

A photograph of an iceberg floating in a dark blue ocean under a bright blue sky with wispy clouds. The iceberg's visible tip is small and jagged, while its submerged portion is much larger and more complex in shape, illustrating the concept of hidden systemic risk.

# Integral Risk Management

## *Navigating An Era of Systemic Risk*

# Agenda

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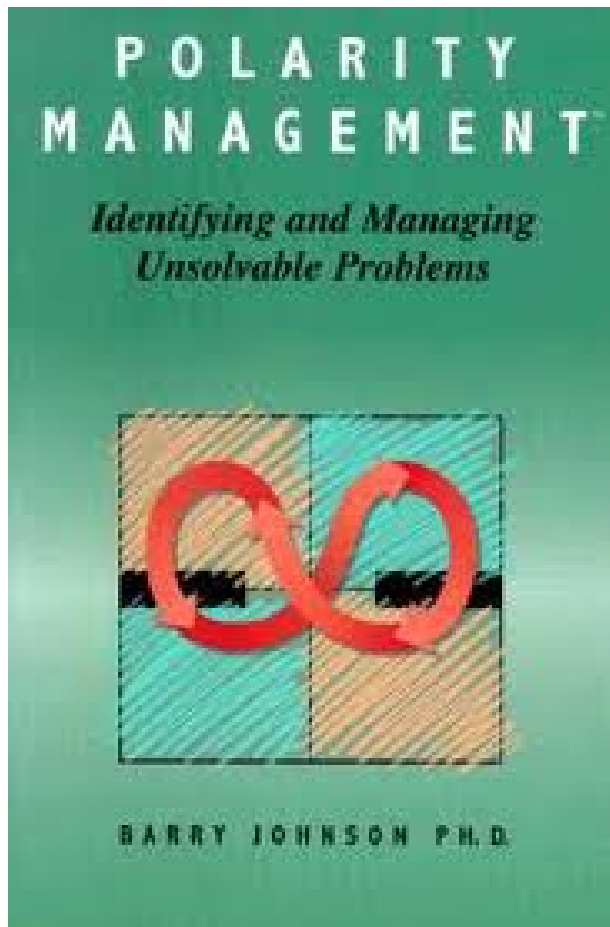
1. Polarity Management

2. Integral Risk Management

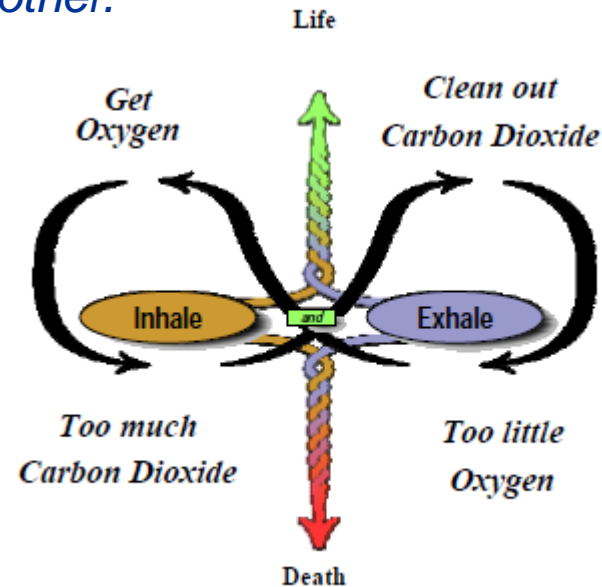
3. Key Lessons and Conclusions

# Managing Polarities

Why did JPMorgan issue juggling balls to new trainees?



*Continual movement from the negative characteristics of one polarity to the positive traits of the second one. Then, from the negative of the second one to the positive of the other.*



Source: [www.polaritymanagement.com](http://www.polaritymanagement.com)

# Which do you prefer?

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- Individual or team
- Autonomous or collaborative
- Directive decisions or participative decisions
- Centralized or decentralized
- Standardized or customized
- Left brain or right brain
- Optimized or flexible
- Short term or long term
- Tactical or strategic
- Macro or micro
- Independent risk management or embedded risk management
- Focus on profitability or focus on risk

# Risk Polarities

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**Risk management is not just about problem solving**

