Geopolitical Risk Management for Financial Institutions

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INTRODUCTION

In this article we describe a framework for financial institutions that wish to manage geopolitical risks attached to their global investments. We define geopolitical risk management as identifying, assessing, and mitigating risks from political, economic, and social events (e.g., conflicts, sanctions, trade disputes or international supply chain disruptions) that could affect financial performance.

The management of geopolitical risks is done by building scenarios and a forecast. A forecast is a forward-looking analysis of a particular issue that incorporates data inputs – such as open-source news monitoring, quantitative research, or primary sources from the field – within a strategic analysis context, one which analyses the strategy and decision-making process of relevant actors.

We will introduce the 6-step geopolitical forecasting framework that shows the risks affecting financial performance.

In addition, the article explains the external supervision on the management of geopolitical risk by the Dutch Central Bank and the challenges this supervision faces.

WHAT IS GEOPOLITICAL RISK MANAGEMENT?

Dario Caldara and Matteo Iacoviello of the US Board of Governors of the Federal Reserve System define geopolitical risk management as "the process of identifying, assessing, and mitigating risks arising from political, economic, and social events across different countries or regions that could impact an organisation, government, or investment".[1] These risks stem from factors such as political instability, regulatory changes, trade disputes, sanctions, terrorism, or conflicts that can disrupt operations, markets, or supply chains.

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The European Central Bank (ECB) states in its 2024 Financial Stability Review that financial institutions should apply a combination of risk management strategies and business diversification to address geopolitical risk.[2] As of January 2025, the Dutch Central Bank requires financial institutions in the Netherlands to manage geopolitical risks, incorporating geopolitical risks into financial and non-financial risk processes by risk identification and risk assessment.

Geopolitical risks are managed by scenario building and forecasting, a widely used framework for which is the Intuitive Logics Method.[3] It's drawn from practices at organisations like Shell and supported by academic reviews.

FRAMEWORK/EXPLANATION OF TERMINOLOGY

The framework to manage geopolitical risks is applied to create scenarios and a forecast. The purpose of the exercise is for a financial institution with interests in a country or region to determine whether to take certain risk-mitigating measures, given the likelihood of whether or not a country will be secure militarily and stable economically and politically.

As touched upon in the introductory paragraph, the framework consists of six key steps:

1) THE FIRST STEP IS ESTABLISHING THE SCOPE OF WHAT YOU ARE FORECASTING

For example, an outlook for US-China relations in 2026. This topic is relevant to investments as a declining relationship may affect the international supply chain, driving up costs for various sectors in the global economy in which institutional investors may have invested. This first step can apply to various other topics, including country-level forecasts, international-level forecasts, and global/thematic-level forecasts, and the topic can be incorporated across various time frames (quarter, year, decade, etc.). The prompt for the forecast starts with a simple question: What is the outlook for X topic in X time frame? Other examples of this are: What is the outlook for stability in the Middle East in 2026? What is the outlook for US stability in Q1 2026?

As investments are made in countries and in regions, it is important to monitor geopolitical risks both at the country and at the regional level. A region is often demarcated by its regional name, such as South-East Asia, features some physical and cultural homogeneity, and has a boundary, such as the Himalayan region.

2) THE SECOND STEP IS TO CONDUCT A STRATEGIC ANALYSIS OF THE COUNTRY OR REGION YOU WISH TO FORECAST

First, one must identify the key actors that are most relevant within the country across various themes/sectors, including:

- Political actors
- Security actors
- Economic actors
- International actors

Then, one can analyse the decision-making of those actors. This includes the combination of two analytical approaches: geopolitical analysis and human agency analysis.
As stated in the CFA Level 1 programme "Introduction to Geopolitics[4]" geopolitical analysis is the study of how impersonal forces shape state behaviour. This rests on five key pillars of state power, defined as geopolitical fundamentals:

- Geography – physical terrain, location, size, climate
- Demographics – population, ethnicity, religion
- Resources – energy, minerals, agriculture, etc
- Culture – societal values/norms
- Technology – development/utilisation of technological advancements

