European Risk Management Council

Risk Landscape Review

March 2025

Q1 2025 Risk Sentiment Index: Looking Ahead to 2026

DEAR READER,

I am delighted to present the Q1 2025 edition of the Risk Landscape Review.

This issue focuses on the Q1 2025 update of the Risk Sentiment Index (RSI), a forward-looking, expert-driven index that captures expectations about the financial sector's risk landscape over the next 12 months. The European Risk Management Council conducted RSI surveys of Chief Risk Officers simultaneously in the UK, the US, and Asia-Pacific, enabling a comprehensive comparison of risk perceptions across these key markets. The findings highlight respondents' views on top risks, emerging trends, and potential developments extending into 2026.

The RSI results reveal significant global trends in risk perception, shared across all three regions, while also uncovering some intriguing regional differences explored in this issue.

A huge thank you to all contributors and survey respondents. I hope you find this edition insightful. Happy reading!

Yours sincerely,

Dr Evgueni Ivantsov

Chairman of European Risk Management Council

Table of Contents

Risk Sentiment Index: Q1 2025 Update

Looking Ahead to 2026: Market Risk on the Rise

In Q1 2025, the European Risk Management Council conducted surveys and produced Risk Sentiment Index (RSI) for the UK, the US and the APAC region. The aggregated results unveiled a global trend in risk perception shared by all three regions, albeit with some intriguing regional differences.

While RSIs are not intended to predict future risks, they provide valuable insights into the perceptions of banking executives responsible for risk management functions regarding dynamic trends within the risk landscape. RSIs evaluate seven major risk categories that have a first-order impact on financial institutions: credit, market, liquidity, operational, cyber and IT, conduct, and regulatory risks.

The RSI is derived from surveys of CROs and other risk executives in the financial services sector, serving as a numerical representation of the adjusted percentage of respondents anticipating an increase in risk over the next 12 months. Consequently, a higher RSI indicates that more respondents expect an upswing in risk.

Aggregated Results

For the first time in many years, market risk has emerged as a dominant concern, fuelled by escalating trade tensions and policy shifts in the wake of Donald Trump's return to the White House. On the opposite side of the spectrum, regulatory risk has seen a positive shift, reflecting CROs' optimistic expectations of a more lenient regulatory environment in the year ahead.

The latest survey results highlight similar perspectives from CROs in three different markets. The aggregated RSI for APAC and the UK decreased compared to the previous quarter. The UK RSI has reduced from 0.43 to 0.41 between Q4 2024 and Q1 2025 (Figure 1), while the APAC RSI has also decreased in the same period from 0.49 to 0.38 (Figure 2).

The aggregated US RSI showing no change compared to the previous measurement, and the aggregated RSI remains at 0.38.

It's important to note that these movements in the aggregated RSIs across all three markets are relatively small compared to the last period. This indicates that CROs' expectations for the future risk landscape remain largely consistent with those observed in the previous surveys. Overall, the aggregated RSIs remain below the long-term average (Figure 3). However, a deeper analysis of individual risk categories reveals a more nuanced picture with some regional distinctions.