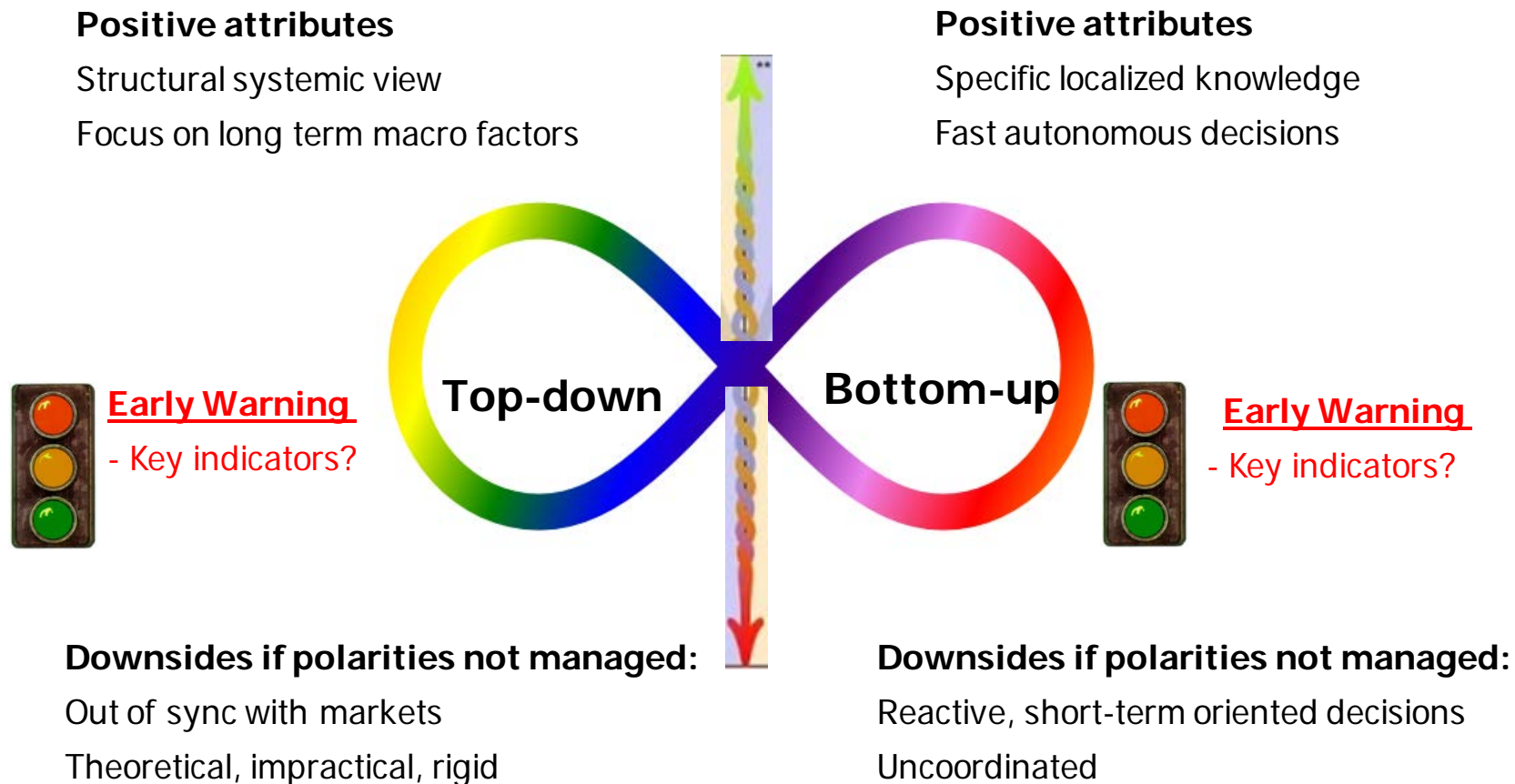
**Risk management is a continual practice of managing polarities**

- “Decentralized risk taking and centralized risk management”

**Dynamic cycling between polarities and integration of perspectives**

- Integrating polarities is NOT blending information. For example, use of extensive historical data to create stable daily VaR estimate muddles short and long term risk polarities.

# Risk Polarities: Top-down vs Bottom-up



# Risk Polarities: Focus on Visible vs Potential Risks

## Positive attributes

Search to identify hidden risks  
Forward looking  
Considers potential extreme risks

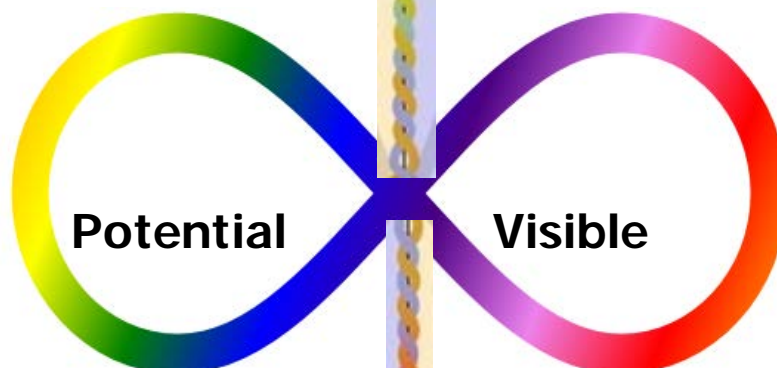
## Positive attributes

Concrete and present oriented  
Manage risks that matter now



Early Warning

- Key indicators?



Early Warning

- Key indicators?

