GEOPOLITICAL SANCTIONS AND THE SECURITY OF FOREIGN EXCHANGE RESERVES

by

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ABSTRACT

Foreign exchange reserves constitute an essential component of the "international monetary and financial system", enabling central banks to maintain external payment capacity, support exchange-rate stability and strengthen confidence in national economies. Traditionally, reserve management has been guided by the principles of safety, liquidity and return. However, increasing geopolitical tensions and the use of financial sanctions have exposed vulnerabilities in the accessibility of sovereign reserves held through foreign financial institutions. The immobilisation of Russian foreign exchange reserves following the conflict in Ukraine demonstrates that the security of reserve assets depends not only on their financial quality but also on the jurisdictional, institutional and geopolitical conditions governing their custody and utilisation. This article examines the changing dimensions of reserve security by analysing the relationship between geopolitical sanctions, international financial intermediaries and central bank reserve-management strategies. It evaluates the implications of foreign-held reserve immobilisation for custodial arrangements, currency diversification, cross-border payment infrastructure and global financial stability. The study argues that conventional reserve-management frameworks do not sufficiently recognise geopolitical accessibility as an independent dimension of reserve security. It proposes an analytical framework incorporating financial, operational and geopolitical security and recommends stronger geopolitical risk assessment, diversified custodial arrangements, institutional accountability and contingency planning. The article concludes that incorporating geopolitical considerations into reserve-management practices is necessary to strengthen the resilience of sovereign reserves and maintain confidence in the international financial system.

Keywords: Foreign Exchange Reserves, Geopolitical Sanctions, Reserve Management, Financial Intermediation, Financial Fragmentation, Global Financial Stability.

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1. INTRODUCTION

Foreign exchange reserves are among the most important instruments through which central banks maintain monetary and financial stability. They enable countries to meet external payment obligations, intervene in foreign exchange markets, manage exchange-rate volatility and maintain confidence in their ability to withstand external economic shocks.[1] In an increasingly interconnected international economy, the availability of adequate reserves is essential for maintaining financial credibility and supporting international transactions.[2]

Traditionally, the management of foreign exchange reserves has been guided by three principal objectives: safety, liquidity and return.[3] These objectives require central banks to preserve the value of reserve assets, ensure their availability when required and generate reasonable returns within acceptable risk limits. The International Monetary Fund's Revised Guidelines for Foreign Exchange Reserve Management recognise the importance of controlling market, credit, legal, settlement, custodial and operational risks.[4] However, recent geopolitical developments have demonstrated that reserve security involves vulnerabilities extending beyond conventional financial risks.

The immobilisation of Russian foreign exchange reserves following the conflict in Ukraine in 2022 brought this issue into particular focus.[5] A substantial portion of Russia's foreign-held sovereign reserves became inaccessible through financial institutions and jurisdictions implementing international sanctions.[6] Although the reserves continued to be associated with their Russian owner, their practical availability was restricted. This development demonstrated that the financial quality of an asset does not necessarily guarantee the sovereign authority's ability to access or utilise it.

The issue raises an important question concerning the adequacy of conventional reserve-management practices. If sovereign reserves can become inaccessible because of geopolitical restrictions, should their security be assessed only through financial indicators such as liquidity, creditworthiness and market value? This article argues that geopolitical accessibility

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[1] INTERNATIONAL MONETARY FUND, *REVISED GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT* ¶ 5 (2013), https://www.imf.org/external/np/pp/eng/2013/020113.pdf.

[2] Olivier Jeanne & Romain Rancière, The Optimal Level of International Reserves for Emerging Market Countries: A New Formula and Some Applications, 121 *ECON. J.* 905, 905–30 (2011), https://doi.org/10.1111/j.1468-0297.2011.02435.x.

[3] INTERNATIONAL MONETARY FUND, *supra* note 1, ¶¶ 8, 45–46.

