



8 steps to mitigate today's balance sheet risk

Unlock a pre-emptive strategy



From CRE pressures to evolving interest rate dynamics and emerging geopolitical risks, are you on top of growing threats to your deposit books, investment portfolios and the full balance sheet?

Whether you're a universal bank, a regional bank or a community institution, it's time to get a handle on your ALM exposure by putting your money to work. Here are eight pre-emptive steps to follow.

1 Deep dive into your deposits

While the deposit stability crisis that marked 2023 has moderated, regional and community banks continue to face challenges with deposit retention and pricing competition. As the Federal Reserve began cutting rates in late 2024, and continued into 2025, with rates moving from 5.25%-5.50% down to 4.00%-4.25% by October 2025, competition for deposits remains elevated though deposit betas have begun stabilizing.

To maintain a stable funding base, you need to start with a segmented view of your customers and their deposits. What concentrations do you have? Which segments and vintages are stickier, and which are most likely to decay? Only with this knowledge can you start building an alternative funding and deposit retention strategy that ensures a more stable source of funding in a moderating but still competitive rate environment.

2 Rethink and review deposit strategies

Today's customers continue to seek security, liquidity and yield from their deposits. As of October 2025, high-yield savings accounts at online banks are offering rates around 3.75%-4.50% APY, while CD rates range from approximately 3.50%-4.35% APY depending on term length. Traditional brick-and-mortar banks at large institutions often offer significantly lower rates, creating ongoing pressure for regional banks.

As well as reinforcing trust in your services, it's critical to provide a mix of products that meets individual customer needs. A well-diversified, sticky base of smaller deposits in high volumes can be healthier in the long run than concentrations of large deposits. With deposit betas gradually declining as rate cuts continue, you'll need to carefully balance competitive rates with profitability. Preview strategy alternatives in a sandbox to see potential impacts and collectively assess the interdependent impacts on NII, NIM, liquidity and capital.

3 Assess alternative funding and test your limits

Whatever strategies you devise, are you sure they'll survive a significant risk event? Carrying out a broad range of stress tests across multiple scenarios will show you what losses you could incur or whether you should redefine your risk appetite. Plus, with reverse stress tests, you can pinpoint vulnerabilities in your business models.

By digitally processing and analyzing all your risk data, a liquidity dashboard will help you quickly understand your liquidity profile and survival horizon at portfolio and bank level – in normal times and in a crisis. At preset trigger points, you'll also see when contingent funding plans should kick in or whether your ALCO needs to rethink its strategies. Recent regulatory focus following the 2023 regional banking stress has heightened supervisory expectations around liquidity risk management and stress testing capabilities.

4 Assess your commercial real estate exposure

Commercial real estate remains a critical focus area for U.S. regional banks in late 2025. According to Q2 2025 data, nearly one-third of U.S. banks have CRE loan portfolios exceeding 300% of their tier-one capital – a threshold regulators view as indicative of elevated risk. Regional banks with assets between \$10 billion and \$100 billion hold approximately 44% of their total loans in CRE, compared to just 13% at large banks.

The challenges are particularly acute in the office sector, where structural shifts to remote work have driven vacancy rates to record highs near 20%. With approximately \$2.2 trillion in CRE debt maturing between 2024-2027, many borrowers face refinancing at significantly higher rates than their original loans. CRE loan growth has slowed to an 11-year low as of mid-2025, reflecting tighter lending standards and property value pressures.

Regulators continue to scrutinize banks with rapid CRE portfolio growth or high concentrations. Be ready to demonstrate robust risk management, comprehensive stress testing of CRE exposures, and realistic loss provisioning. The Federal Reserve's most recent stress tests projected approximately \$80 billion in potential CRE-related losses across the banking system under adverse scenarios.

5 Expand your horizons

Interest income measures may receive significant attention from executives and ALCO, but full balance sheet net present value or EVE (economic value of equity) provides early warnings of risks that extend beyond the net interest income horizon. EVE analysis readily surfaces longer-term impacts to earnings such as mortgage extension and prepayments, as well as caps, floors and lag effects on floating instruments.

By using sophisticated behavioral assumption modeling, you can flex and twist your balance sheet forecasting. Whether assessing the impact of rate changes, spreads or other shocks across the entire balance sheet, you can determine which products are most sensitive and why. This comprehensive view is essential as the interest rate environment transitions from peak rates toward a lower, but still elevated, equilibrium.