## Downsides if polarities not managed:

Excessive risk aversion, paralysis  
May fail to prioritize immediate needs

## Downsides if polarities not managed:

Reactive to current environment  
Myopic, underestimate potential tail risks

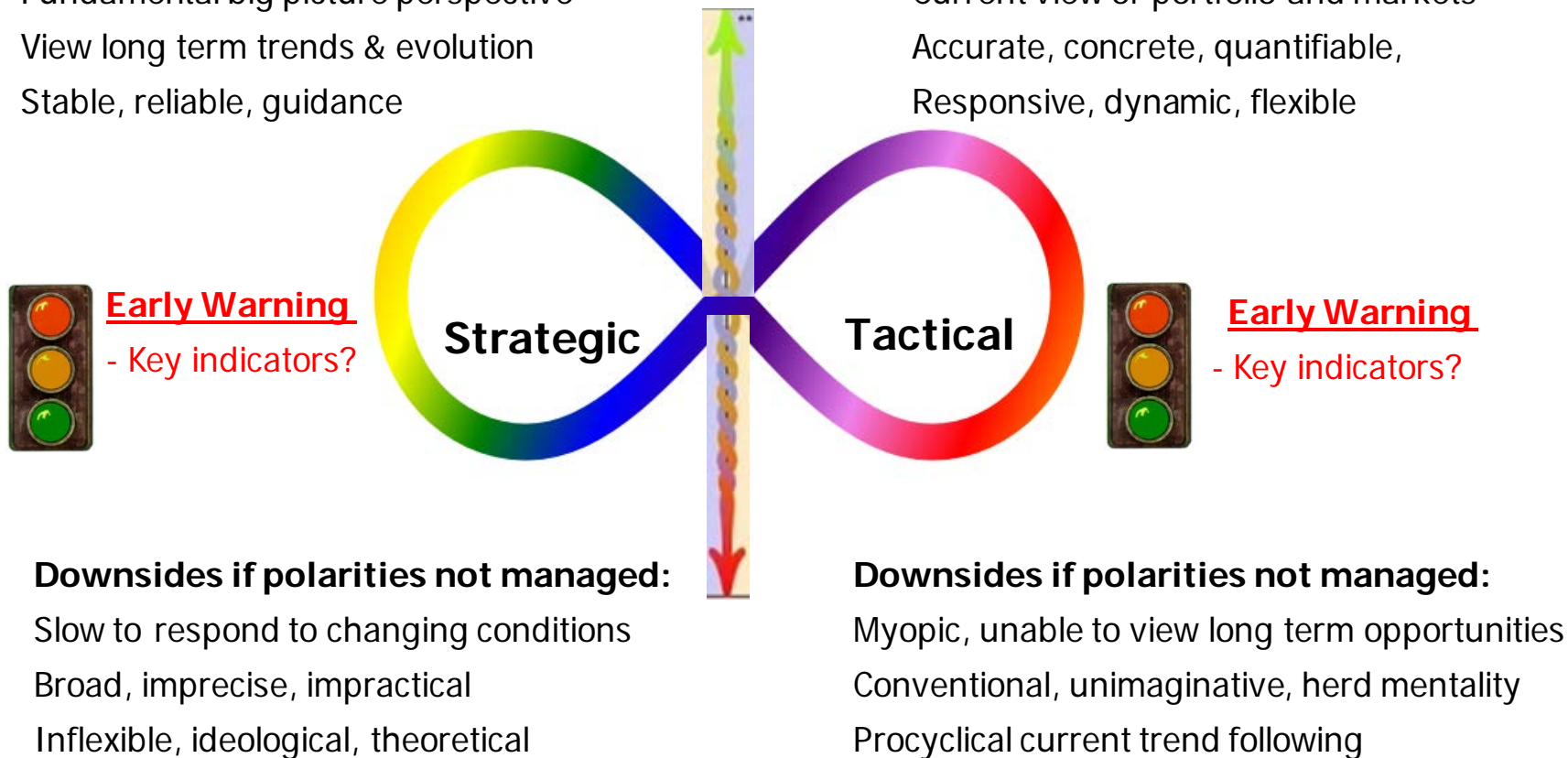
# Risk Polarities: Strategic vs Tactical

## Positive attributes

Fundamental big picture perspective  
View long term trends & evolution  
Stable, reliable, guidance

## Positive attributes

Current view of portfolio and markets  
Accurate, concrete, quantifiable,  
Responsive, dynamic, flexible





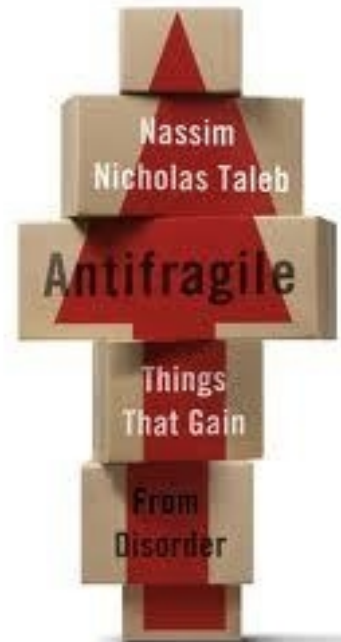
# Antifragile: Things That Gain from Disorder

Fragile = hurt by volatility, uncertainty, change, time...

Modernity often lowers volatility at expense of fragility

What's the "Value of Risk"?

- Volatility contains information
- Stressors strengthen systems (antifragility)
- J-curve effect: learn from many small risks



# The Signal and The Noise

- Fox or hedgehog?



*the signal and the noise and the noise and the noise and the noise why so many predictions fail – but some don't the signal and the noise and the noise and the noise nate silver noise noise and the noise*

- Beware of overconfidence, be open to new ideas and information
- More minds can improve forecasts: potential for markets and networks

# Agenda

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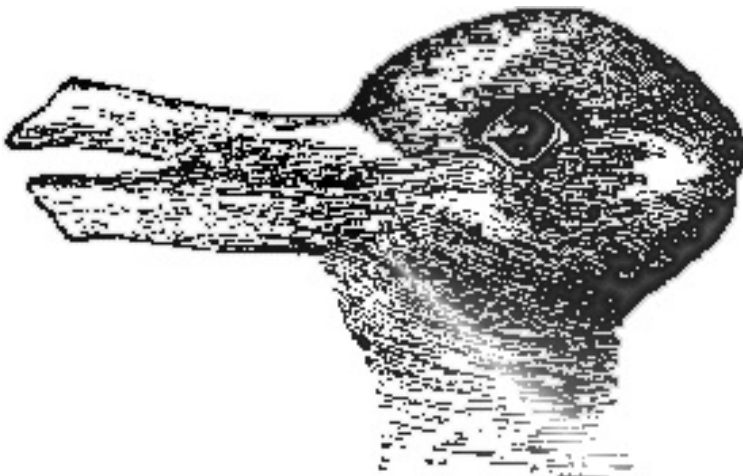
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# Qualitative vs quantitative risk management