These pillars shape the ability of any given country to meet its geopolitical imperatives, which can be thought of as the primary objectives of a country, regardless of who is in power:

- Domestic political and security consolidation
- Protection from neighbors/external powers
- Expansion of regional/global influence and countering challengers

> COLLECTING DATA AND INTEGRATING THEM IS EXPENSIVE

Next, human agency analysis is considered. This is the study of how personal forces shape a country's behaviour as a legal state. This rests on two fundamental questions:

- Who are the key decision-makers? This includes the study of their background and worldview, how they interpret/process their state's geopolitical imperatives and the incentives and pressures they are under (i.e. why do they implement specific decisions?)
- What shapes their decision-making? This includes the study of the structural context in which they are operating (i.e. what is the organisational structure in which decisions are made, who is in their network of decision-making, and who is impacted by their decisions and how?)

3) THE THIRD STEP IS TO IDENTIFY KEY INDICATORS

These are elements to track that indicate trendlines across:

- *Political:* This indicator covers institutional strength, political leadership, policy coherence, and public legitimacy. It represents the strength or stability of a regime/political system which can in turn have numerous impacts internally and externally.
  Examples: Approval Ratings, Media Polarisation, Protests, or Legislative Cohesion.
- *Economic:* This indicator tracks the financial and material conditions that support societal wellbeing and state capacity. The economic indicator may be the most relevant for particular audiences due to the significant impact it can have on business operations.

Examples: Inflation, Interest Rates, Stock Market, Currency Valuation, Trade/Supply Chains

- *Security:* This indicator focuses on physical safety and the monopoly of violence – who controls the streets, the borders, and the use of force. Even prosperous or politically functional states can unravel if they lose control over security.
  Examples: Crime, Political Violence/Riots, Terrorism, Deployment of Police/Military.
- *Diplomatic:* This indicator of the degree of stability examines how the state interacts with other states and systems, and how it is perceived internationally. A state's diplomatic standing can affect its access to aid, investment, markets, and shape its perceived legitimacy.
  Examples: Bilateral/Multilateral Engagements, Diplomatic Incidents, Global Reputation.

Following the identification of key indicators, data inputs can be gathered and integrated. Collecting data and integrating them across the four indicators of Political, Economic, Security and Diplomatic is expensive, as these data are usually purchased from data providers. Gathering and integrating data is done through various qualitative and quantitative means, including:

- Monitoring – day-to-day news flow across a variety of open sources
- Research - in-depth information gathering (qualitative and quantitative)
- Fieldwork – primary source information from contacts in the field

Monitoring, Research and Fieldwork are used to indicate trendlines qualitatively and quantitatively but how does one go about it?

Qualitative Information Gathering. This is the gathering of non-numerical data to capture context, opinions, and narratives about geopolitical conditions. Examples are:

- *Expert Consultations:* Engaging with analysts, policymakers, or local experts to uncover political motivations or tensions;
- *Media Analysis*: Reviewing detailed reports from outlets such as Reuters, for nuanced views on events;
- *Social Media Insights*: Monitoring posts on X or Telegram for example to assess public sentiment, unrest, or reactions to political developments;
- *Cultural and Historical Analysis*: Examining historical events or cultural factors to understand current geopolitical dynamics;
- *Official Statements*: Studying government speeches, policy papers, or diplomatic communications for insights into state priorities.

Quantitative Information Gathering means collecting numerical data for statistical analysis to identify measurable trends or patterns. Examples are:

- *Economic Metrics*: Tracking GDP, inflation, or trade data from sources such as World Bank or OECD to gauge economic health;
- *Conflict Statistics*: Using databases such as Global Peace Index for stability rankings, ACLED or Uppsala Conflict Data Program to quantify incidents of violence or instability;
- *Political Data*: Analysing election results or voter turnout to measure political legitimacy or public support;
- *Social Data*: Monitoring unemployment, poverty, or migration data to evaluate societal pressures, using for example UN's Human Development Index;
- *Defence Spending*: Reviewing military expenditure data from SIPRI to assess security dynamics.