6 In times of uncertainty, assess more often

While acute market stress has moderated from 2023 levels, uncertainty remains elevated in late 2025. The Federal Reserve's cautious approach to rate cuts – projecting only two additional quarter-point reductions for the remainder of 2025 and one more in 2026 – reflects ongoing concerns about inflation persistence and labor market dynamics. Political uncertainty and evolving regulatory expectations add additional complexity.

State-of-the-art balance sheet management systems provide a single platform to gather data, analyze risks and drive insights beyond traditional ALM. With highly automated workflows and powerful analytics, you can spend less time crunching numbers and more time on strategic analysis and ALCO preparation. Running ad hoc stress tests on liquidity and contingency funding plans keeps you aware of both downside risks and upside opportunities.

7 Review hedging strategies and optimize hedge accounting programs

The 2022-2023 rate hiking cycle exposed vulnerabilities driven by unhedged exposures, interest rate inter-tenor mismatches and insufficient hedges which became ineffective. The rapid 525 basis point increase from near-zero to over 5% led to significant unrealized losses on securities portfolios and depleted regulatory capital ratios at many institutions.

As we navigate the current environment of elevated but moderating rates, banks must comprehensively review their interest rate risk positions and economic hedges. Understanding the difference between economic (EVE) and accounting (net after hedge accounting) views on both standalone legal entity and consolidated group levels remains critical. Running stress tests and scenario analyses helps calibrate risk appetite and risk limits for various rate paths.

With the Fed funds rate currently at 4.00%-4.25% and projected to decline gradually toward 3.25%-3.50% by end-2026, banks should assess how different rate trajectories impact hedge effectiveness and whether hedge strategies require adjustment for this new rate environment.

8 Assess geopolitical risk transmission channels

Geopolitical risk has emerged as a critical threat to U.S. community and regional banks in 2025, introducing unprecedented complexity and velocity. Unlike traditional financial risks, geopolitical disruptions create multi-dimensional, rapidly-evolving exposures that manifest through financial markets, the real economy, and safety/security channels.

Financial markets transmission

Geopolitical shocks trigger asset price volatility and capital flow disruptions. Research shows bond yields rise 7 basis points per standard deviation increase in geopolitical risk for exposed banks. Regional banks face amplified vulnerability due to smaller capital buffers, limited diversification and higher reliance on short-term funding.

Real economy impacts on borrowers

Your borrowers face supply chain disruptions, trade policy volatility and commodity price shocks. The erratic U.S. trade environment in 2025 – including abrupt tariff announcements targeting major partners – creates immediate uncertainty. These stresses translate to higher default rates, increased provisions and deteriorating credit quality. With U.S. GDP growth projected at just 1.5% for 2025 (down from 2.7% in 2024), loan demand weakens while repayment capacity erodes.

Cybersecurity and operational threats

State-sponsored cyberattacks represent the most critical operational risk, with 53% of bank leaders identifying this as their top concern in 2025. Successful attacks have nearly tripled since 2022 as state actors shift tactics from espionage to disruption. Annual industry costs exceed \$100 billion. Evolving sanctions regimes add compliance complexity while physical infrastructure remains vulnerable.

Critical spillover effects

Federal Reserve research reveals how foreign geopolitical risk impacts domestic banks. Large banks with foreign operations facing heightened risk must satisfy capital requirements. Rather than divesting, they reduce domestic lending – directly constraining credit availability for community banks' local markets and crowding out small business lending.

Essential risk management actions

Integrate geopolitical risk into your ALM framework through five critical actions:

- **Reassess risk appetite:** Traditional frameworks built for stable environments no longer reflect reality. Account for multi-pathway risk propagation and velocity of materialization. Assume moderate-to-significant instability as baseline for 3-5 years.
- **Implement dynamic monitoring:** Track U.S.-China relations, conflict zones and trade policy continuously. Establish early warning systems given shock velocity.

- **Expand scenario planning:** Incorporate geopolitical shocks into stress tests. Model trade war escalation, technology supply chain disruption and cyber-attack scenarios that test how risks interact across credit, market, operational and liquidity dimensions simultaneously.
- **Evaluate borrower exposure:** Assess client dependencies on global supply chains, international markets and geopolitically sensitive technologies. Monitor concentration in trade-vulnerable industries.
- **Strengthen cyber defenses:** Treat cybersecurity as business survival, not IT. Scale threat intelligence and detection capabilities with geopolitical tensions. Maintain robust incident response for state-sponsored attacks.

In 2025's environment of elevated tensions and accelerating change, geopolitical risk management has evolved from optional to essential for community and regional bank resilience.

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