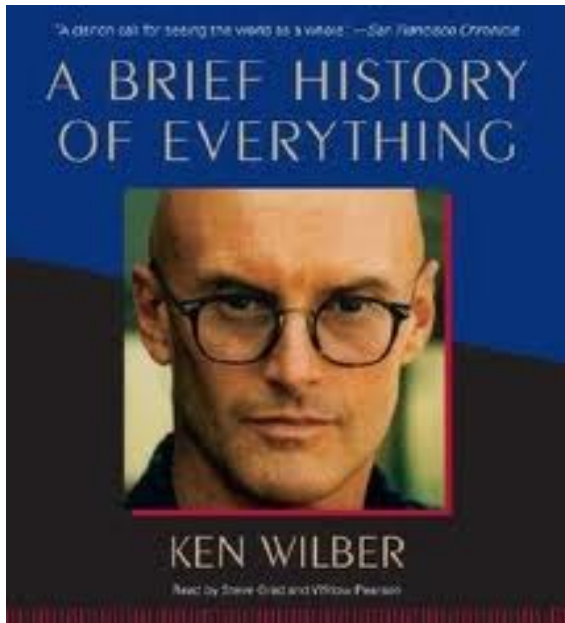
*'The story that I have to tell is marked all the way through by a persistent tension between those who assert that the best decisions are based on quantification and numbers, determined by the patterns of the past, and those who base their decisions on more subjective degrees of belief about the uncertain future. This is a controversy that has never been resolved.'* — FROM THE INTRODUCTION TO "AGAINST THE GODS: THE REMARKABLE STORY OF RISK," BY PETER L. BERNSTEIN

- Classic polarity



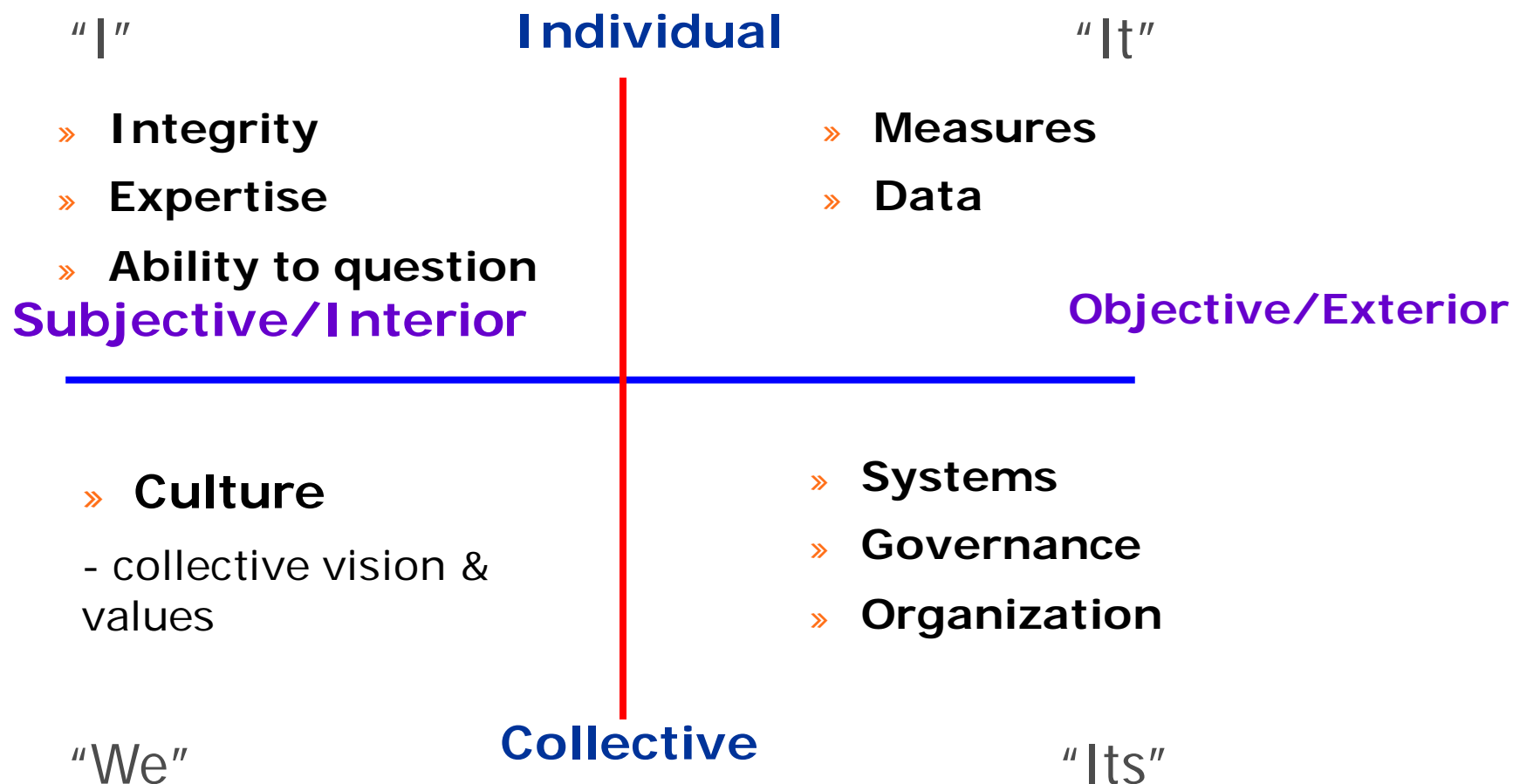
# Integral Framework: The Four Quadrants

- "Integral" means "balanced, comprehensive, interconnected, and whole"
- At minimum, consider four interdependent perspectives



» For more information, see Ken Wilber's AQAL Integral Framework

# Integral Risk Management Quadrant



Each quadrant represent key perspectives and polarities

# Risk Management Culture

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- Culture is essential. It is the basis for continuous evolution of an organization.
- What are attributes of Strong Risk Management Culture
  - Constant discussions between risk management, traders, business managers, senior managers
  - Respect for different viewpoints and new ideas
  - Independent and empowered risk management group
  - Tapping into network intelligence within and outside the organization
- Greatest challenge?