[4] Henry Farrell & Abraham L. Newman, Weaponized Interdependence: How Global Economic Networks Shape State Coercion, 44 *INT'L SEC.* 42, 42–79 (2019), https://doi.org/10.1162/ISEC_a_00351;

[5] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–95 (2023), https://doi.org/10.1080/01402382.2022.2155906.

[6] Anton Moiseienko, Legal: The Freezing of the Russian Central Bank's Assets, 34 *EUR. J. INT'L L.* 1007, 1007–20 (2023), https://doi.org/10.1093/ejil/chad050.

must also be considered an independent dimension of reserve security. It examines the role of international financial intermediaries, the implications of reserve immobilisation for central bank strategies and the broader consequences for global financial stability.

2. FOREIGN EXCHANGE RESERVES AND THE INSTITUTIONAL ARCHITECTURE OF THE INTERNATIONAL MONETARY SYSTEM

Foreign exchange reserves are external assets held or controlled by monetary authorities and readily available for meeting balance-of-payments financing needs, influencing exchange rates and addressing other related purposes.[7] They generally include foreign currency deposits, securities, monetary gold, Special Drawing Rights and reserve positions in the International Monetary Fund. The Currency Composition of Official Foreign Exchange Reserves (COFER) database maintained by the IMF provides information on the distribution of official foreign exchange reserves among major currencies.[8]

The international monetary system is substantially dependent on a limited number of currencies, particularly the United States dollar and the euro. These currencies benefit from established financial markets, international acceptance, convertibility and extensive use in cross-border transactions. Central banks therefore hold significant portions of their foreign exchange reserves in assets denominated in these currencies. According to the IMF's second-quarter 2026 COFER data, global foreign exchange reserves amounted to approximately US$13.22 trillion.[9] The US dollar accounted for 56.70 per cent of reported reserves, while the euro represented 20.60 per cent.[10]These figures demonstrate the continued importance of established reserve currencies in the international monetary system.

However, reserve management does not involve merely selecting a currency or purchasing financial instruments. Sovereign reserves are frequently held through a network of foreign banks, custodians, securities depositories and international settlement systems. Central banks may maintain accounts with foreign commercial banks or hold securities through international

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[7] INTERNATIONAL MONETARY FUND, *BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION MANUAL* ¶ 6.64 (6th ed. 2009), https://data.imf.org/-/media/iData/External-Storage/Documents/73FBCD5B6CDE4D289C60B9B0CAA40622/en/2-bpm6.pdf.

[8] *Id.* ¶¶ 6.76–6.77.

[9] INTERNATIONAL MONETARY FUND, *CURRENCY COMPOSITION OF OFFICIAL FOREIGN EXCHANGE RESERVES (COFER)*, https://data.imf.org/en/Datasets/COFER (last visited Nov. 17, 2026).

[10] INT'L MONETARY FUND, *REVISED GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT* ¶¶ 97–98 (2013), https://www.imf.org/external/np/pp/eng/2013/020113.pdf.

central securities depositories.[11]These institutions provide essential services relating to safekeeping, transfer, settlement and administration of financial assets.

Consequently, the accessibility of foreign exchange reserves depends partly on the institutional and legal arrangements governing the intermediaries through which they are held. The jurisdiction in which a custodian operates, the rules governing settlement and the legal restrictions applicable to financial transactions may affect the practical availability of reserve assets. This creates a structural relationship between reserve management and international financial infrastructure. The security of sovereign reserves must therefore be understood in the context of both the financial assets themselves and the institutions responsible for their custody and transfer.

3. GEOPOLITICAL SANCTIONS AND THE EMERGING VULNERABILITIES OF FOREIGN HELD SOVEREIGN RESERVES

Financial sanctions have become an important instrument of international economic policy. They may include restrictions on financial transactions, prohibitions on dealing with designated persons or entities, limitations on access to financial markets and restrictions affecting the movement or utilisation of assets. Although sanctions are commonly discussed in terms of their effect on targeted governments and economic sectors, they also have implications for the international financial institutions through which sovereign assets are administered.[12]

The immobilisation of Russian central bank reserves following the events of 2022 provides a significant example. Sanctions imposed by the United States, the European Union and other jurisdictions restricted transactions involving certain Russian central bank assets. As a result, substantial portions of Russia's foreign-held reserves could no longer be freely accessed or transferred.[13] This demonstrated that the ability of a central bank to utilise its reserves may be affected by the political and regulatory decisions of the jurisdictions in which those assets are held.

