

Five insights in Risk Management

Julian Talbot

#RISKWARENESSWEEK2020

**RISK
AWARENESS
WEEK** 2020



The Insights

1. Swiss Cheese = Causal Chains
2. It isn't what you think
3. The inevitable
4. The matrix we all use
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16. Fooled by randomness
17. Intuition
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19. Culture = performance
20. Anxiety is your friend
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22. Who makes your decisions?
23. Nothing is as important as you think

The Evidence

'Five' Insights in Risk Management

Links to references and further reading that I mentioned in a presentation at Risk Awareness Week 2020. And yes, there are more than five... (Disclosure: I've used affiliate links for the books).

Against the Gods: The Remarkable Story of Risk
PETER L. BERNSTEIN

Risk management = future management

The concept is simple and obvious. But we often forget that by attempting to manage risk, we are attempting to shape, or even invent the future of our choosing. In his acclaimed book, *Against the Gods*, Peter Bernstein gives us an insight into the idea that by taking our future into our own hands, humanity made a fundamental change. In many early cultures, our fate was in the hands of the gods. Today, we defy the gods in large and small ways, by attempting to choose our own destiny. The audacity is impressive. Whatever will humans think of next? Or more to the point, we created the discipline 'risk management' as a way of managing our future. But what is the next step in this process of shaping our reality?

Nothing in life is as important as you think it is while you are thinking about it.
DANIEL KAHNEMAN
Psychologist, Princeton University, 2002 Nobel Prize in Economic Sciences

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Daniel Kahneman was once described by Harvard psychologist Daniel Gilbert, as "... the most distinguished living psychologist in the world ..." and he made the above statement in answer to a question from a colleague. "What scientific concept would improve everybody's cognitive toolkit?"

Truly successful decision-making relies on a balance between deliberate and instinctive thinking.
Malcolm Gladwell

Anxiety is your friend

We all feel anxiety. It exists because it provides an evolutionary benefit. Many people find it difficult dealing with ambiguity and uncertainty. Colin Powell is reported to have said "

When Genius Failed: The Rise and Fall of Long-Term Capital Management
ROGER LOWENSTEIN

Geniuses they may be

It's tempting to believe that other people know more than you. Especially when they are very confident. But bear in mind the case study of Long Term Capital Management. A classic case study of Nobel Prize winners and teams of PhDs who achieved 40% per annum for 5 years in the stock market... And then almost bankrupted the entire system. Just because someone is smart or sounds smart, isn't enough. The title of the book 'Only the Paranoid Survive' by Andy Grove, founder and former CEO of Intel sums it up. And last but not least, don't fall for someone who is very confident. Remember the Dunning-Kruger effect. It is a type of cognitive bias in which



**What project or issue is my
biggest challenge?**



It isn't what you think



Risk... it's NOT the effect of uncertainty on objectives

Risk management = future management

- Against The Gods
 - Volcanoes
 - Gods
 - Risk management
 - What next?

A photograph taken from the driver's perspective looking into a car's side-view mirror. The mirror shows a road with a white line on the right side, lined with trees. A dark car is visible in the distance. A dark circular overlay with the text "Blind spots" is positioned in the upper left corner of the mirror's view. The background outside the mirror is blurred, showing green foliage.