**Group Think**

# Lines: Multiple Intelligences

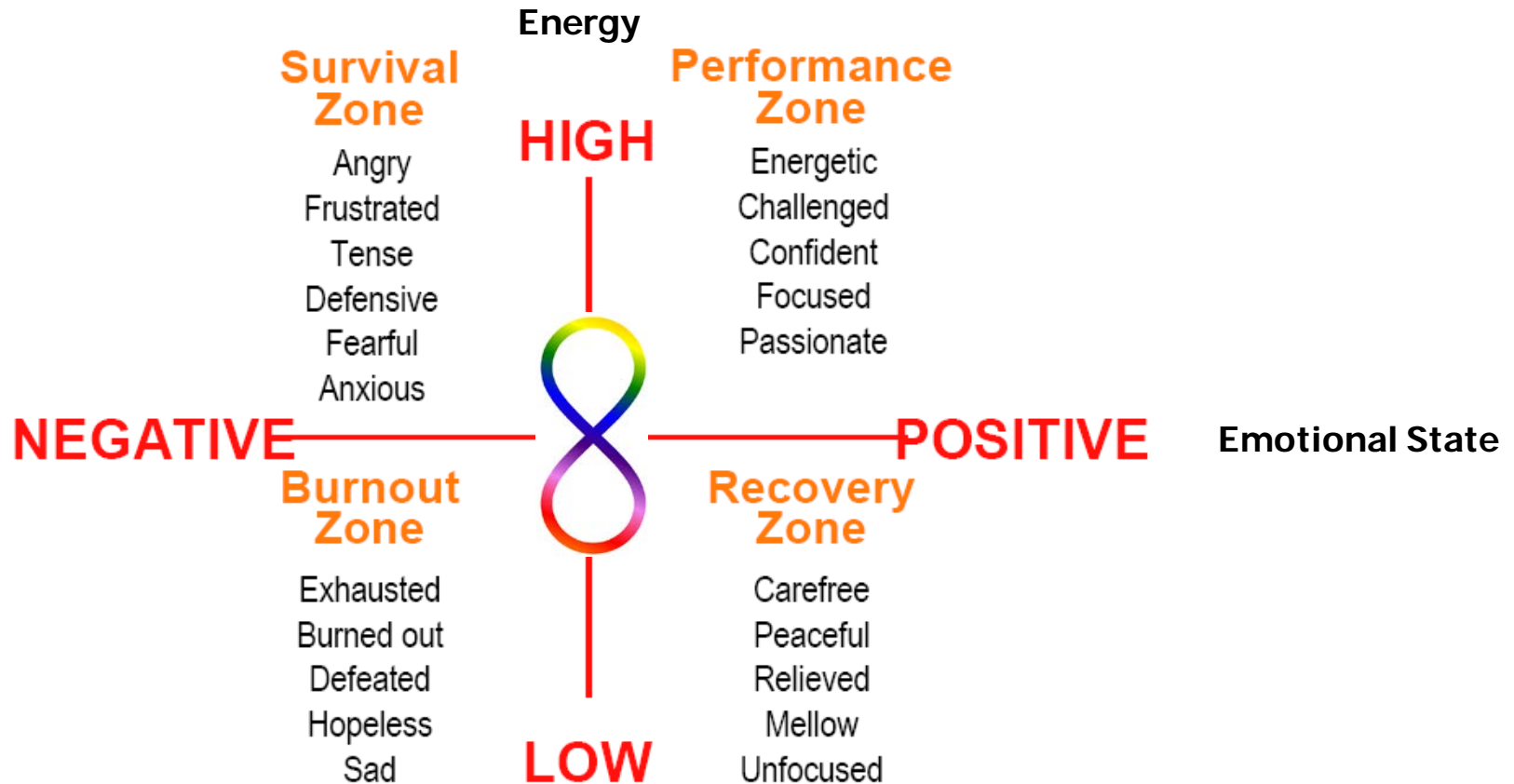
- Assemble a diverse team of empowered individuals with intellectual curiosity, confidence, and experience
  - Seek a team with multiple intelligences (cognitive, analytical, quant, interpersonal, etc.)
  - Must have the confidence to stand up to powerful traders and senior business managers, and be good communicators
  - Need vision, ability to imagine multiple possibilities

*"I think I'm a polymath. I'm interested in everything. When I was a senior in college at the University of Michigan, I was dazzled by the choice set that we had. Young people, you can do whatever you want, and I was disappointed that I had to choose one, realistically. You like to be a renaissance man and do everything. I took long walks trying to decide whether I wanted to be a physicist or a medical doctor or a sociologist, whatever-a scientist, an astronomer." - Source: Portfolio.com, "World According to Robert Shiller," by Lloyd Grove*



# Creating sustainable personal performance

- Tony Schwartz's Energy/Emotion Quadrants



Source: [www.theenergyproject.com](http://www.theenergyproject.com)

# Evolution of Risk Management Stages

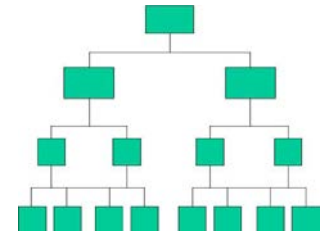
## 1. “Intuitive” (Subjective)

- Subjective views dominated by principals, inability to take different perspectives
- Reactive: not integrated with decision making, post-mortem, compliance driven
- Focus on parts, not the whole



