



Banking on Geopolitics: Embedding Risk and Building Resilience



As the global order shifts, governments are taking increasingly bold and geopolitically-motivated actions to protect their interests. Financial institutions, given their central role in the global financial system, are especially exposed. Yet many still lack a structured approach to geopolitical risk, leaving them with a critical blind spot. European supervisors are responding by pressing banks to strengthen their risk frameworks. By taking a pragmatic approach to enhance existing frameworks to incorporate geopolitical risk, banks can navigate this complex landscape, strengthen their resilience and safeguard their competitive edge in a rapidly changing world.

Geopolitical Risk is Back

For decades, the dominance of trade free from state intervention and the international rule of law led many to believe that geopolitical risk, the danger of geopolitically motivated actions by state actors that can negatively impact the economic environment, was a relic of the past. However, since the U.S. “Pivot to Asia”, the Russian annexation of Crimea and subsequent conflicts as well as crises across multiple regions, it has become clear that geopolitical risk is back and shows little sign of going away. Today’s geopolitical environment is also shaped by a race for technological supremacy and the use of geo-economic tools to assert national interests, such as tariffs, export restrictions and sanctions. These trends signal a fundamental change in the global order with multiple possible trajectories for the future on the table.

Businesses must take the associated risks seriously and this is particularly true for the financial services industry, who face a wide range of geopolitical risks. Some affect them directly, such as state-sponsored cyber-attacks, sanctions and conflicts, while others materialise indirectly through their on- and off-balance sheet exposures, for example via capital markets volatility or trade disruptions affecting corporate borrowers.

Naturally, not every financial institution is affected equally: a Global Systemically Important Bank (“G-SIB”) with retail, corporate and capital markets businesses may face greater risks than a local retail lender. Yet, local players are not immune to these risks either. Hence, the fundamental change in the global business environment requires all banks to thoroughly assess their exposure to geopolitical risks, not just the obvious first-order effects, and to adopt a more systematic approach to managing them, with varying levels of complexity depending on the institution.

The Blind Spots for Banks

Today most banks lack a structured approach to incorporate geopolitics into their risk management frameworks, leaving them vulnerable to potentially far-reaching consequences. Traditional risk types, such as credit, market, operational and liquidity, do not adequately capture the complex and transversal nature of geopolitical risks, which can cascade across multiple business lines, portfolios and geographic regions simultaneously. This gap represents a significant vulnerability in existing risk management approaches.

To address this blind spot, banks need to integrate geopolitical risks through a structured, comprehensive framework. This approach shares some similarities with recent ESG integration efforts, as both geopolitical and ESG risks are systemic, multidimensional and challenging to quantify. However, geopolitical risk integration need not be as resource intensive as ESG implementation has proven to be for many institutions. The benefit for banks is heightened risk awareness, strengthened resilience and, if a risk event materialises, an ability to maintain or recover rapidly its competitive position.

A Turning Point in European Supervisory Focus

European banks, in particular, are required to address this blind spot by their supervisors. The Bank of England (‘BoE’) has identified geopolitical risk as one of the leading systemic threats to the UK financial system, recognising its potential to trigger far-reaching disruptions, with rising energy prices, supply chain breakdowns and heightened market volatility.¹

Meanwhile, the European Central Bank (‘ECB’) has made geopolitical risk a key supervisory priority for 2025-2027, emphasising the need for a “holistic supervisory strategy and a special focus on bank’s ability to withstand such

shocks”.² With progress so far deemed “inadequate”, the ECB plans to assess banks’ resilience, strategies and risk management through benchmarking exercises and onsite inspections. Notably, its 2026 thematic stress test exercise will require “banks to evaluate firm-specific geopolitical risk scenarios that could severely impact their solvency”, as part of their internal capital adequacy assessment process (‘ICAAP’)³.