Blind spots



RIP Black Swan

The matrix we all use

Stroud Matrix



Likelihood

ROUTINE
Likely but Minor

DANGER ZONE
Likely & Major

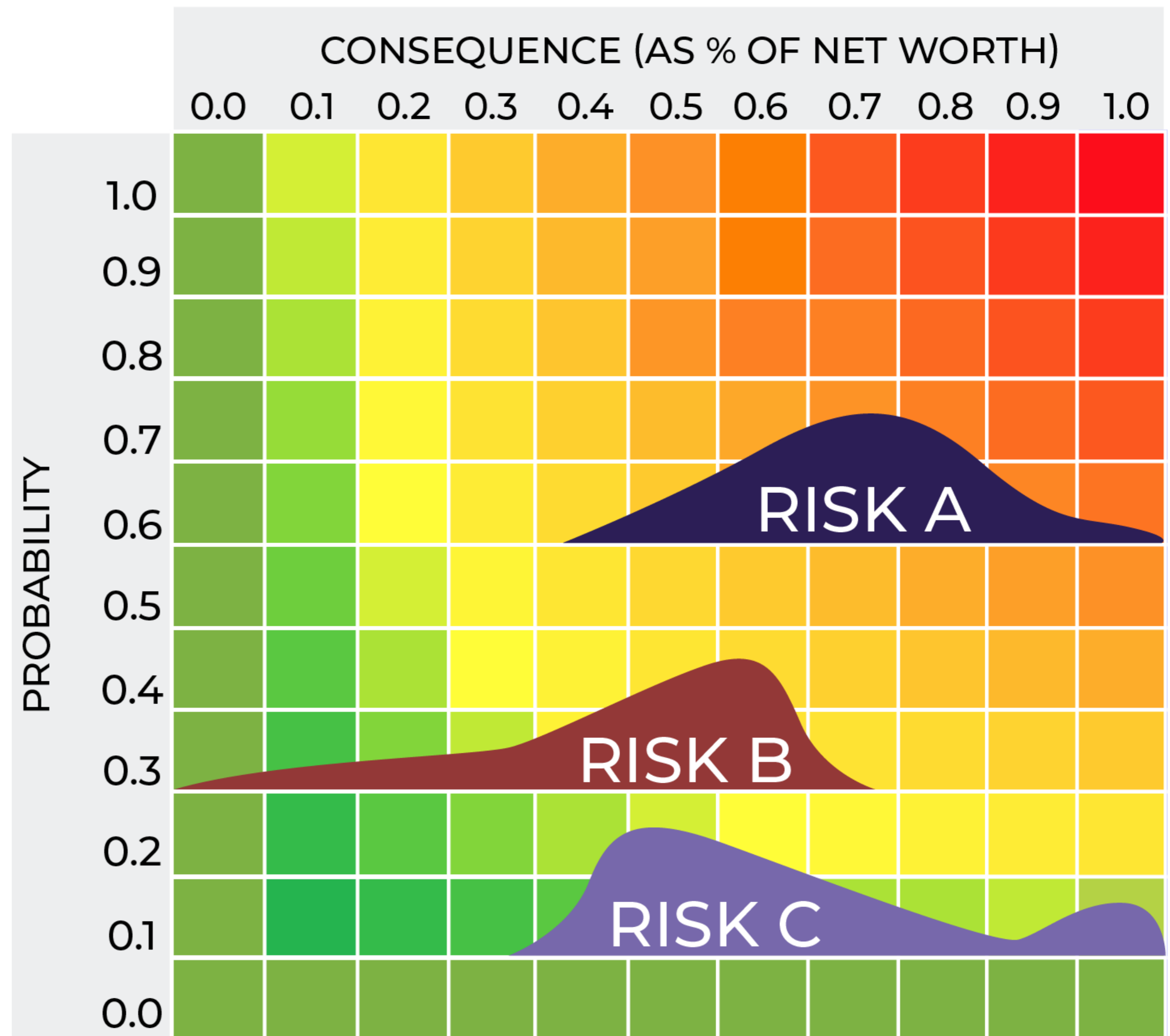
BUSINESS AS USUAL
Unlikely & Minor

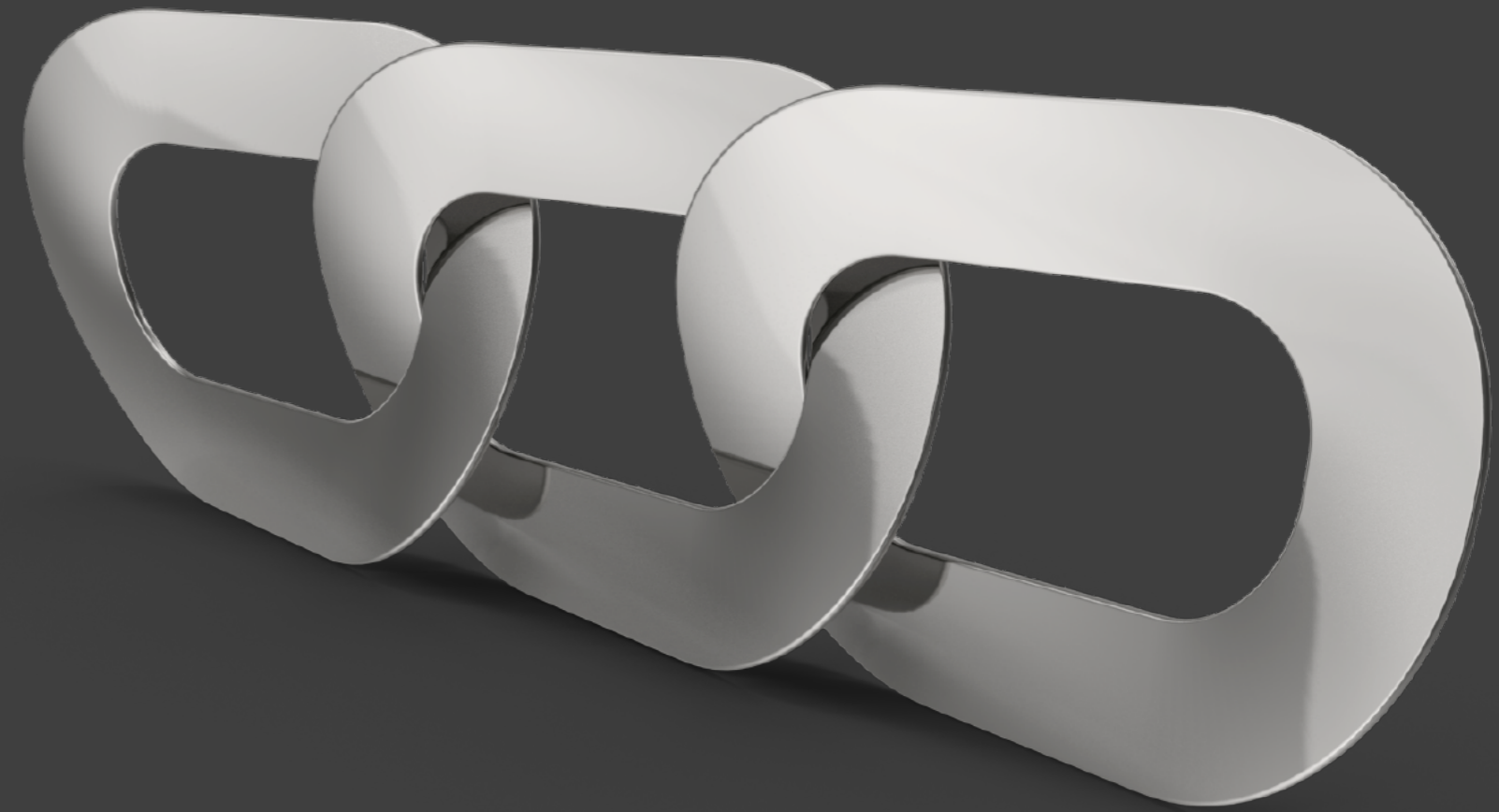
SWANS
Unlikely but Major

Consequence



The matrix we should use





Swiss Cheese
= Causal Chains

- Piper Alpha case study
- Our modelling needs to improve