Figure 1. UK RSI trend: Q4 2018 – Q1 2025

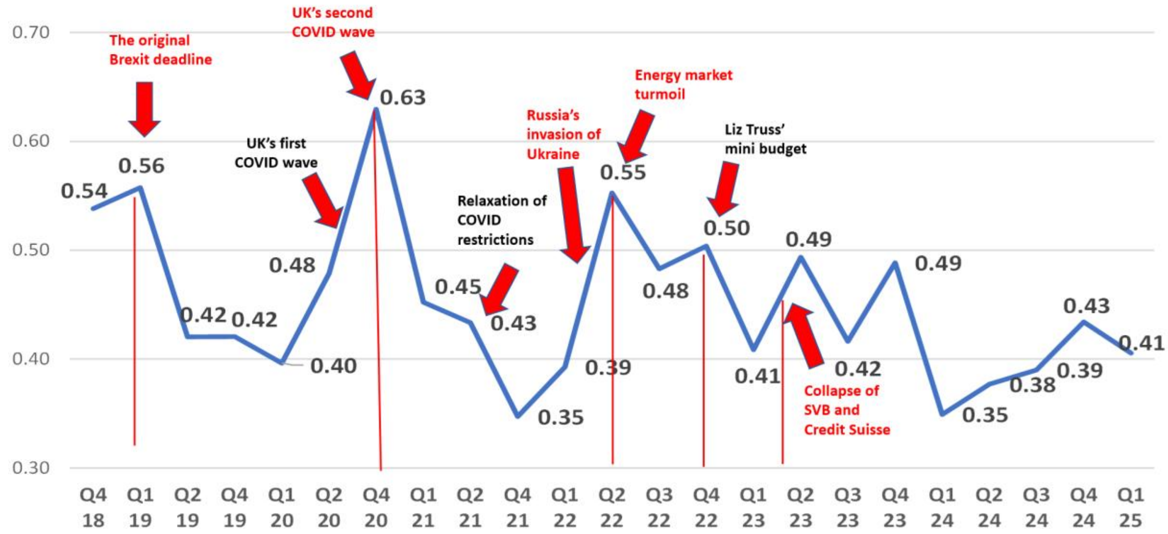


Figure 2. APAC RSI trend: Q4 2018 – Q1 2025

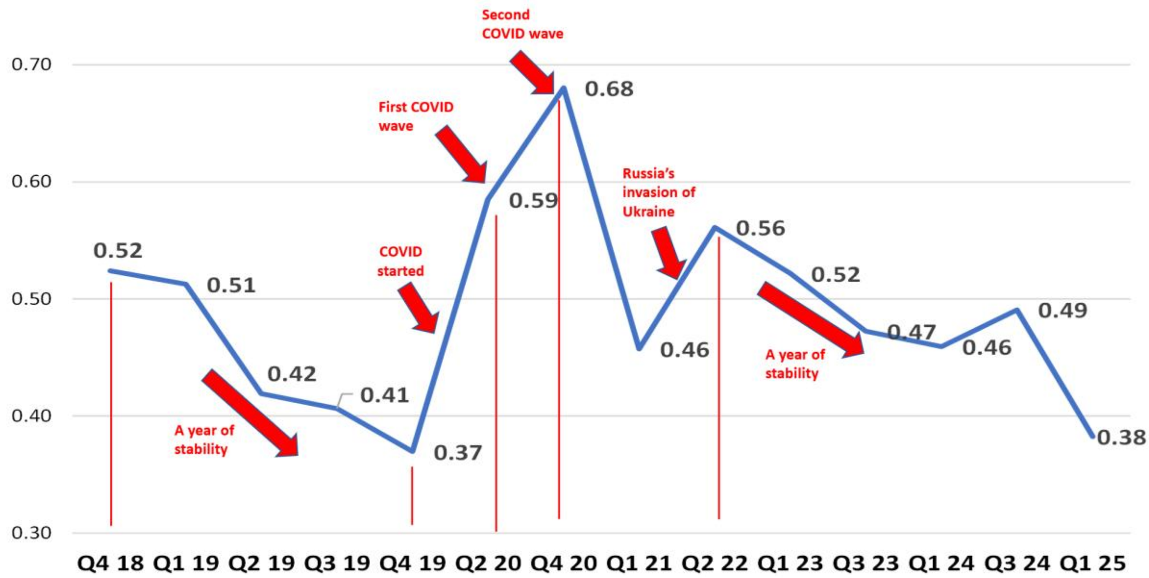
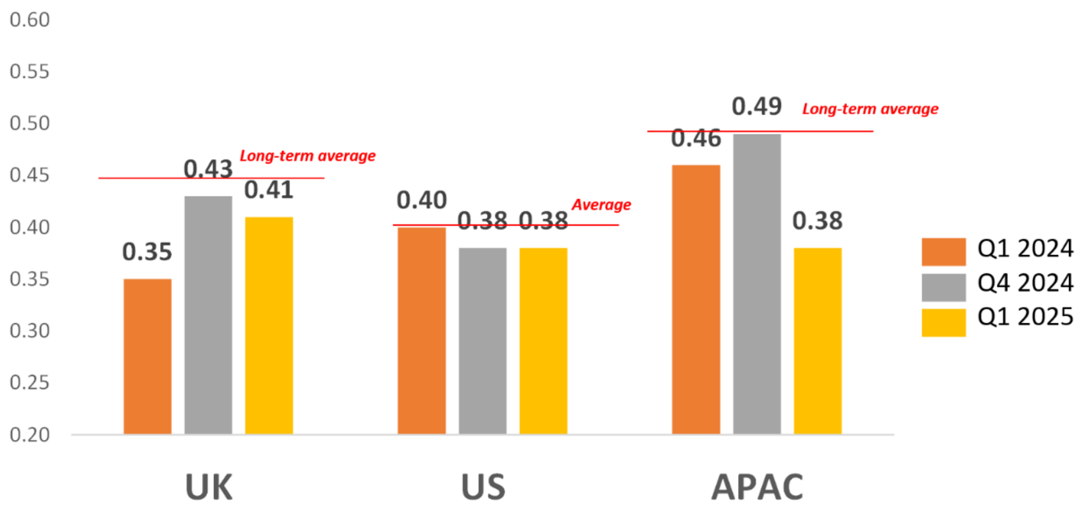