These developments mark a significant shift for European supervisors and banks can expect both the BoE and ECB to take a hardline approach, demanding robust risk management and demonstrable resilience. As a result, banks will be expected to demonstrate a clear understanding of how geopolitical developments could affect their operations and portfolios or to provide evidence that such risks are not material. Where material risks have been identified, they will also need to articulate proactive strategies to manage and mitigate them.

A Pragmatic 4-Step Roadmap to Geopolitical Risk Management

The significant increase in geopolitical risks for banks across the world and, for European ones, the supervisory focus of the BoE and the ECB, provide a timely catalyst for banks to reassess their approach. It doesn’t require a leap in the dark, it requires a four-step pragmatic approach to take tangible steps to strengthen risk management and resilience.

— **Risk identification and scenario design:** Banks should identify relevant geopolitical themes (e.g., border disputes or trade policy) and plausible trigger events

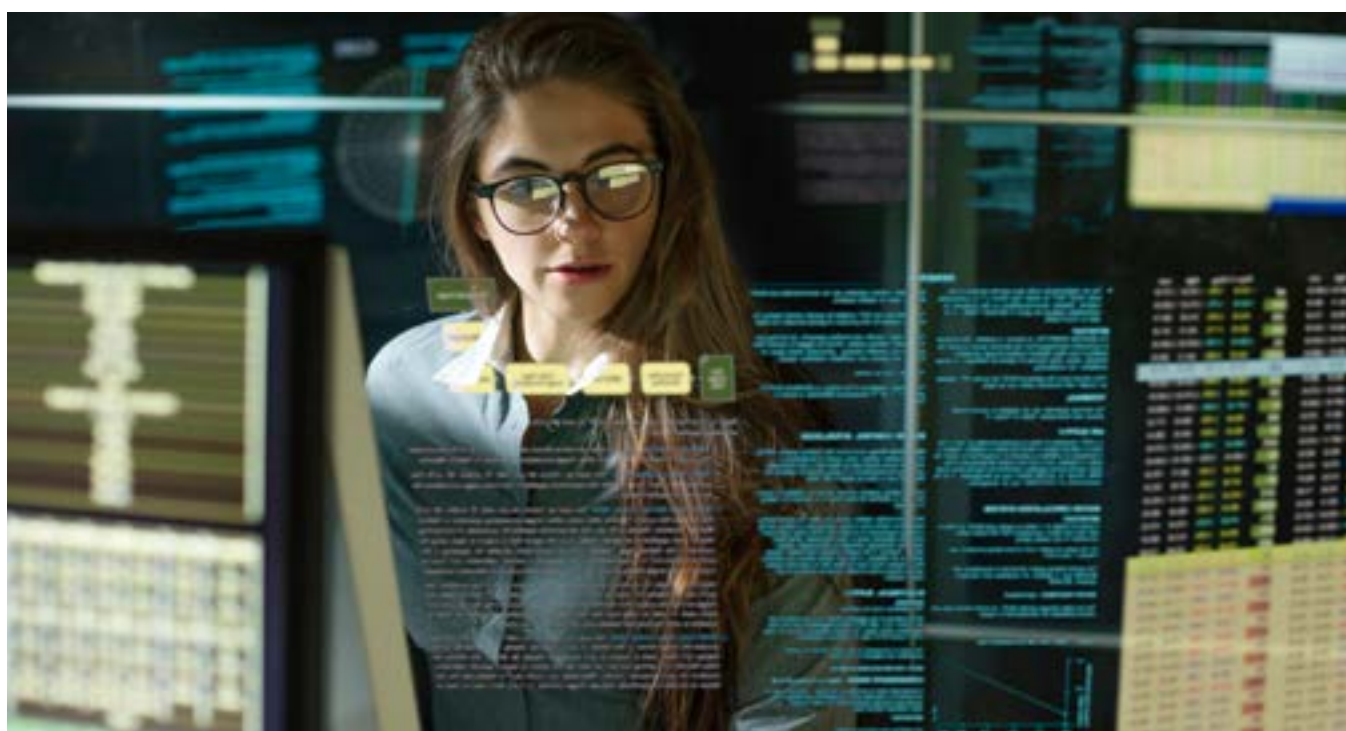
(e.g., war, embargo or export restrictions) specific to their institution and its exposures and the transmission channels (e.g., corporate profitability, FX rates or supply chain) through which these would translate into financial risks. A high-level materiality assessment should then help calibrate the subsequent efforts required to integrate geopolitical risk effectively.