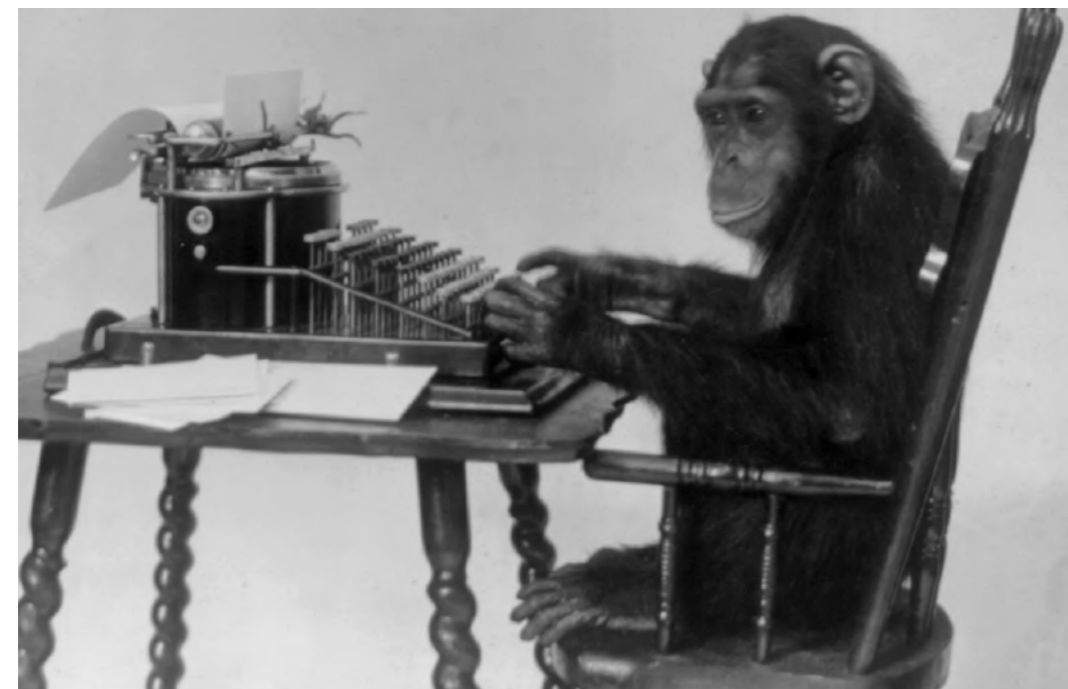


Rock pools of risk

Thank you COVID19

- The next pandemic
- Jakarta Embassy





Fooled by Randomness

- 95% of managed funds don't beat the market
- 1,024 → 512 → 256 → 128 → 64 → 32 → 16 → 8 → 4 → 2 = 1 successful investor
- Infinite number of monkeys with infinite time and typewriters will produce the complete works of Shakespeare

Geniuses they may be

- *“Don't be buffaloed by experts and elites. Experts often possess more data than judgment. ... Don't be afraid to challenge the pros, even in their own backyard.” – Colin Powell*
- Long Term Capital Management: the case study of when genius fails

Anxiety is your friend

- Many people have trouble dealing with ambiguity
- Anxiety serves a purpose
- Define uncertainty and make it your friend