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An important distinction must be made between financial ownership and practical accessibility. The immobilisation of an asset does not necessarily mean that ownership has

[11] Anton Moiseienko, Legal: The Freezing of the Russian Central Bank's Assets, 34 *EUR. J. INT'L L.* 1007, 1007–20 (2023), https://doi.org/10.1093/ejil/chad050.

[12] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–75 (2023), https://doi.org/10.1080/01402382.2022.2155906.

[13] U.S. Dep't of the Treasury, *Treasury Prohibits Transactions with Central Bank of Russia and Imposes Sanctions on Key Sources of Russia's Wealth* (Feb. 28, 2022), https://home.treasury.gov/news/press-releases/jy0612.

automatically been transferred to another State. However, restrictions on transactions, transfers and payments may substantially limit the owner's ability to use the asset. From a reserve-management perspective, the practical inability to access an asset can undermine its usefulness as an instrument of external liquidity.[14]

The Russian example therefore reveals an additional category of risk. Traditional financial assessments may indicate that a sovereign security is highly liquid, creditworthy and readily marketable.[15] Nevertheless, geopolitical restrictions may prevent its sale, transfer or utilisation. The resulting risk cannot be adequately assessed through conventional market and credit-risk indicators alone.

This development does not establish that all foreign-held sovereign reserves are inherently insecure or that sanctions will necessarily be imposed against every State experiencing political disagreement. Rather, it demonstrates that geopolitical circumstances can affect the accessibility of reserve assets and should therefore form part of prudent reserve-management decisions.

4. INTERNATIONAL FINANCIAL INTERMEDIARIES AND THE INSTITUTIONAL RISKS OF HOLDING IMMOBILISED SOVEREIGN ASSETS

International financial intermediaries occupy a central position in the management of foreign-held sovereign reserves. Custodian banks, securities depositories and settlement institutions facilitate the holding and movement of financial assets across national jurisdictions.[16] Their services enable central banks to invest in foreign securities and conduct international financial transactions without maintaining direct operational arrangements in every market.

However, the involvement of these intermediaries also creates institutional dependencies. Where sovereign assets are held through an intermediary operating under a particular jurisdiction, the availability of those assets may be affected by the laws, sanctions and regulatory decisions applicable to that institution. Consequently, reserve accessibility is influenced not only by the conduct of the asset-owning central bank but also by the legal environment governing the intermediary.

Euroclear, a major international central securities depository based in Belgium, illustrates this relationship. Following the sanctions imposed on Russia, Euroclear Bank continued to hold

[14] Anton Moiseienko, Legal: The Freezing of the Russian Central Bank's Assets, 34 *EUR. J. INT'L L.* 1007, 1007–20 (2023), https://doi.org/10.1093/ejil/chad050.
[15] Moiseienko, *supra* note 5, at 1007–10; van der Horst, *supra* note 5, at 1021–24.
[16] INTERNATIONAL MONETARY FUND, *REVISED GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT* ¶ 5 (2013), https://www.imf.org/external/np/pp/eng/2013/020113.pdf.

substantial amounts of immobilised Russian assets. Its financial disclosures for September 2026 reported a balance sheet of approximately €244 billion, of which €204 billion related to sanctioned Russian assets.[17] The institution also reported that income generated from these assets was managed in accordance with applicable sanctions and regulatory requirements.

The significance of Euroclear extends beyond the volume of assets held by the institution. Its position demonstrates how an international financial intermediary can become central to the practical implementation of geopolitical restrictions. An institution primarily established to provide securities settlement and custody services may consequently face complex operational, regulatory and financial responsibilities arising from international sanctions.