— **Risk quantification and reverse stress testing:**

Banks should harness their existing risk and stress testing infrastructure to translate efficiently the above scenarios into quantifiable risk factors, such as GDP growth, credit spread, FX volatility or commodity price shocks. This will help identify the conditions under which geopolitical risks become material, while ensuring alignment with supervisory expectations.

— **Enhancing the existing risk framework:** Geopolitical risk integration should be embedded, to the extent possible, into existing governance structures, risk appetite, capital planning and related processes, rather than through new dedicated processes.

— **Integration into Business-as-Usual (‘BAU’):** Managing geopolitical risk should be incorporated in day-to-day risk management cycle. For example, banks may decide to add clauses to loan covenants for highly exposed counterparties, adapt underwriting tools or enhance contingency plans. The extent of changes required, if at all, will depend on the materiality and nature of the risks, again with a focus on leveraging existing processes.



3 Key Considerations for Success

For banks, resilience isn't built in theory – there are three areas critical in this journey: scenario design, operational preparedness and efficient execution.

- **Scenario design:** Banks should adopt an iterative approach to scenario design. The process should begin with the institution's specific operational and portfolio exposures, mapping out what could go wrong under a range of potential trigger events. These should then be consolidated into a coherent set of plausible scenarios. The true value of this exercise lies not in attempting to predict the future, but in building a framework that enables senior management to explore diverse trigger events and assess how they could impact the bank's operations, reputation and both on- and off-balance sheet exposures. While most banks possess strong risk management capabilities, many still need to enhance their internal geopolitical expertise. Even more critical is the ability to integrate these two disciplines, risk management and geopolitical analysis, into a practical and actionable approach to scenario design.
- **Efficient execution:** Banks should align their geopolitical risk efforts with the actual materiality of these risks. The priority is to strengthen preparedness without adding unnecessary complexity or duplication, by embedding geopolitical considerations into existing governance and risk structures. This may mean using established board and risk committees as the natural forum for oversight; treat geopolitical risk either as part of strategic business risk or as a distinct transversal category; forming agile, virtual cross-functional teams across risk, compliance, business, operations, legal and strategy rather than building large new central functions; and fine-tuning country or sector risk appetite limits to reflect exposures to pre-identified material geopolitical risks.
- **Operational preparedness:** Banks should institutionalise early warning systems, maintain crisis management playbooks and regularly conduct executive committee and board-level "wargaming" exercises to strengthen organisational resilience and response preparedness. The goal is to ensure that leadership is not caught off-guard by emerging risks but instead is equipped with the foresight and discipline to act decisively. In practice, this involves systematically monitoring a broad spectrum of issues identified as material to the bank and ensuring that predefined response protocols are in place and regularly tested. These protocols should include clear escalation triggers, defined roles and responsibilities and well-rehearsed communication plans – so that when a material trigger event occurs, the institution can respond in a timely, coordinated and effective manner.

Geopolitical risks are reshaping the business landscape, leaving banks with heightened exposure. By adopting a structured and pragmatic approach, anchored in robust scenario design, disciplined execution and operational readiness, banks can strengthen their resilience and safeguard their competitive edge in a rapidly changing world.





JULIEN WALLEN

Senior Managing Director

(+41) 798-959091

julien.wallens@fticonsulting.com

JENS PAULUS

Senior Managing Director

(+49) 151-208-49374

jens.paulus@fticonsulting.com

PAUL FELDMAN

Senior Director

(+1) 212-499-3687

paul.feldman@fticonsulting.com

DR. PETER EITEL

Senior Director

(+49) 302-887-44008

peter.eitel@fticonsulting.com

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Endnotes

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