Geopolitical Risk

2025

ALVAREZ & MARSAL

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Point of View

Risk landscape is being redefined by Geopolitics, prompting banks to respond with heightened vigilance given the scale, severity and interconnectivity of geopolitical shocks.

Definition

Geopolitical risk can be defined as the threat, realization, and escalation of adverse events associated with wars, terrorism, and tensions among states and political actors that affect the peaceful course of international relations. These risks can stem from military conflicts, terrorism, sanctions, political instability, and trade (e.g. tariffs) and diplomatic tensions

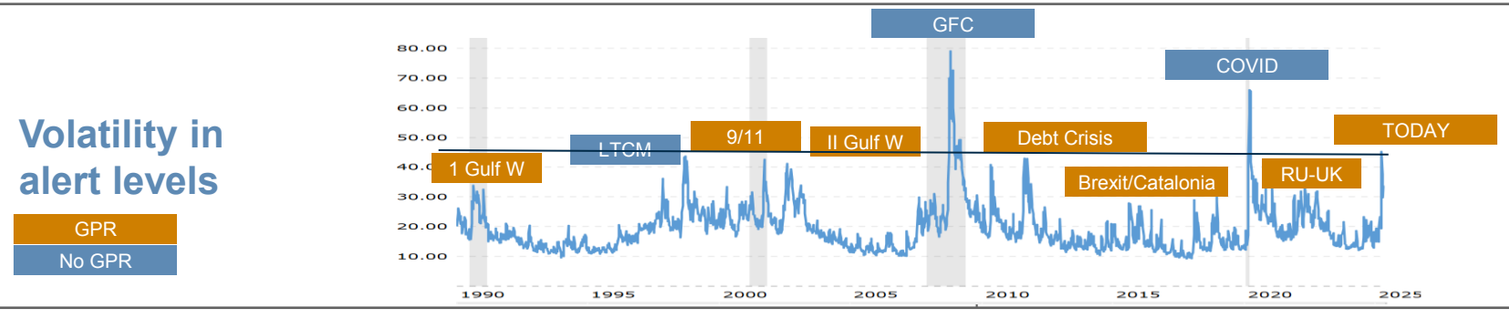
Crystallisation Events

- U.S.–China/World Trade Inestability – 2025
- Israel–Hamas Conflict Escalation – 2023
- Russia's Invasion of Ukraine – 2022
- Catalonia Independence Referendum – 2017
- Brexit Referendum – 2016
- Madrid Train Bombings (11-M) – 2004
- U.S. Invasion of Iraq (II Gulf War) – 2003
- 9/11 Attacks in New York – 2001
- Gulf War (Iraq invades Kuwait) – 1990

Impact on banking sector

- **UniCredit** – *Russia's invasion of Ukraine* – Exposure losses and write-downs due to Russian operations – **2022**
- **Société Générale** – *Russia's invasion of Ukraine* – Losses from disposal of Rosbank and exit from Russia – **2022**
- **Raiffeisen Bank International** – *Russia's invasion of Ukraine* – Operational disruption and reputational risk due to continued Russian exposure – **2022**
- **Sberbank (AT) -** – *Russia's invasion of Ukraine* – Resolution– **2022**
- **CaixaBank / Banco Sabadell** – *Catalonia independence referendum* – Loss of deposits and relocation of legal headquarters – **2017**
- **HSBC / Barclays / Lloyds** – *Brexit referendum* – Operational restructuring and legal entity relocation costs – **2016**
- **Standard Chartered / HSBC** – *U.S.–China trade tensions* – Increased provisioning and reduced profitability in Asian markets – **2018–2023**
- **Spanish banks (general)** – *Madrid train bombings (11-M)* – Market value drop and reputational risk – **2004**
- **Morgan Stanley / Bank of America** – *9/11 attacks* – Physical losses, business interruption, and insurance-related costs – **2001**

Volatility in alert levels



- **Market Volatilty reached 45 and it stands at the highest Geopolitical event driven shock of the last 35 years** only GFC and Covid generated higher level.

Latest market and supervisory reactions:
Integration of geopolitical risk (GPR) is accelerating across banks, with supervisors playing a key role in driving this shift

Market Environment

- Global banks are further enhancing their geopolitical risk frameworks.
- Domestic banks are being driven by supervisory pressure to launch or accelerate their own framework development.

Recent Developments – 2025 U.S. Tariffs and Market Reactions:
In contrast to events like the **Russia–Ukraine conflict** or **COVID-19**, which were rapidly integrated into banks' risk management through provisions and capital measures, the **2025 U.S. tariff measures** have **not yet triggered an immediate reassessment** by the banking sector.

U.S. banks' Q1 results show no explicit consideration of the potential impact of new tariffs. Q2 results will be key.

Only J.P. Morgan has **raised the probability of a recession scenario and pointed to consumer credit as an early warning signal.**

Market Risk are the most impacted in short term (VIX index at highest 2Y level) due to negative volatility* - with limited disclosure on losses.

Supervisory Approach

- **The ECB has identified geopolitical risk as a supervisory priority in the latest Priorities Reports.**
- A **dedicated taskforce** has been established to benchmark how banks are addressing geopolitical risk.
- The focus includes not only **global systemically important institutions**, but also **national banks**, due to **second-round effects**.
- The ECB has issued/will issue **formal communications** requiring banks to address geopolitical risk in both their **ICAAP** and **Recovery Plans**.
- **Certain Joint Supervisory Teams (JSTs)** are conducting **targeted exercises and questionnaires** to assess banks' preparedness and integration of geopolitical risk into their frameworks.

*Volatility is not always negative as in some cases could generate revenues due increase in trading volumes and fees

A&M View:
GPR requires action across three dimensions: a dedicated risk framework, active risk management, contingency planning and client support

1 Risk Framework

GPR Framework Development

- Taxonomy of GPR
- Transmission channels
- Risk assessment
- Risk measurement
- Risk mitigation

Integration into Risk Appetite Framework (RAF)

- Integrate GPR in RAF
- Establish metrics and limits
- Cascade down to business units and geographies.

2 Risk Management

Provisioning (IFRS 9)

- Develop approach
- Scenario-based overlays
- Sector-specific PD/LGD uplifts (energy, export-reliant corporates, FX-liquidity) – Bottom-up adjustments
- First round and second round effects.
- Document expert judgement; risk committee sign-off
- Back-test overlays/bottom-up adjustments and benchmark

Capital & ICAAP and Stress Testing

- Incorporate severe geopolitical scenario
- Measure CET1 & leverage impacts; size management buffer gaps
- Mirror stress in ILAAP: FX outflows, collateral haircuts, payment blockage
- Align capital plan & dividend policy with scenario outcomes
- Begin monitoring the relevance and impact of geopolitical risk factors within IRB models throughout the model life cycle

3 Contingency

Recovery Plan

- Integrate (if applicable) into recovery dahsboard
- Develop GPR scenarios
- Assess feasibility and impact of recovery options under GPR
- Adapt governance and communication plans

4 Business Areas support: Focus on GPR in clients

- Government measures: Government support aid deployment
- Anticipation : Liquidity, Re-financing, Restructurting
- Corporate Product measures: FX hedging, Comex business lines, WK
- Individual: I. Funds GPR exposures, Hedging

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