Monitoring: For monitoring day-to-day news flow to assess geopolitical stability, specific examples of open sources include:

- *News Websites*: International outlets like BBC or Reuters for global coverage of political events, conflicts, and diplomacy;
- *Social Media Platforms and Blog Forums*: Posts on for example Facebook or X for real-time public sentiment, reactions to events, or statements from policymakers and influencers;
- *Government and NGO Reports*: Publicly available briefings from organisations such as the United Nations, World Bank, or think tanks such as the International Crisis Group.
- *Regional News Outlets*: Local sources, for example South China Morning Post, or AllAfrica for region-specific perspectives;
- *Public Databases*: Economic indicators from sources such as Trading Economics

Research. In-depth information gathering to evaluate geopolitical stability involves systematically collecting and analysing both descriptive (non-numerical) and numerical data to understand the political, economic, social, and security dynamics affecting a region, country, or global environment. This approach integrates detailed narratives, expert perspectives, and contextual insights with measurable data to provide a comprehensive assessment of geopolitical risks and trends.

Fieldwork. This refers to firsthand, unfiltered data or insights gathered directly from individuals who are physically present or have direct involvement in a specific region, event, or situation. These contacts could include local experts, journalists, diplomats, community leaders, or other on-the-ground observers who provide direct accounts, observations, or evidence about political, economic, social, or security conditions. Using such information helps assess geopolitical stability by offering authentic, real-time perspectives that complement or validate data from open sources, enabling a more accurate understanding of risks, trends, or dynamics in a given area.

An example of fieldwork is a phone call with a local NGO worker in Mali reporting on recent militia activity and community tensions. Then combine this with quantitative data (e.g., ACLED conflict statistics) to evaluate the risk of escalating violence and its impact on regional stability, leading to a more accurate assessment of whether the situation is deteriorating, informing decisions on investment.

4) THE FOURTH STEP IS TO FORM A NET ASSESSMENT ONCE THE PRECEDING THREE STEPS HAVE BEEN COMPLETED

This is a strategic evaluation method originally used in military and defence contexts.[5] A net assessment is comparative analysis of military, technological, political, economic, and other factors influencing the relative military capabilities of nations or coalitions. The net assessment is combined with scenario-based reasoning, using "what-if" scenarios. The purpose of creating what-if scenarios is to evaluate the potential consequences of specific events or decisions on geopolitical stability. This is done by testing how different variables (e.g., policy changes, economic crises, or natural disasters) could unfold. With the data gathered and analysed across the categories Political, Economical, Security and Diplomatic factors are pinpointed that could influence stability, such as leadership changes, economic sanctions, or social unrest. Then, hypothetical situations are created, for example "What if a major oil-producing country faces a coup?"

Types of What-If Scenarios are:

- *Best-Case Scenario*: Assumes favourable conditions (e.g., successful peace negotiations in a conflict zone);
- *Worst-Case Scenario*: Assumes adverse events (e.g., escalation of a regional conflict into a broader war);
- *Most Likely Scenario*: Reflects the most probable outcome based on current trends and data;
- *Alternative Scenarios*: Explore less likely but plausible outcomes (e.g., unexpected alliances or technological disruptions).

Examples in Geopolitical Stability:

- **Scenario 1: Economic Sanctions**
  - *What-If*: What if the U.S. imposes stricter sanctions on for example Iran?
  - *Analysis*: Use primary source information (e.g., interviews with Iranian business leaders) and quantitative data (e.g., oil export declines from World Bank data) to assess impacts on Iran's economy, public unrest, and regional influence.
  - *Outcome*: Potential for increased domestic instability or heightened tensions with neighboring countries.
- **Scenario 2: Leadership Change**
  - *What-If*: What if a key leader in North Korea is replaced unexpectedly?
  - *Analysis*: Combine qualitative insights with quantitative indicators (e.g., military activity data from SIPRI) to evaluate risks of internal power struggles or aggressive foreign policy shifts.
  - *Outcome*: Possible destabilisation or changes in diplomatic relations.
- **Scenario 3: Natural Disaster**
  - *What-If*: What if a major earthquake hits a politically fragile region like Venezuela?
  - *Analysis*: Use field contacts (e.g., local NGOs) for qualitative insights on government response capacity and quantitative data (e.g., economic losses from past disasters) to predict impacts on stability.
  - *Outcome*: Risk of social unrest or impact on oil prices.

