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Understanding and managing geopolitical risks – a strategic perspective

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Learning objectives:

- Understand how and why geopolitics plays an important part in our clients' risks and opportunities
- Understand the complexity and interconnectivity of geopolitical drivers of risk
- Understand how geopolitical risks can be identified, monitored and factored into strategic and emerging risk management



Approach

Research questions:

- **What** is geopolitics, its nature and its impact upon our clients?
- **Why** is geopolitical risk management increasingly important for the insurance industry and its clients?
- **How** can this be implemented in practice?
- **What** can be done by the insurance industry to foster and promote geopolitical risk and opportunity management?

Methodology:

- Analysis of pertinent academic and professional literature
- Reflection on experience in helping clients to monitor, evaluate and manage geopolitical risk.
- Incorporation of experience from working with UK Government and International Organisations on geopolitically driven risk.

What is geopolitics, its nature and its impact upon our clients?

Characteristics

- Complex and contentious conceptual history.
- Multiple Definitions.
- Interconnected and driven.
- Most organisations are affected and shape their own exposures differently.
- Shaped by global and local forces often beyond clients' control.

Pragmatic Definition

- 'Geopolitical risk is about relations between nations – at the political, economic, military, and cultural/ideological level'. James Tunningley, GRI: <https://globalriskinsights.com/2022/01/top-11-geopolitical-risks-for-2022/>
- Risk conventionally occurs when status quos (and stakeholders) are threatened.
- Fundamentally about control.

MACKINDER'S WORLD (1904)



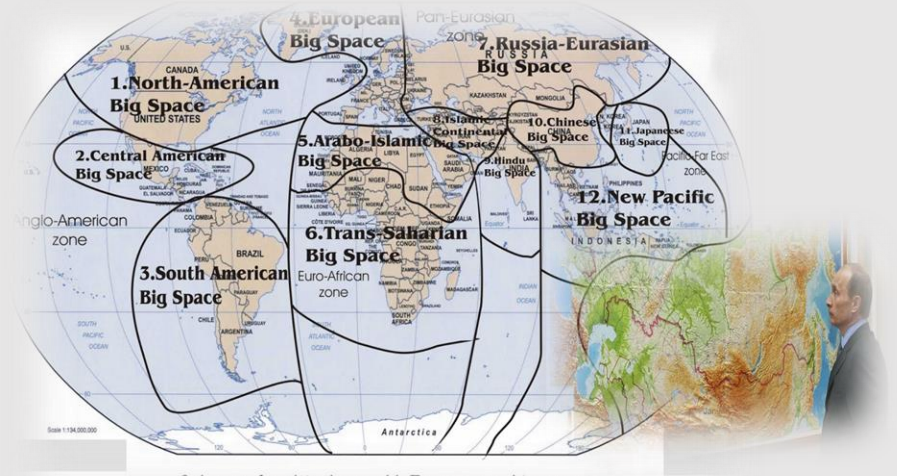
Heartland
Rimland
Boundary of World-Island

Geostrategic Model: the Heartland

LAND POWER

SEA POWER

SEA POWER

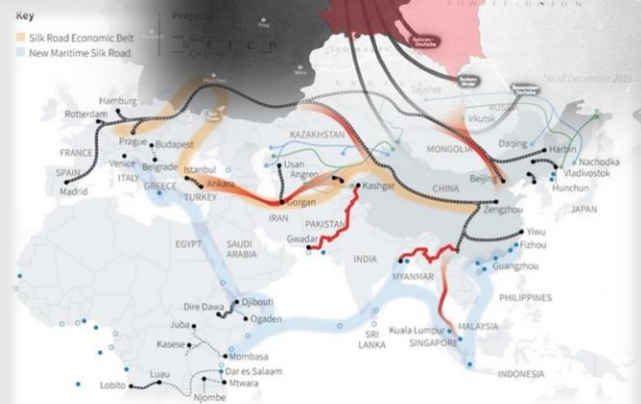


2-d map of multipolar world. Four zones - big spaces.

THE DEMON OF GEOPOLITICS



Nach dem Scheitern der ersten Weltkriege begann die größte großräumige Umfiedlungsaktion der Weltgeschichte. Alle Volkgruppen, die Druck ihrer Aufgaben erfüllt haben, der Führer zurück in die Heimat ihrer Väter. Sie haben in der Lage und der Fertigkeit der deutschen Reiches. In bestimmten Maße werden beim Aufbau der Weltgeschichte ihre kolonialen Fähigkeiten wirksam werden.



source: Mercator Institute for China Studies. Inton, 24/03/2017



PARACEL ISLANDS
SPRATLY ISLANDS
China, Taiwan, Malaysia, Brunei, Philippines and Vietnam claim sovereignty over all or parts of these scattered islands and reefs.
Subi Reef, Gaven Reefs, Fiyero Cross Reef, Cuarteron Reef, Hughes Reef, Mischief Reef, Johnson South Reef