This raises questions concerning institutional accountability, continuity of financial services and the concentration of sovereign assets within particular custodial jurisdictions. It also demonstrates why central banks should assess custodial arrangements not merely on the basis of cost, efficiency and market access, but also by considering jurisdictional exposure and the possibility of restrictions affecting asset accessibility.

5. GEOPOLITICAL RISK AND THE TRANSFORMATION OF CENTRAL BANK RESERVE MANAGEMENT STRATEGIES

The immobilisation of foreign-held reserves has encouraged greater attention towards the relationship between geopolitical risk and central bank reserve-management strategies. Traditionally, reserve diversification has been undertaken to reduce exposure to currency fluctuations, market instability and credit risks. However, geopolitical developments have expanded the considerations involved in determining the currency composition and geographical distribution of reserve assets.[18]

One possible response is currency diversification. Central banks may consider reducing excessive dependence on a limited number of reserve currencies by allocating a portion of their holdings to other currencies.[19] Such decisions may reduce concentration in particular financial jurisdictions. Nevertheless, diversification is subject to practical limitations. Alternative currencies may not offer the same degree of liquidity, convertibility, market depth

[17] Euroclear, *Euroclear Delivers Record Business Income and Accelerates Strategic Growth* (Oct. 30, 2026), https://www.euroclear.com/newsandinsights/en/press/2026/mr-31-euroclear-q3-2026-results.html.

[18] Henry Farrell & Abraham L. Newman, Weaponized Interdependence: How Global Economic Networks Shape State Coercion, 44 *INT'L SEC.* 42, 42–79 (2019), https://doi.org/10.1162/ISEC_a_00351;

[19] Anton Moiseienko, Legal: The Freezing of the Russian Central Bank's Assets, 34 *EUR. J. INT'L L.* 1007, 1007–20 (2023), https://doi.org/10.1093/ejil/chad050.

or international acceptance as the US dollar and euro.[20]Excessive diversification may also increase transaction costs and create additional management difficulties.

Another consideration is geographical diversification of custodial arrangements. Holding reserve assets through institutions located in different jurisdictions may reduce dependence on a single financial centre. However, geographical diversification does not automatically eliminate geopolitical risk because financial institutions may remain connected through international payment systems, correspondent banking relationships and coordinated regulatory restrictions.[21]

Central banks may also reconsider the balance between foreign securities, deposits, monetary gold and other reserve assets. Gold, for instance, does not carry the same foreign issuer credit risk as sovereign securities.[22] However, its usefulness depends on its physical location, custody arrangements and ability to be converted into usable foreign exchange when required. Therefore, changing the composition of reserves must be accompanied by an assessment of operational accessibility.

The IMF's Revised Guidelines for Foreign Exchange Reserve Management emphasise diversification, risk management, transparency and institutional accountability.[23] These principles provide a foundation for incorporating geopolitical considerations into reserve-management strategies. The objective should not be to abandon established reserve currencies or international financial markets, but to ensure that reserve portfolios remain resilient under different geopolitical and economic conditions.

6. FINANCIAL FRAGMENTATION AND THE RISKS TO CROSS – BORDER FINANCIAL INFRASTRUCTURE

Geopolitical sanctions may have implications extending beyond the countries directly affected. Restrictions on financial transactions and the immobilisation of foreign-held assets may influence the confidence of other States in international financial arrangements. Countries may become more attentive to the jurisdictional risks associated with holding

[20] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–75 (2023), https://doi.org/10.1080/01402382.2022.2155906.

[21] Henry Farrell & Abraham L. Newman, Weaponized Interdependence: How Global Economic Networks Shape State Coercion, 44 *INT'L SEC.* 42, 42–79 (2019), https://doi.org/10.1162/ISEC_a_00351;

[22] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–75 (2023), https://doi.org/10.1080/01402382.2022.2155906.