Plans may be
worthless, but
a good Plan B
is priceless



Intuition as a 4 step process



Listen



Recognise



Trust



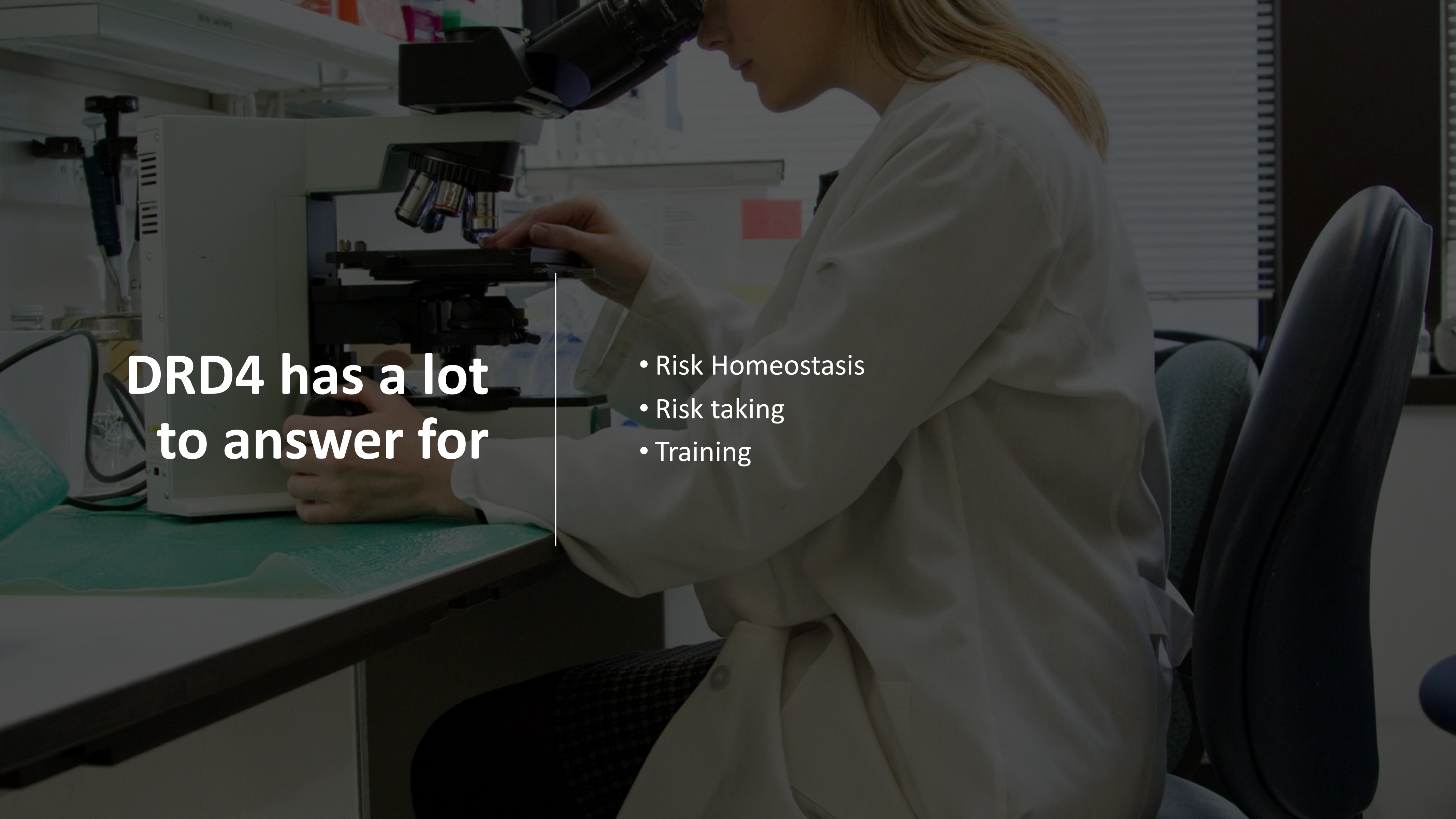
Act

The Road to Hell

- We judge ourselves by our intentions but others by their behavior
- Ergo: people judge you by what you do – not what you intended
- And if you want to impress on people, what exactly is important... People don't judge what is important by what you tell them is important, they don't judge what is important by what you do. They judge what is important by where you spend your time.
- If you talk big about risk management but then spend all your time working on marketing and finances – that is what your people will spend their time on also.