COUNTER-STRATEGY OF EURASIAN GEOPOLITICS

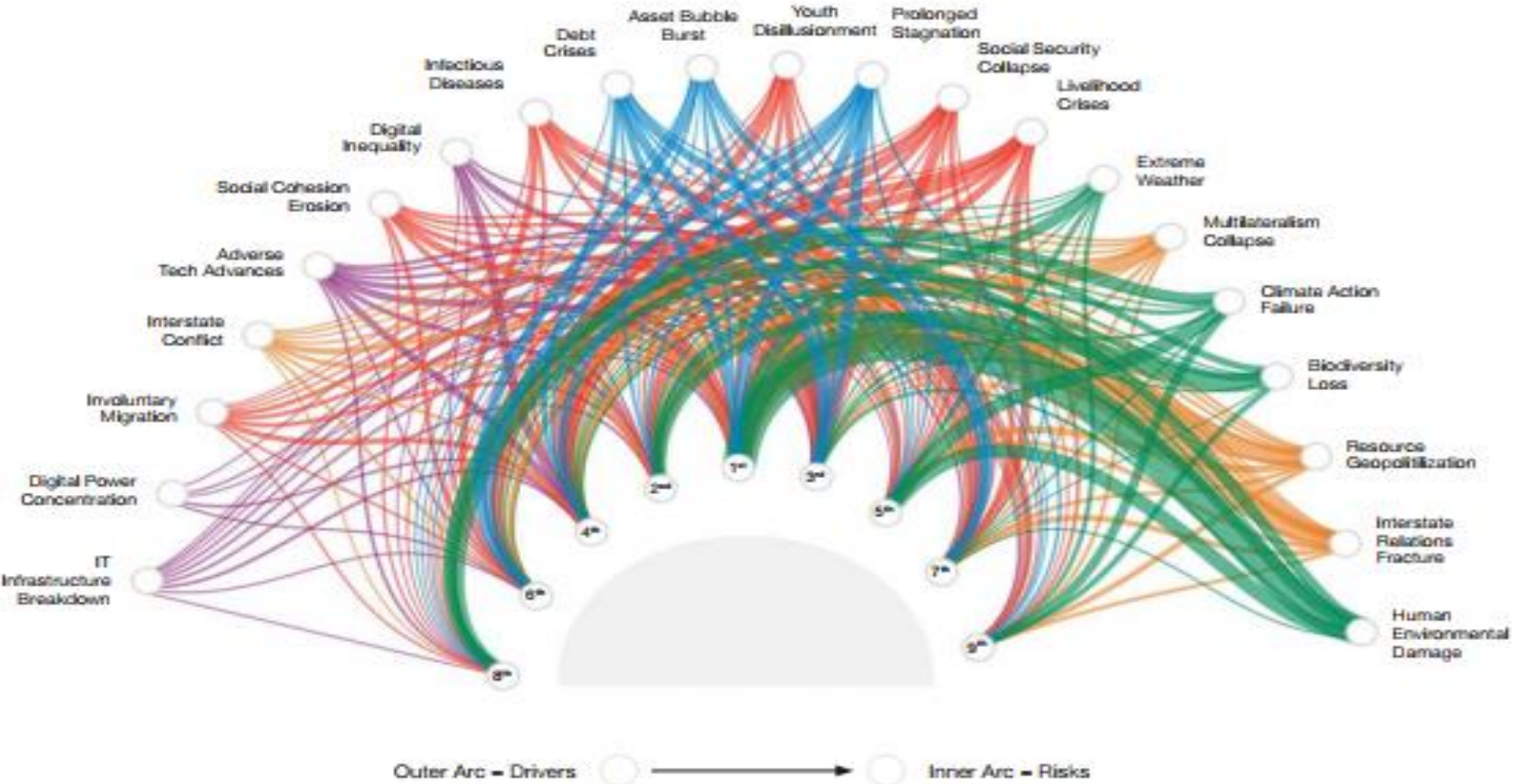
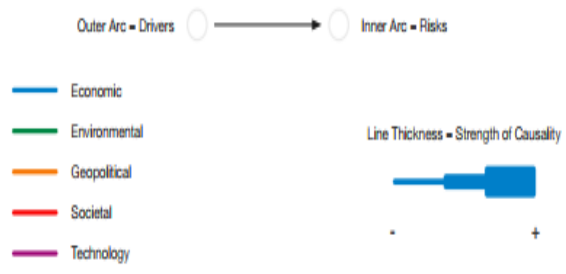


Impacts of Geopolitical Volatility and Uncertainty

- Erosion of international institutions and ‘The New World Order’
- Political and military tensions and expenditure (guns or butter/ESG dilemma?)
- Trade Tariffs/ Investment restrictions (geo economic degradation)
- Increase in regionalism
- Vaccination Nationalism
- Resource competition (and resource nationalism)
- Supply chain frictions (leading to near and onshoring regionalism)
- Geopolitically driven cyber-aggression
- Credit, market and capital liquidity risks (in Financial Services).
- Increased insurance premiums

Interconnected Drivers

8 th	6 th	4 th	2 nd	1 st	3 rd	5 th	7 th	9 th
Extreme Weather	Debt Crises	Social Cohesion Erosion	Infectious Diseases	Climate Action Failure	Livelihood Crises	Biodiversity Loss	Prolonged Stagnation	Human Environmental Damage



N.B. Each driver of the risks shown here has multiple drivers of its own. Each Risk can then act as a driver in its own right.

