybrid models, federated learning, and privacy-preserving AI may open the door to more secure and collaborative stress testing ecosystems and eventually make the financial system more resilient to never-before-seen shocks.

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