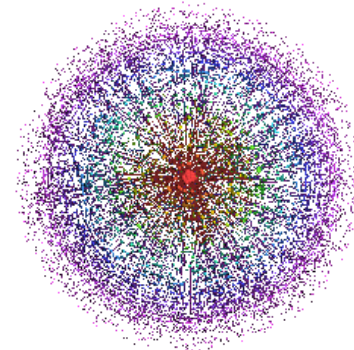
## 2. “Predict & Control” (Objective)

- Classification of risks (operational, market, credit, liquidity, etc.)
- Standardized risk measures to quantify and minimize risk
- Controls using traditional hierarchies, rules, and processes



## 3. “Sense & Respond” (Integral)

- Transformational: risk management viewed key to unlocking value
- Risk viewed as core competence and integrated with decision making
- Network intelligence with continual integration of multiple perspectives
- Dynamic steering and coordination, flex flow



# Activate a Learning-Spiral through “Polarity Management”

- Learning spiral driven by continuous differentiation and re-integration

## Positive attributes

Big picture, holistic, ecosystem view  
Long term orientation  
Aware of interdependent risks

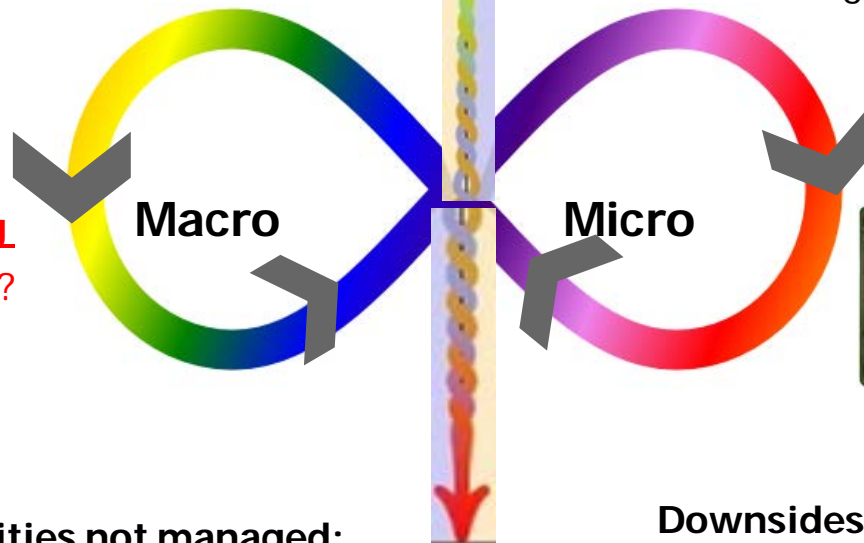
## Integral Risk Management

## Positive attributes

Agile, quick to respond to change  
Highly focused, fast decisions  
Learning through feedback and data



Early Warning  
- Key indicators?



Early Warning  
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## Downsides if polarities not managed:

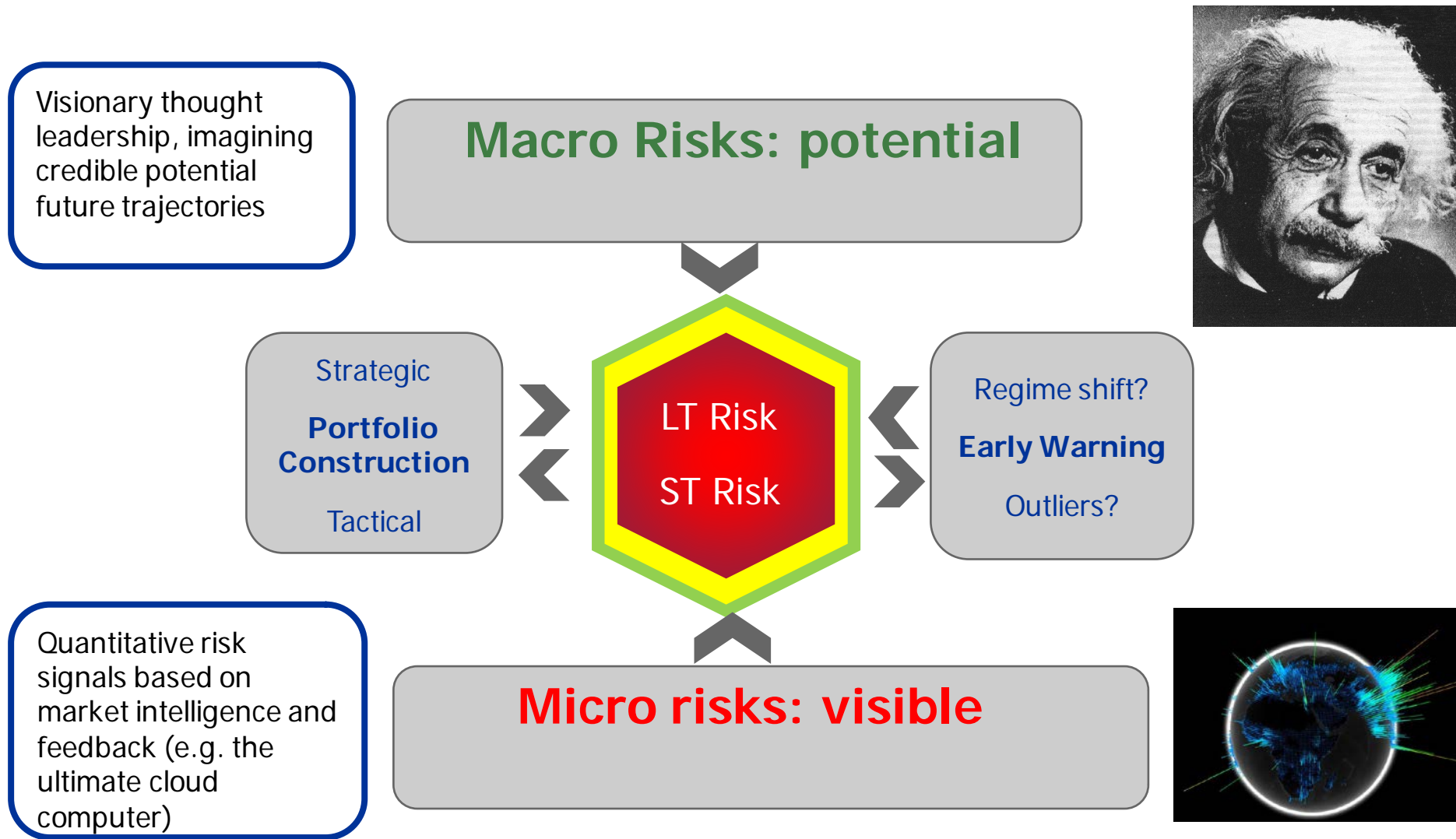
Theoretical, ignores reality  
Slow to learn and adapt  
Rigid frameworks risk breakdown