Geopolitics is driven by societies, their environments, economies, demographics, cultures and history.

Emerging Risks: An increasingly complex web:

- Geopolitical risks are becoming more complex and intertwined with other emerging risks in a 'Transformative Age'.
- Complex risks require complex adaptive responses.
- Understanding and managing geopolitical risk therefore requires a holistic, cross disciplinary (and synthetic) approach.

Why is geopolitical risk management increasingly important for the insurance industry and our clients?

- Erosion of global stability, uncertainty and notions of 'new normals'.
- Greater awareness and ranking of geopolitical risk on registers
- Regulatory obligations to consider scenarios since 2008 crash.
- Dual exposure to shocks and chronic developments.
- Increased uncertainty demanding more resources for sense-making and strategic adjustments.

But:

- Insurance policies cater mostly for political risks at state level – risk transfer opportunities fewer and reactive. Therefore:
- Risks need to be incorporated at a **strategic level of understanding and response**

Strategic Treatment of Geopolitics

Assign ownership and management of the risk at Group or Company level

in order to:

- Identify and understand plausible scenarios.
- Foresee the risks.
- Identify the dependencies and business impacts.
- React to the risks and capitalize on changes in the operating environment.

How? – General Approach

- There is no syllabus and no ISO – but others are relevant and adaptable.
- Risk ownership – who is responsible for geopolitical risk
- Board buy-in is critical.
- Capacity – Different minds experience and imagination required.
- Quant Models tend not to work alone – build scenarios and indicators.
- Holistic and integrated approach.
- Adapt / augment RM frameworks already currently in place e.g, ERM, Security, Market Risk.
- Blister on to 3 Lines oD model where appropriate
- ‘Create your own Foreign Office’ Adopt the skills of the diplomat from ground level (the field) to the boardroom.
- Well-honed guidance on implementation is emerging and available.

Activities – Towards Strategic Agility through Diversity



Board

Geopolitical Risk Ownership

- Terms of Reference for strategic geopolitical risk
- Periodic Scenario Reviews
- Challenge assumptions.
- Consider and Measure Business Impacts
- Define and direct business response to impacts
- External Relations: Direct the tone of corporate narratives
- Allocate resources to risk mitigation strategies
- Exploit strategic opportunities
- Set questions for the Risk Committee
- NEDs



Risk Functions

Risk Committee, security markets risk etc.

- Development and monitoring of plausible scenarios and indicators.
- Alignment of models across functions
- Identify dependencies
- Challenge assumptions
- Business Impact analysis
- 2nd and 3rd order risks
- Challenge and develop mitigation strategies
- Identify strategic opportunities

Requires:

- Structure, discipline people resources to acquire the granularity for geopolitical analysis.
- Corporate Strategy and Risk Framework
- Cultural Change



Regional and Country

- Identify geopolitical effects and business impacts.
- Anticipate likely effects and plan accordingly..
- Feed back into the risk analysis function.
- Amplify corporate narratives.
- Lobbying, where appropriate.
- Resilience through the building of trust.
- Spot local and regional opportunities and feedback for replication elsewhere.
- Identification and liaison with stakeholders e.g. governments

Barriers to effective Implementation

- Treatment in silos (e.g. country, market and security risk team models and figures incoherent or misaligned)
- Provenance of quant numbers – can be misleading or do not reflect nuance.
- Human factors:
 - Boards sometimes reluctant to consider scenarios (but ECB, Basel and B of E all insists on this at board level downwards)
 - Cultural and skills shift difficult
 - Saliency bias (referring to the past as a model)
 - Group think
 - Beware the ‘Hippo’ the ‘Zebra’ and ‘dinner party darlings’.
 - National and cultural biases
- Forecasting may fail – therefore may be a need to increase resilience in pipelines or capital allocations.

What can be done by the insurance industry to foster and promote geopolitical risk and opportunity management?

- Build geopolitical analysis capacity in tandem with ESG and other emerging risk offerings in order to help clients identify geopolitical risks.
- Offer geopolitical risk management advisory linking analysis to statutory scenario-building obligations and proactive strategic planning.
- Build links with and act upon interactions with academics, diplomats and thought leaders.
- Do not rely on AI feeds to gauge future plausible scenarios. Invest in qualitative analysis as well as quant feeds.
- Grow practical geopolitical analytical and implementation expertise within and across relevant (for example, ERM, ESG and Political Risk) insurance offerings.

Key Points:

- Ownership.
- Capacity and systems adjustments.
- Challenge assumptions and dependencies at board level.
- Scenario Building and moving this to:
- Business Impact analysis
- Integrate understanding and analysis within all risk functions.
- Plan to mitigate **and** exploit.
- Insurance industry needs to move further to the left of the event, pre-crisis.



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What we have covered:

Why geopolitics plays an important part in our clients' risks and opportunities

The complexity and interconnectivity of drivers of geopolitical and other associated emerging risks

Some approaches to the ways in which our clients can be assisted in the strategic management of geopolitical risk





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