Figure 3. Aggregated RSI trends Q1 2024 – Q1 2025

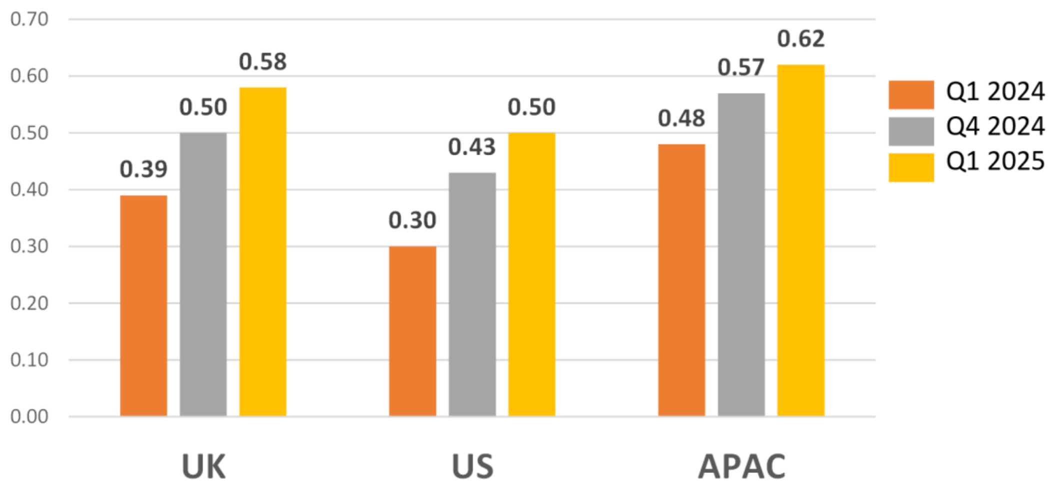


Market Risk Surges Amid Trump's Trade Policies

A key trend emerging from the latest RSI survey is the sharp rise in market risk expectations across all three regions. This quarter, market risk has joined cyber risk as one of the top two risks to watch over the next 12 months. APAC, given its deep trade ties with both China and the U.S., is expected to experience the most significant rise in market risk, with its RSI for market risk reaching 0.62 in Q1 2025—the highest level since the COVID crisis (Figure 4).