[23] INTERNATIONAL MONETARY FUND, *REVISED GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT* ¶ 5 (2013), https://www.imf.org/external/np/pp/eng/2013/020113.pdf.

reserves abroad and reconsider the extent of their dependence on particular financial institutions and payment systems.

The IMF's April 2023 Global Financial Stability Report examined how geopolitical tensions could contribute to financial fragmentation.[24] It identified possible consequences for cross-border capital allocation, international payment systems and asset prices.[25]Financial fragmentation may increase funding costs, reduce opportunities for international risk diversification and intensify capital-flow volatility.

The implications for reserve management are significant. If central banks increasingly organise their reserve holdings according to geopolitical relationships, the international monetary system may become more divided into separate financial networks. Such developments could reduce the efficiency of cross-border transactions and weaken the benefits of an integrated global financial system.

There may also be increased interest in alternative payment arrangements and settlement mechanisms. However, the development of alternative infrastructure requires substantial investment, international acceptance and reliable operational capacity.[26]Existing international financial systems benefit from established networks, liquidity and institutional trust, making rapid replacement difficult.

It is therefore important to avoid assuming that geopolitical sanctions will automatically lead to the collapse of the existing reserve currency system. IMF COFER data for the second quarter of 2026 continue to show the dominant position of the US dollar and the significant role of the euro.[27] Changes in currency composition may reflect exchange-rate valuation, market developments and active portfolio decisions, and should not automatically be interpreted as evidence of politically motivated diversification.

The broader concern is that excessive financial fragmentation could weaken international cooperation and make the global financial system more vulnerable to economic shocks. Maintaining confidence in cross-border financial infrastructure is therefore important not only for individual central banks but also for global financial stability.

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[24] INT'L MONETARY FUND, *GLOBAL FINANCIAL STABILITY REPORT: SAFEGUARDING FINANCIAL STABILITY AMID HIGH INFLATION AND GEOPOLITICAL RISKS*, ch. 3 (Apr. 2023), https://www.imf.org/en/publications/gfsr/issues/2023/04/11/global-financial-stability-report-april-2023.

[25] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–75 (2023), https://doi.org/10.1080/01402382.2022.2155906.

[26] Henry Farrell & Abraham L. Newman, Weaponized Interdependence: How Global Economic Networks Shape State Coercion, 44 *INT'L SEC.* 42, 42–79 (2019), https://doi.org/10.1162/ISEC_a_00351;

[27] INT'L MONETARY FUND, *GEO-ECONOMIC FRAGMENTATION AND THE FUTURE OF MULTILATERALISM* (2023), https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2023/01/11/Geo-Economic-Fragmentation-and-the-Future-of-Multilateralism-527266.

7. INSTITUTIONAL ACCOUNTABILITY AND RISK GOVERNANCE SAFEGUARDS FOR THE PROTECTION OF RESERVE SECURITY

The developments discussed above demonstrate the need to strengthen reserve-management practices by incorporating geopolitical accessibility into existing risk-governance frameworks. This does not require abandoning the principles of safety, liquidity and return. Rather, geopolitical risk should be considered alongside the financial, legal, custodial and operational risks already recognised in international reserve-management guidance.

First, central banks should incorporate geopolitical risk assessments into their reserve-management policies. Such assessments should consider the jurisdiction of custodial institutions, the possibility of sanctions-related restrictions and the operational consequences of interruptions to cross-border financial services.[28]Regular scenario analysis may help identify the potential consequences of geopolitical developments for reserve accessibility.

Second, central banks should consider appropriate diversification of custodial arrangements. Excessive concentration of sovereign assets within a single institution or jurisdiction may create additional exposure to institutional and political restrictions.[29] Where financially and operationally feasible, diversified custody arrangements may strengthen resilience. However, diversification should be undertaken without compromising liquidity, safety or effective supervision.

