



Banking DSR: Challenges and Opportunities

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Introduction

At the 2025 NATO Summit, leaders made a historic commitment to shared transatlantic security announcing an increase in annual defence spending to 5% of GDP: 3.5 % for traditional defence and security and an additional 1.5 % for resilience including for protection for networks, civil preparedness, and innovation in the defence industrial base.

Many of the solutions needed to support the future goals of the Alliance will be generated by early-stage innovative dual-use companies in the defence, security, resilience (DSR) sector. Evidence from Ukraine illustrates the essential role of ambitious startup and scaleup ventures in the rapid development and adaptation of new defence capabilities. Across the Alliance, these startups must work closely with SMEs (Small and Medium-Sized Enterprise) and traditional Primes to rebuild the Alliance's defence industrial base so that innovative solutions can not only be imagined but also deployed at scale.

NATO Allies have demonstrated the political will to drive to additional government spending, recognising that this is in fact an investment in the future. But for public sector investment to have a lasting impact it must be matched by effective financial conditions that amplify private sector capital flows: startups, SMEs, and even the Primes must be adequately supported from equity to debt capital to listing opportunities, financial services and insurance. To date, this 'capital stack' has yet to be fully developed. The European Commission's March 2025 white paper, *European Defence Readiness 2030*, notes that access to finance is a concern for 44 percent of defence SMEs, notably higher than their non-defence counterparts.

At the earliest stages of innovation, venture capital is becoming more plentiful for DSR startups: Our work with Dealroom shows a 30% uplift in VC for DSR investments: marking the strongest growth among all VC segments. Since Russia's invasion of Ukraine, VC funding in DSR is at an all-time high, reaching \$5.2 billion in 2024, with defence startups among the leading recipients.

Despite this, challenges remain in the capital stack especially as companies grow and build their innovations to industrial scale.

Banking in particular plays a crucial role in financing the DSR sector by providing access to credit, guarantees, export finance, equity investments and general services but has not kept pace with the needs of the rapidly expanding DSR sector. Part of the challenge lies in longstanding perceptions of the defence industry, that have seen it as operating at odds with a strong ESG orientation. In January 2025, the NIF 'NATO Innovation Fund' published a white paper, *Removing Barriers to Responsible Investment in Defence, Security, and Resilience*, arguing that an industry that protects and upholds Western values should not be excluded on ESG or ethical grounds.

With the changing geopolitical landscape, public and investor perceptions of defence have started to shift, but barriers remain. Limits in banking services and bank-led financing are felt across the entire defence industry, but particularly for early-stage DSR companies. We identified four key challenges that must be resolved if capital commitments are to be leveraged into vibrant DSR innovation ecosystems and a robust defence industrial base:

- 1. Restrictions on financing conventional weapons, dual-use startups, or the defence industry at large remain.**
- 2. Lack of familiarity with the sector limits banks' ability to support DSR ventures.**
- 3. Regulatory requirements for DSR companies are not standardized and may vary.**
- 4. Capital flows into DSR ventures are hindered because the companies are often considered riskier.**



Challenges & Opportunities for the banking industry to support the DSR Sector

1 | Exclusion lists remain, but sentiment is changing

The NIF examined the available exclusion lists of 75 of Europe's largest banks (by total assets and market share) and conducted interviews with senior banking professionals. The majority of these banks naturally restrict their investments in companies developing controversial weapons, including chemical and biological weapons, cluster munitions, and nuclear weapons. But in some cases (over 9%), they have additional exclusions restricting conventional weapons, dual-use startups, or the defence industry at large.

To date, higher defence spending, as a percentage of GDP, has yet to correlate with more expansive policies. Germany, France, and the UK have all been strong advocates for increasing defence spending across the Alliance, but their financial institutions have more restrictive policies than others. Indeed, we found that Eastern European institutions have the least restrictive policies and those closest to the imminent threat of Russia are taking more action to invest in and finance defence capabilities.

As public sentiment continues to shift, such restrictions may further diminish.

Our evidence suggests that even where restrictions remain, the banking industry is finding ways to support the defence sector.

For example, some bankers we interviewed described the issues largely in terms of reputational risk, especially associated with global conflicts.

To manage this, they were able to ring-fence their financing by providing project financing to non-weapons programmes. They argued that this was a faster solution than changing a corporate policy. That said, for dual-use startups, such project-level financing is not possible given the stage of the company. Instead, exclusion lists must continue to be adapted and reduced.

2 | DSR Expertise and transparency is limited, but growing

Banks' ability to support DSR ventures at every stage is also hindered by the lack of familiarity with the defence sector. Finance professionals struggle to underwrite defence companies or provide suitable banking services due to limited exposure to and understanding of the sector's unique characteristics. If an account is perceived as too sensitive or time-consuming, managers noted that they may stop pursuing it given lack of expert support. A particular challenge is that banks are frequently asked to extend credit based on complex, opaque government contracts, making it difficult for banks to accurately assess (and lower) the risks of lending. Without clear insight into contract terms and obligations, financial institutions struggle to support defence startups.

Addressing this expertise gap, particularly regarding contracts, requires two complementary solutions: first, developing sectoral specialists within banks and second working closely with Ministries of Defence to improve understanding of contract details.