**Culture =
performance**

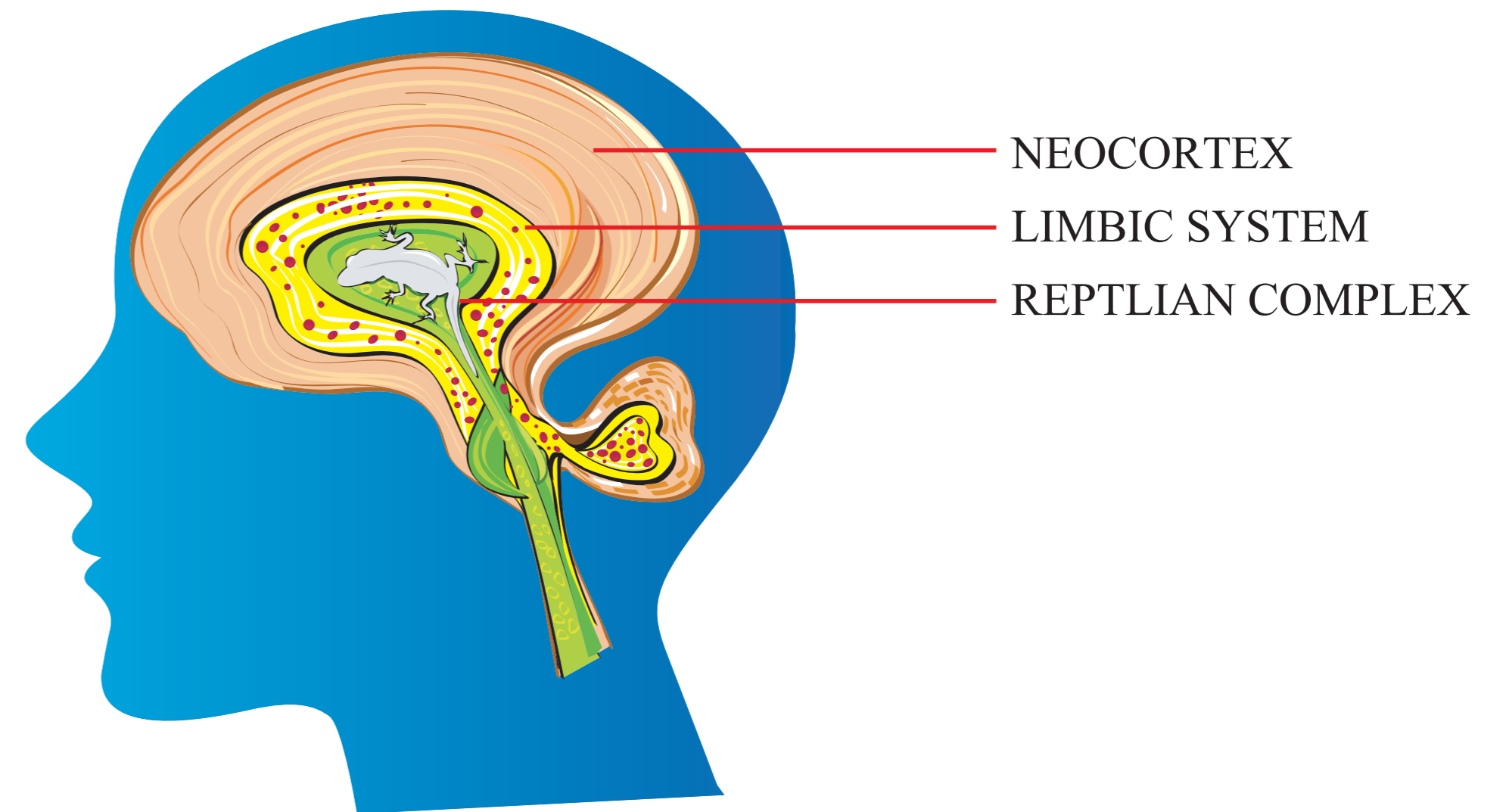


A scientist in a white lab coat is seated at a desk, looking through a microscope. The scene is dimly lit, with the primary light source coming from the microscope's illumination. The scientist's hands are visible, adjusting the microscope's stage. The background shows a typical laboratory environment with shelves and equipment.

DRD4 has a lot to answer for

- Risk Homeostasis
- Risk taking
- Training

Dinosaurs (still) rule the world





Who makes your decisions?

$2^{128} = 340,282,366,920,938,463,463,374,607,431,768,211,456$

In practical terms 'only'

2^{125} or 4.2×10^{37} (42 undecillion) 'things' can connect



Cyber!





The inevitable

-
- Artificial Intelligence → Artificial General intelligence → Artificial Super Intelligence
 - Convergence
 - Data → Information
 - Integration
 - Genetics
 - Nanotechnology
 - Robotics
 - Quantum computing
 - Entanglement

Nothing is as important as you think it is when you are thinking about it

- Attention is the new oil
- Big data = selling certainty = human capitalism
- Social media is addictive and millions of years of evolution are being co-opted by 25 to 35-year-old white guys in silicone valley



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