## Fragmented Risk Breakdown

## Downsides if polarities not managed:

Overfocus, misses big picture  
Reactive, short term decisions  
Uncoordinated, isolated

# Integrated Risk Management Process



Source: Alan Laubsch "Integrated Risk Management - Early Overview", RiskMetrics

# Agenda

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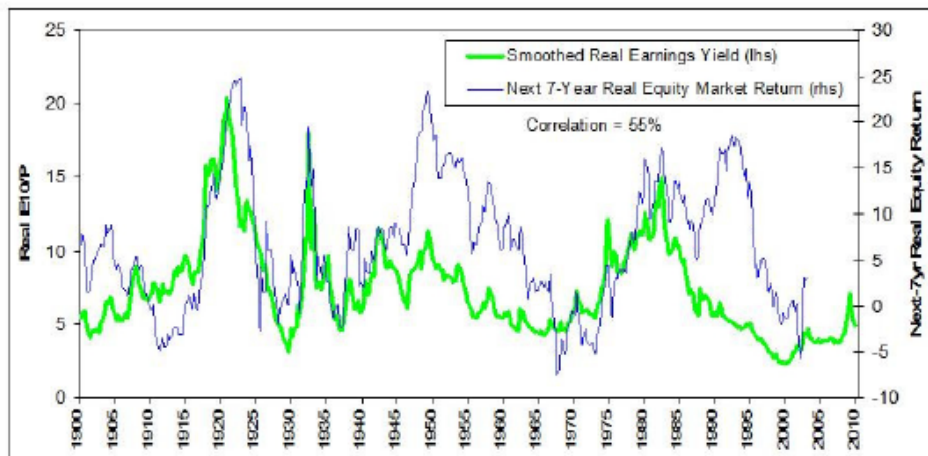
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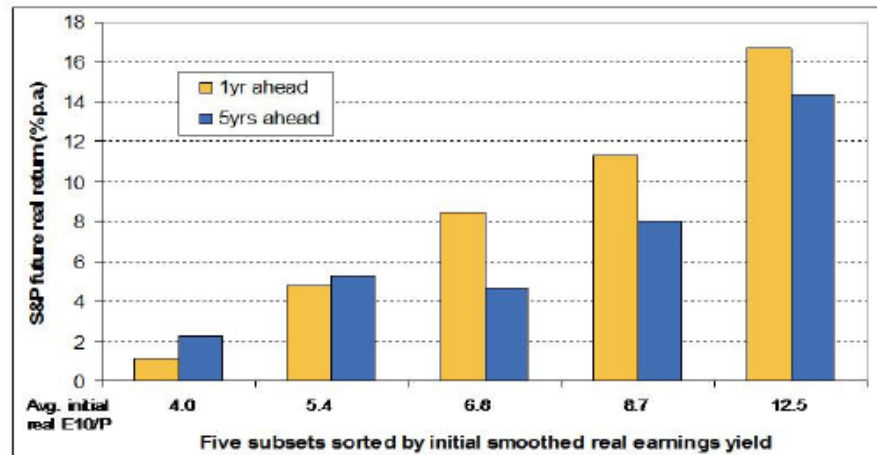
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# Investment Strategy: contribute to decoupling through long term profitable contrarian strategies

Equity markets: Time varying reward for risk



Future equity returns are higher when market's starting valuations are cheap, 1900-2009

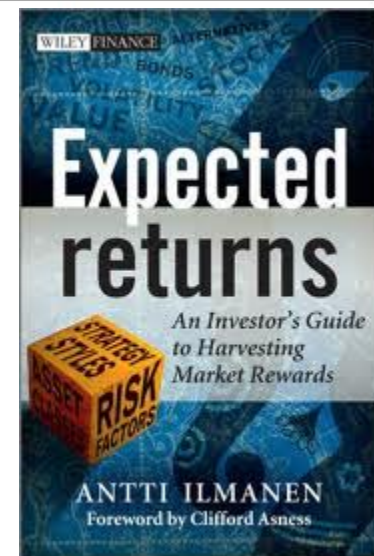


Charts: Anti Ilmanen →

"The (future) reward for risk may be at the highest when the market sentiment for risk taking is at the lowest"

"The biggest pitfall in investments is herd behavior. Large gains in performance can be achieved by investors with ability to consistently act contrarian"

Source: Knut N Kjaer, "New Ideas on Future Portfolio Design", 4 May 2011





Mont Maudit: a lead climber accidentally broke a 16 inch slab of ice...