A small number of banks are setting up teams focused on defence innovation to identify emerging technologies trends and to develop sectoral insights. For instance, earlier this year, Deutsche Bank established a special team to support SMEs in the defence sector. As the DSR sector expands, in-house expertise on emerging technologies and the defence industry is essential to ensure companies remain effectively capitalised across their lifecycle.

As banks gain expertise in the DSR sector, Ministries of Defence can unlock banking services for their innovator community of startups and SMEs by providing stakeholders, including banks, with greater transparency and consistency around 'demand signals', procurement processes and contracts. Clear visibility of spending priorities and longer-term contracts will provide confidence and assurance to the financial industry of a startup or SME's cash flow stability, lowering the risk of lending. The UK's Defence Investment Plan (DIP) will demonstrate how the government intends to spend money over the next 10 years, but clear, simple and consistent contracts will be needed to unlock access to capital for defence and dual-use startups.



3 | Regulatory Requirements Must be Standardised

Financial professionals we spoke to suggest that beyond ethical principles/exclusion lists, banking DSR startups and SMEs raises additional concerns about financial crime such as money-laundering and adherence to global sanctions and banking regulations. These issues are grounded in the need for compliance with banking regulations. The key regulatory framework is Basel III - implemented after the 2008 financial crisis which requires banks to assess reputational and compliance risks through an operational risk framework. Additionally there are the 2017 Money Laundering Regulations which include enhanced Know Your Customer (KYC), anti-money laundering (AML), and anti-bribery due diligence.

Our interviews revealed that these two due diligence frameworks - one focused on reputational risks, the other on operational/financial crime risks, are arduous, frequently conducted in sequence, and duplicative. The ADS Group and TheCityUK recently

advocated for government, regulators and industry to work towards 'deduplication of due diligence for SMEs who are MoD-approved suppliers.' Developing such a workflow could ensure compliance and create a more efficient due diligence process.

A process such as the US FedRamp could provide a way forward by standardising data collection and ensuring that private sector DSR firms are already in compliance and have appropriate documentation before they seek specific banking services.

Prior to such a system, startups can also play a role in easing this process by being more transparent: In our interviews, banks described how dual-use startups hesitate to disclose their involvement in the defence sector, fearing exclusion. While understandable given past history, cooperation (especially within a formal system) can ensure compliance and improve procedural inefficiencies.



4 | The Capital Stack Needs De-Risking

Banks lending to their customers must do so off their balance sheets and maintain a certain level of capital adequacy to ensure financial stability. When companies are deemed riskier, banks must maintain a higher capital ratio, reserving more capital for each loan. Equally, banks must maintain a AAA rating to preserve low borrowing costs and market confidence. With risk perception artificially high for the defence industry, banks are traditionally discouraged from lending including in essential areas such as supply chain financing.

One solution is to structure partnerships between commercial banks and state-owned or development finance institutions (DFIs) who can help de-risk lending by providing credit guarantees for DSR-focused loans.

In June 2025, for example, the European Investment Bank (EIB) tripled its intermediated financing for SMEs in the defence industrial base to €3 billion. As part of this, the Bank is providing a new €500 million facility to Deutsche Bank for long-term liquidity designed



for defence and security investments. Such intermediated lending de-risks banks' lending to startups, ensuring companies in the defence supply chain have access to financing.

At the same time, Santander's CEO has called on authorities to let lenders across Europe use their capital buffers to support growth and investments in the defence sector. In their May 2025 report ADS called on the UK government to consider a new Guarantee Scheme for Defence, like the British Business Bank to provide a level of assurance to lenders. A related solution to expand access to credit is the recently proposed Defence, Security & Resilience (DSR) Bank - an initiative led by former NATO designed to address challenges of government and private sector defence spending and lending. The proposed DSRB would be the first multilateral financial institution created in the past decade and aims to offer guarantees to reduce risk for commercial banks and institutional investors, lowering the cost of borrowing and enabling a longer loan period for borrowers. Such financial mechanisms are crucial to de-risking capital in the DSR sector



Conclusion

There is some way to go before DSR startups and SMEs have access to the same banking and financing opportunities as their counterparts in other sectors. Despite signs of change, barriers remain due to a lack of understanding and low tolerance for risk and change. With the advent of a new era of geopolitical competition and a newly established role for defence, security and resilience, now is a moment for change. The adaptation of the financial sector must not only improve the financial opportunities for large defence Primes. If the commitment to 5% defence spending is to truly drive economic growth and national security, then financing must flow without friction to high-growth innovative startup-ups in our innovation ecosystems as they start to grow and industrialise.

Exclusion lists, lack of in-house defence expertise, inefficient processes, and high capital costs have limited financing for DSR startups and SMEs. Simple solutions could reduce these barriers and facilitate the banking industry's support for the DSR sector:

- 1** Continue to revise and reduce exclusion lists.
- 2** Develop sectoral expertise within banks and work closely with the Ministry of Defence to deepen understanding of contract specifics.
- 3** Improve procedural efficiencies by conducting processes in tandem and consider expedited due diligence for MOD-approved suppliers.
- 4** De-risk lending through public-private partnerships such as the creation of the DSR Bank.

Building a strong defence industrial base cannot be done by political leaders, innovators or managers alone. The financial sector must advance at the same pace. Addressing the four barriers and solutions laid out above can unlock capital and services for the DSR sector and drive wider European economic security at an unprecedented rate.



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