The primary driver behind this surge is Trump's aggressive tariff policies and trade protectionism, which have already destabilised markets. CROs anticipate that volatility will accelerate as new tariffs disrupt global supply chains and provoke retaliatory measures from key trade partners.

Figure 4. RSI trend: Market risk Q1 2024 – Q1 2025



Putting Market Risk in Perspective: The Consequences of Trade Protectionism

Trump's focus on tariffs and trade barriers is sending shockwaves through global financial markets. The impact is already being felt, with tariffs imposed on imports from Canada, Mexico, China, and global metal industries. However, the potential expansion of trade restrictions, particularly in sectors such as technology and automotive, is further fuelling uncertainty. Survey results indicate that CROs expect a prolonged and increasingly disruptive trade war, leading to an even greater surge in market risk.

While market risk traditionally accounts for a relatively small portion of total risk exposure for banks—typically 10-15% of total RWA for commercial banks and 25-30% for investment banks—its potential impact on the financial sector and broader economy should not be underestimated.

Financial markets thrive on stability and predictability, particularly when global supply chains have been optimised over decades. Sudden shifts in trade policy, as observed now, can lead to significant market dislocations. Increased tariffs disrupt global supply chains, raise costs for businesses, lower corporate earnings, and reduce consumer spending—factors that could trigger a chain reaction, including a credit crunch and broader economic recession.

In response to rising uncertainty, investors are likely to seek safer assets, further amplifying market volatility due to disruptions in bond markets, fluctuations in equity prices, and heightened currency volatility. Additionally, escalating trade tensions could tighten global liquidity conditions, disrupt capital flows, and increase credit risk exposure for financial institutions.

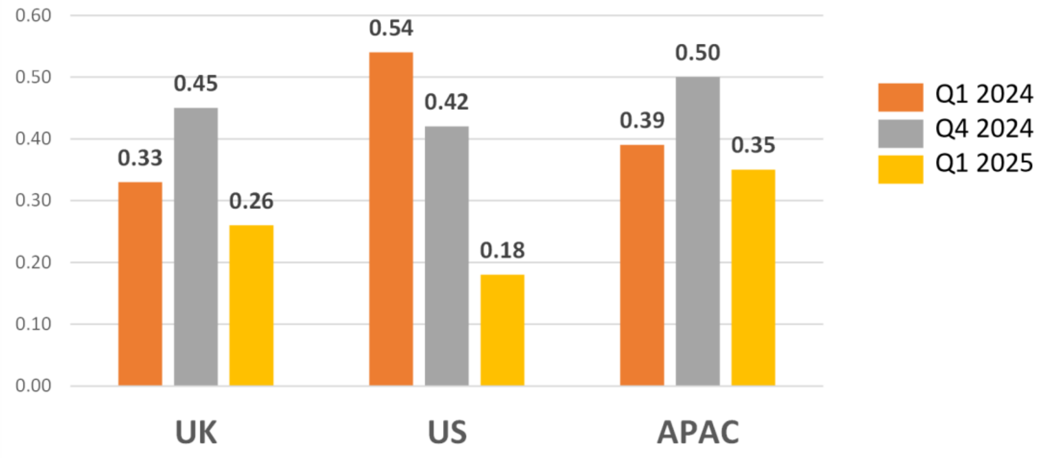
To prepare for this scenario, banks must proactively stress-test their portfolios and reassess risk mitigation strategies to ensure resilience against a more turbulent market environment.

Regulatory Risk Declines as Trump's Deregulation Agenda Takes Hold

In contrast to rising market risk, the RSI indicates a sharp decline in regulatory risk expectations across all three regions. The UK and APAC have recorded their lowest levels of regulatory risk since the COVID period, while the U.S. has reached its lowest level since the surveys began in 2023 (Figure 5).

The primary factor behind this decline is the US administration's commitment to rolling back financial regulations. Expectations are growing that post-2008 banking regulations will be further relaxed, easing compliance burdens for financial institutions.