Third, stronger transparency and accountability mechanisms are necessary. Reserve-management institutions should maintain clear policies governing asset allocation, custodial exposure, risk assessment and contingency arrangements. Internal audit, independent oversight and appropriate reporting mechanisms can strengthen institutional responsibility and reduce operational vulnerabilities.

Fourth, central banks should develop contingency arrangements for circumstances in which foreign-held assets become temporarily inaccessible. These arrangements may include alternative liquidity sources, emergency payment procedures and operational continuity plans.[30]The objective should be to ensure that essential external payment obligations can continue to be met even during periods of financial disruption.

Finally, international cooperation remains necessary. The IMF and other international financial institutions can contribute by promoting common risk-assessment practices, sharing

[28] INTERNATIONAL MONETARY FUND, *REVISED GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT* ¶ 5 (2013), https://www.imf.org/external/np/pp/eng/2013/020113.pdf.
[29] INT'L MONETARY FUND, *supra* note 1, ¶¶ 14–15;
[30] INT'L MONETARY FUND, *supra* note 1, ¶¶ 14–15; INT'L MONETARY FUND, *supra* note 3, ch. 3.

institutional experience and encouraging dialogue on the implications of geopolitical restrictions for reserve management.[31] Greater cooperation may help preserve confidence in international financial infrastructure and prevent the development of unnecessarily fragmented financial arrangements.

These safeguards should be understood as measures for improving institutional resilience rather than as guarantees against every form of geopolitical restriction. No reserve-management strategy can completely eliminate political or jurisdictional risk. Nevertheless, identifying and managing such exposure can strengthen the ability of central banks to respond to unexpected disruptions.

8. CONCLUSION

Foreign exchange reserves remain essential to monetary stability, external payment capacity and confidence in the international financial system.[32] The traditional principles of safety, liquidity and return continue to provide the foundation for their management. However, the immobilisation of Russian sovereign reserves has demonstrated that the practical security of foreign-held assets may also depend on geopolitical, jurisdictional and institutional conditions.[33]

The analysis of international financial intermediaries, particularly Euroclear, illustrates the importance of custodial and settlement arrangements in determining the accessibility of sovereign reserves.[34]Geopolitical restrictions may affect the practical utilisation of assets even where their financial value and ownership are not automatically extinguished. Such developments require central banks to reconsider whether conventional reserve-management frameworks adequately address geopolitical exposure.

This article proposes that reserve security should be assessed through three interconnected dimensions: financial security, operational security and geopolitical security. Incorporating these dimensions into reserve-management practices would enable central banks to identify vulnerabilities that may not be reflected in traditional financial risk assessments.

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[31] INT'L MONETARY FUND, *supra* note 1, ¶¶ 16–21; *Principles for Financial Market Infrastructures* princs. 2–3, 17 (Comm. on Payment & Settlement Sys. & Tech. Comm. of the Int'l Org. of Sec. Comm'ns 2012), https://www.bis.org/publ/cpss101a.pdf.

[32] Henry Farrell & Abraham L. Newman, Weaponized Interdependence: How Global Economic Networks Shape State Coercion, 44 *INT'L SEC.* 42, 42–79 (2019), https://doi.org/10.1162/ISEC_a_00351;

[33] Anton Moiseienko, Legal: The Freezing of the Russian Central Bank's Assets, 34 *EUR. J. INT'L L.* 1007, 1007–20 (2023), https://doi.org/10.1093/ejil/chad050.

[34] Lucia Quaglia & Amy Verdun, Weaponisation of Finance: The Role of European Central Banks and Financial Sanctions Against Russia, 46 *W. EUR. POL.* 872, 872–75 (2023), https://doi.org/10.1080/01402382.2022.2155906.

Accordingly, stronger geopolitical risk assessment, diversified custodial arrangements, institutional accountability and contingency planning should form part of modern reserve-management strategies. The objective is not to weaken international financial integration but to strengthen its resilience. Ultimately, the security of sovereign reserves must be measured not only by their value and liquidity but also by the ability of monetary authorities to access and utilise them when required.

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