

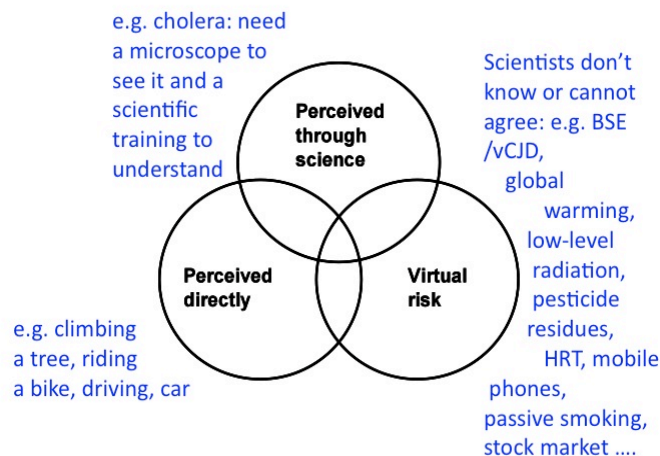
## The pursuit of resilience

Resilience is a relative quality. There are no units by which it can be measured, but some have more of it than others. The ability to prevent bad things happening, and to mitigate their consequences and speed recovery when they do, is not equitably distributed.

It is also limited. Ultimately the pursuit of it ends in failure. Empires collapse, companies go out of business, everyone dies. On a geological time scale tectonic plates shift, ice ages come and go, asteroids impact, the sun goes cold. On a human time scale tsunamis, earthquakes, credit crunches, diseases and simple traffic accidents, can overwhelm the most resilient of individuals. But still we strive to prevent bad things happening, mitigate their consequences and speed recovery when they do.

The pursuit of resilience involves risk management. The Venn diagram of Figure 1 identifies three different types of risk with which we all, as risk managers, wrestle. The diagram could, of course, be overlaid with a multitude of other circles – health risk, emotional risk, enterprise risk, financial risk, reputational risk, value at risk, fraud risk, political risk, military risk, security risk, traffic risk, environmental risk .... – but the three in the diagram capture essential attributes of all the others.

Figure 1. Different kinds of risk



Some risks are visible to the naked eye. We manage them using *judgment*. We do not undertake a formal probabilistic risk assessment before crossing the road. Some combination of instinct, intuition and experience usually sees us safely to the other side.

Others are perceptible only to those armed with microscopes, telescopes, scanners and other measuring devices, surveys, and the data they produce. This is the realm of quantified risk management. In this realm uncertainty is qualified by probability.

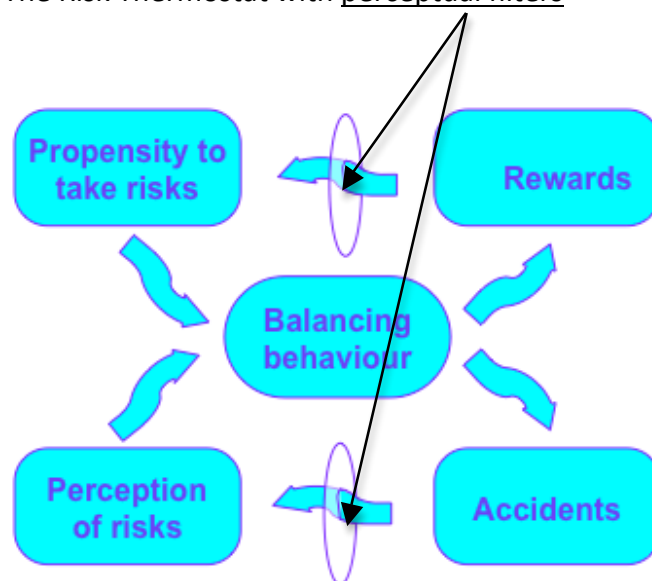
Virtual risks may or may not be real – scientists disagree – but they have real consequences. The uncertainty is liberating; if science cannot settle the issue people

feel free to argue from their beliefs, convictions, prejudices or superstitions. Here we are thrown back, as in the first circle, on *judgments* that cannot be objectively validated.

Figure 2 proffers the essence of the process of risk management. It describes the “risk thermostat” that everyone of us employs in the pursuit of resilience. “Propensity” in this diagram represents the setting of the thermostat. Some thermostats are set high, others low. I have yet to meet anyone with a zero setting; life would be unutterably boring.