5) THE FIFTH STEP IS FORECAST BUILDING

Only after the data have been gathered, analysed and used in the creation of a net assessment a forecast can be made. This depends on a scenario-building process which includes the following components:

- Scenario – a future outcome for the direction of a particular topic
- Drivers – what would cause such a scenario to materialise?
- Signposts – what are signs this scenario is coming to fruition?
- Arrestors – what are signs of deviation from this scenario?
- Implications – what are the consequences of such a scenario?

The following indicators for scenarios towards or from stability of the country are distinguished:

Quantifying Indicators: Impact is a non-standardised concept. Events in one country will have a different impact than the same events in another country. Some examples:

- A protest in Tehran is likely to be more significant than a protest in Taipei.
- A 2% drop in GDP in the US is likely to be far more significant than it is in Venezuela.
- A low approval rating in France is likely to be more significant than it is in Russia.

The impact of events cannot be standardised across all countries because the same event in one country (an inflation rate of 10% in the US) can be more significant than in another (an inflation rate of 10% in Belgium). Each event requires context. Forecasting has got as much to do with how "big" an event is as the impact of the event can have on the system it takes place within.
Therefore, the most effective way to forecast shifts in stability-instability is to look at both the *significance* of events, as well as the *resilience* of the system.

GEOPOLITICAL RISKS DRIVE UP COMPLIANCE COSTS

Significance: Significance focuses on the actual size of the event. For example, protests in the US are common, hence they are relatively weak indicators of destabilisation. However, protests in North Korea are extremely uncommon and should be taken seriously as a strong indicator of political or security destabilisation.

Resilience: Resilience refers to the flexibility and durability of the system itself. A fragile regime or a smaller country can feel the impact of events more intensely because they are less flexible. For example, ships and boats – In a country like Qatar, a supply chain issue could be very significant because Qatar's main export is Liquefied Natural Gas (LNG). If Qatar were to lose its market share on global LNG exports, it could have

massive repercussions for the country. Comparatively, Australia, which has an even larger share of the LNG market, would not suffer as much because Australia also has a very diverse variety of other exports which could mitigate the damage. Resilience is not only a knowledge of systemic factors, but also the understanding of human agency under pressure and uncertainty.

This step 5 leads to a forecast stating the likelihood of a country's or a region's or global:
- Destabilisation (political, economic, security, diplomatic)
- Status Quo
- Stabilisation (political, economic, security, diplomatic)

Stabilisation refers to events, developments, or signals that indicate a country is moving towards a more stable and predictable state. This might include the resolution of a political crisis, improved macroeconomic indicators, a truce between warring factions, or diplomatic breakthroughs. In essence: signs that the country is becoming more governable, predictable, or resilient.

Destabilisation is the inverse; events which signal that the country is slipping into disorder or dysfunction. Destabilisation doesn't necessarily entail dramatic or immediate collapse; it can be slow or passive, for example when political institutions weaken over time, or there is an economic slowdown.

Status Quo is the current, prevailing condition of the country, based on ongoing trends and persistent indicators within each domain. It is not a neutral/middle between stability and instability, but rather a snapshot of where things currently stand across political, economic, security, and diplomatic realms at a broad level. To determine the status quo one must examine ongoing events, evolving patterns, and signposts that are already entrenched or unlikely to change.

Understanding Actors/Regimes: One of the most significant factors that must be accounted for when forecasting a trend towards stabilisation or destabilisation is the decisions actors make. This is a key aspect of predicting resilience. Often, stabilisation or destabilisation are the results of key decisions being made under various pressures. Stable regimes have destabilised rapidly because a leader made a poor call, comparatively, volatile regimes have persisted with high stability because the right calls were made.