Figure 5. RSI trend: Regulatory risk Q1 2024 – Q1 2025



Global Impact of US Deregulation

While deregulation is primarily a US policy shift, its effects are expected to extend beyond American borders. Historically, U.S. financial regulatory trends have influenced global frameworks, particularly in Europe and APAC. If Trump moves to reduce capital requirements and simplify compliance frameworks, international regulators may feel pressure to follow suit in order to maintain the competitiveness of their banks.

However, regulatory relaxation requires a delicate balancing act, as deregulation can be a double-edged sword.

- In the short term, reduced regulatory constraints could provide banks with greater flexibility in lending, investment activities, and capital allocation, potentially boosting economic activity.
- In the long term, if deregulation removes essential risk mitigants, the banking industry could accumulate hidden risks that may eventually trigger a full-scale financial crisis.

As banks navigate these shifting regulatory landscapes, it will be critical to strike a balance between regulatory efficiency and financial stability—ensuring that deregulation fosters growth without increasing systemic vulnerabilities.

Navigating a Shifting Risk Landscape

The latest RSI update underscores a rapidly evolving risk environment. While the decline in regulatory risk provides some relief, the surge in market risk poses significant challenges. As Trump's trade war escalates, banks must brace for greater volatility and assess the potential fallout on credit markets, liquidity, and investment portfolios. The coming months will be crucial in determining whether market confidence can withstand the turbulence or if further destabilisation is on the horizon.