## **Implications of highly coupled global risks**

Prepare for breakdowns, respond rapidly to mitigate worst effects

# WEF Global Risk 2013: Resilience and Systems Thinking

## Resilience is...



...Bouncing back faster after stress, enduring greater stresses, and being disturbed less by a given amount of stress...

For an Object

...Maintaining system function in the event of a disturbance...

For a System

...The ability to withstand, recover from, and reorganize in response to crises...

For an Adaptive System

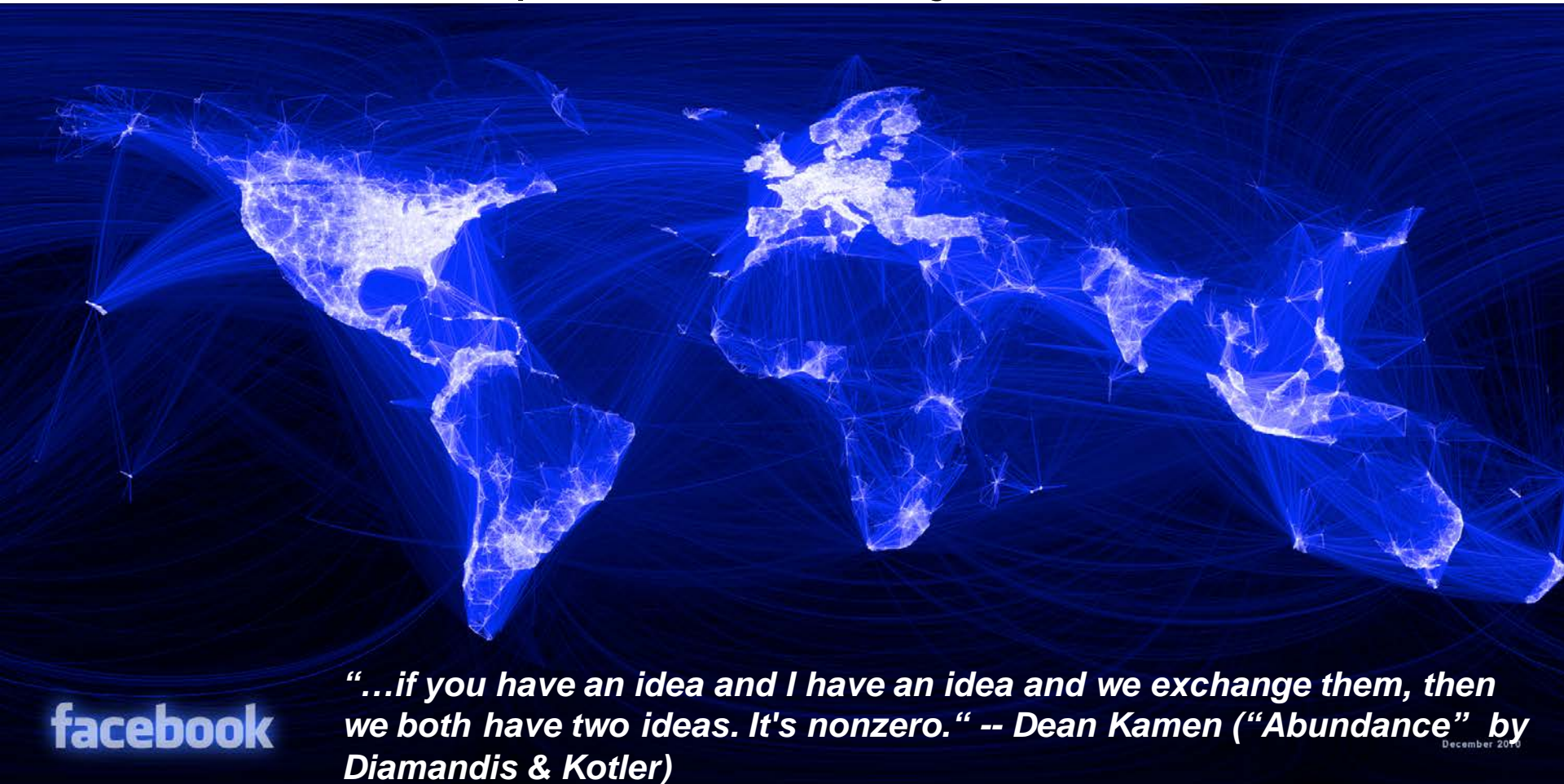
Source: [WEF](#), adapted from Martin-Breen, P. & Anderies, J.M. "Resilience: A Literature Review". Rockefeller Foundation, <http://www.rockefellerfoundation.org/news/publications/resilience-literature-review>, 2011.

**Promote network intelligence through Resilience Practices Exchange (RPE)**



# How can we spark network intelligence in risk management?

Build collaboration platforms to exchange risk information



facebook graph of social relationships

# Conclusion: Risk Management Is A Common Good

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## Adaptive risk management

- Polarities (Top down & bottom up)
- Sense & Respond

## Social collaboration platforms

- Real time analytic s, data, visualizations
- Predictive markets

## Proactive global action

- Mopping up the mess afterwards is NOT risk management
- Encourage diversification and decoupling at all levels: from contrarian investment strategies to countercyclical capital allocation and monetary policy
- Protect our institutions AND ecosystems

# Questions?

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Thank you!

- Riskcommons.org is currently developing cloud infrastructure for systemic early warning indicators and stress scenarios

For more information and updated systemic risk graphs please email  
[alaubsch@gmail.com](mailto:alaubsch@gmail.com)