6) THE SIXTH STEP IS TO UNDERSTAND THE TIMEFRAMES FOR FORECASTING

The same event may have a significant impact in the short term and have little to no impact in the long term. An event such as a protest can occur and seem very significant in the moment and have absolutely zero long term impact on a country. Comparatively, the impact of something like a lower interest rate may only really be seen in the long term as it won't have an instantaneous impact.

Weekly:
- Focus: Immediate developments (protests, policy moves, breaking news).
- This forecast is relative to the dominant trends from the most recent headlines.

Quarterly:
- Focus: Structural trends, institutional shifts, medium term projections.
- This forecast is relative to the averaged behaviour or performance from the prior quarter.

Annually:
- Focus: High level shifts, long-term trends, broad systemic implications.
- This forecast is relative to the previous year's prevailing systemic conditions.

The most common timeframes for domestic stability-instability forecasting are quarterly and annually as the objective is to track systemic trends. Systemic trends refer to broad, interconnected patterns or shifts that affect entire systems – such as economies, societies, or environments – rather than isolated parts. They often highlight persistent issues or changes that influence how a system functions as a whole, and analysing them involves identifying root causes, interdependencies, and potential future projections.

EXTERNAL SUPERVISION ON THE MANAGEMENT OF GEOPOLITICAL RISK BY THE DUTCH CENTRAL BANK

The ECB and Dutch Central Bank[6] urge financial institutions to proactively identify risks and enhance operational resilience, particularly against cyber threats amplified by geopolitical tensions. In addition to risk identification and risk assessment this means:

Mitigation strategies. Financial institutions, including pension funds, are to develop contingency plans, such as diversifying investments or supply chains, or securing insurance.

Continuous monitoring. This means tracking geopolitical developments in real-time using data from news, intelligence reports, or social media platforms for sentiment and trends.

Buffers: adequate capital and liquidity buffers are required to mitigate risks from geopolitical events. In their 2024 Financial Stability Review the ECB emphasises governance, risk management, and capital planning to address country-specific vulnerabilities.

Regulatory frameworks: Regulations such as the EU's Digital Operational Resilience Act (DORA) set requirements for managing risks from third-party IT providers, which are critical in a geopolitically volatile environment.

CHALLENGES FOR FINANCIAL INSTITUTIONS

Financial institutions face several challenges in managing geopolitical risks. Unlike sectors such as oil and gas, financial institutions such as pension funds lack mature, standardised frameworks for geopolitical risk management. Detailed guidance on geopolitical risk management is limited. Many institutions rely on ad-hoc approaches rather than integrating these risks into continuous risk cycles. In its Financial Stability Review from May 2024 the ECB mentions that geopolitical risks affect banks through financial channels (e.g., increased funding costs, higher spreads for credit default swaps) and real-economy channels (e.g., supply chain disruptions impacting credit quality). These interconnected risks require holistic management.

Finally, geopolitical risks, such as sanctions and politically exposed persons (PEP) screening, drive up compliance costs, with 71% of EMEA financial institutions citing geopolitical risk as a top cost driver.

CONCLUSION

This article presents a framework to determine the probability of geopolitical risk affecting financial performance. While this can be done in-house, it is new terrain for many financial institutions, and there is little guidance from the ECB or the Dutch Central Bank.

Geopolitical risks pose complex and multifaceted challenges for financial institutions. The unpredictable nature of these risks, coupled with their transmission through financial markets, the real economy, and operational vulnerabilities like cyberattacks, demands sophisticated risk management and compliance frameworks. Financial institutions must navigate difficulties such as quantifying risks, ensuring sanctions compliance, maintaining liquidity, and addressing data gaps. By integrating qualitative insights from primary sources (e.g., field contacts) and quantitative data (e.g., economic indicators, conflict statistics), and by conducting what-if scenario analyses, financial institutions, including pension funds can better anticipate and mitigate the impacts of geopolitical shocks. As this article shows it is however quite an endeavour to implement and it might be best to outsource this task to a specialised advisory service.

ABOUT THE AUTHORS

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Notes

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