Appendix

Figure 6. UK RSI for credit risk Q4 2018 – Q1 2025

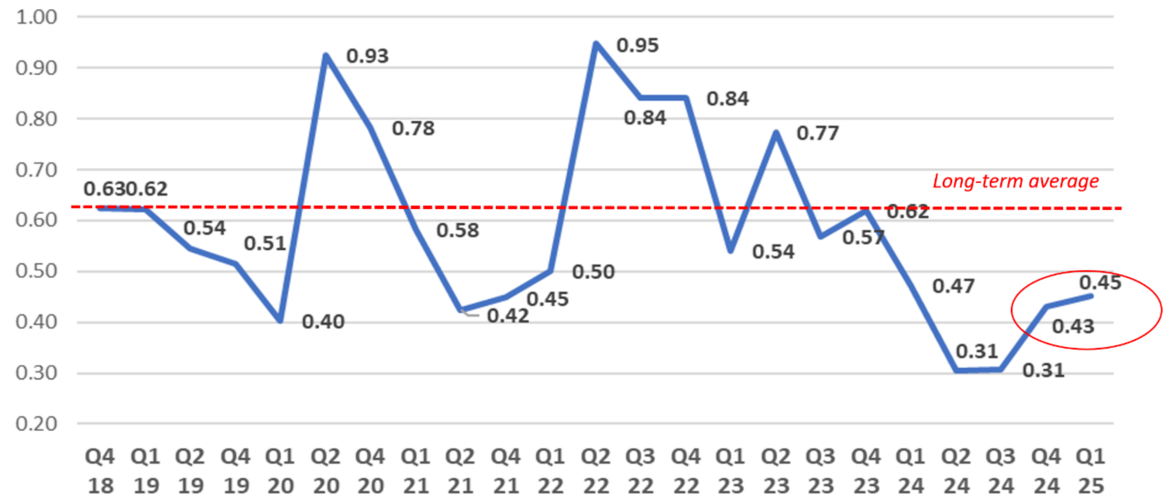


Figure 7. US RSI: Comparison of RSIs for individual risk types

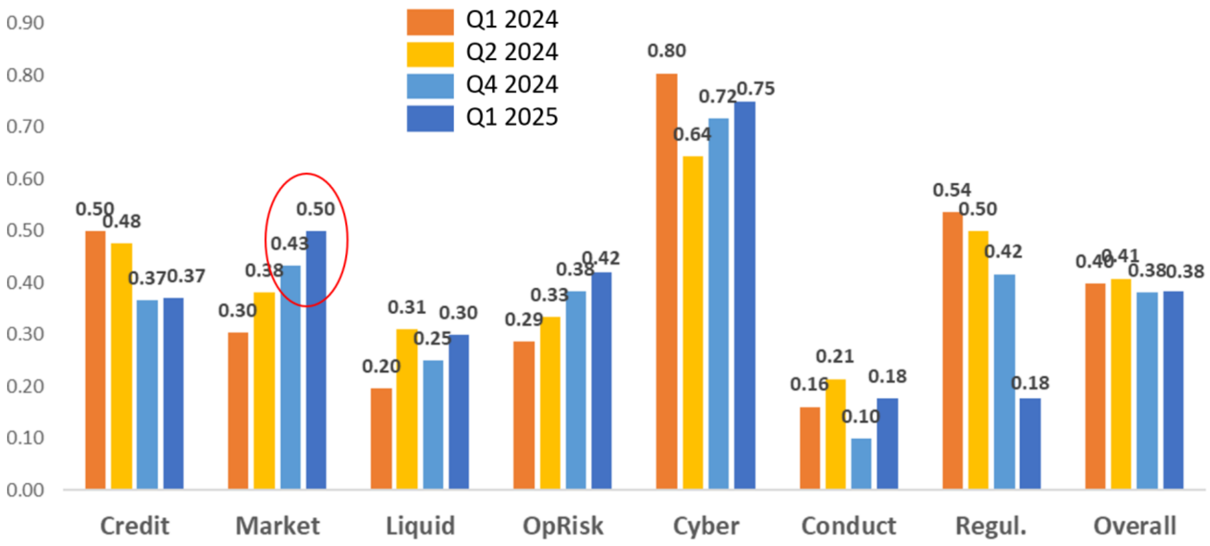


Figure 8. APAC RSI trends for individual risk types

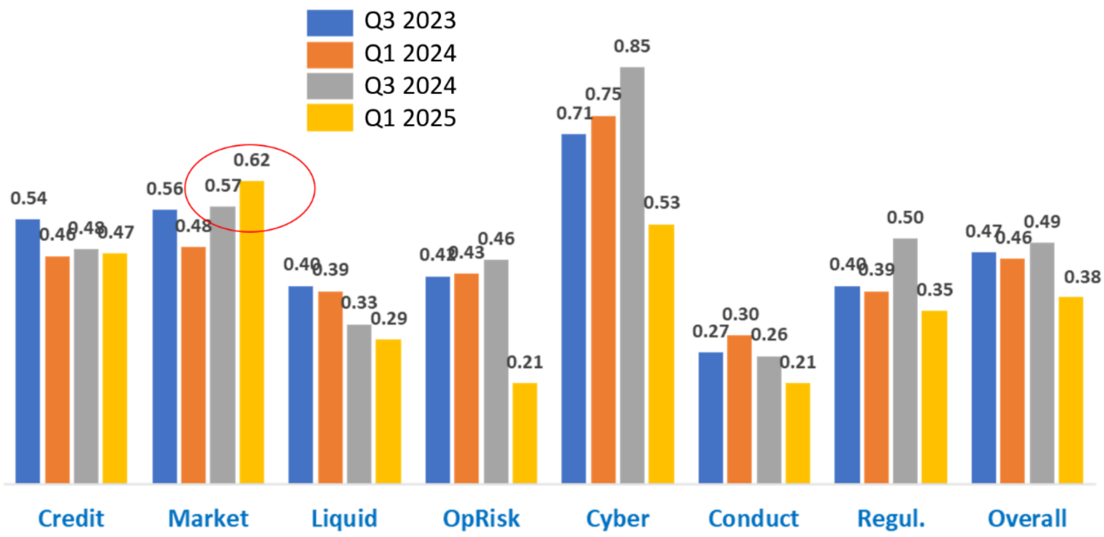


Figure 9. UK RSI trends for individual risk types