Propensity leads to risk taking behaviour that leads, *by definition*, to accidents. To take a risk is to do something that carries with it a probability of an adverse outcome. Through surviving accidents and learning from them, or seeing them on television, or being warned by mother, we acquire our perception of safety and danger. The model postulates that when propensity and perception get out of balance we behave in a way that seeks to restore the balance. Why do we take risks? There are rewards, and the model proposes that the magnitude of the reward influences propensity.

Figure 2. The Risk Thermostat with perceptual filters



Most institutional risk management, outside the offices of venture capitalists, hedge funds managers and sub-prime mortgage brokers, is devoted to the prevention of bad things happening. It is focused on the bottom loop of Figure 2. It is risk averse. But as people or societies become more risk averse they do not necessarily become more resilient.

Resilience requires command over resources. Building flood defences and earthquake resistant buildings, accident and emergency services, and post-disaster continuity planning are all luxuries that the poor cannot afford. The single-minded pursuit of accident avoidance *at all costs* severely constrains the pursuit of the

rewards of risk, the creation of the resources that ultimately make resilience affordable. Achieving resilience is a balancing act. Too little caution can lead to disaster; too much can kill the enterprise. In one company I know the (overly?) enthusiastic health and safety team is referred to as “the sales prevention department”.

### **Too much and too little**

Most of the wealthy resilient world is now becoming less resilient. It is suffering simultaneously from under-regulation and over-regulation. The deregulation of the financial markets has given a relatively small number of financiers free rein to contrive incentive structures that pay them fabulous rewards for taking risk-free risks with other people’s money. Meanwhile other spheres of activity are being suffocated by an excess of regulation. The most egregious example in Britain at the time of writing is the Independent Safeguarding Authority. This new bureaucracy, created as a response to the sensationalist media outcry over the murder of two young girls, is charged with vetting an estimated 9 million people before they will be permitted to work, or volunteer with, children or “vulnerable” adults. The vetting involves a Criminal Records Bureau check on all 9 million after which, according to the Authority’s website, “we will decide on a case-by-case basis whether each person is suited to this work”.

Leaving aside the mind-boggling expense and bureaucracy required to perform this feat, its effect is almost certain to be perverse. The bureaucratization of the protection of children shifts responsibility. A CRB check will be seen as an insurance policy; behaviour that might previously have aroused suspicion is now less likely to be questioned, or acted upon, because some superior authority has certified the suspect as “safe”. But much worse is the damage that will be done by this extraordinarily disproportionate reaction to an extremely rare event. It is already having an impact on volunteering in a wide range of activities requiring adult involvement. From music and drama to sports, scouting, field trips and educational exchanges there can be seen a massive withdrawal of adults unwilling to subject themselves to the cost, inconvenience or indignity of the vetting process.

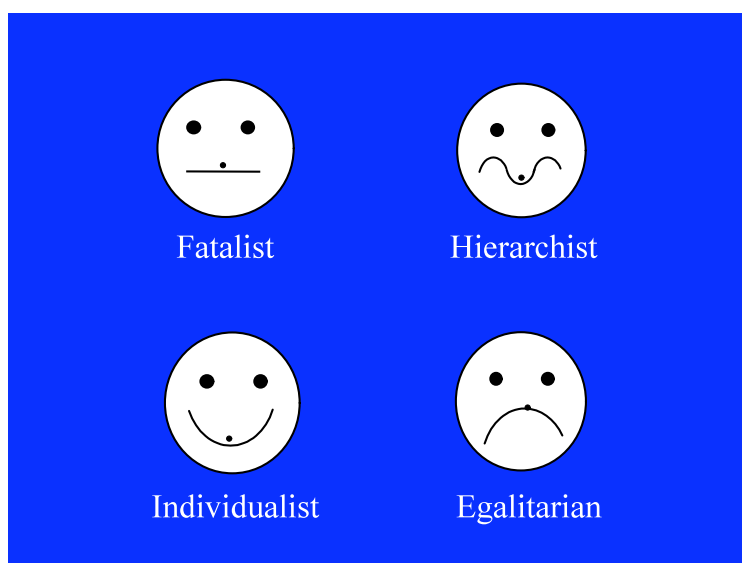
But still worse. Resilience is a skill acquired through experience. Over recent decades in the United States, Britain and many other wealthy countries the pursuit of zero risk to children has led to their increasing confinement under adult supervision. Now the loss of adult supervisors is restricting still further the range of activities in which they can engage, leaving them to grow increasingly obese before their TVs and play stations. Learning through experience the balancing act that underpins resilience is increasingly denied them.

### **Perceptual filters**

The Risk Thermostat of Figure 2 comes equipped with perceptual filters. Cultures and individuals vary widely in their perception of the dangers and rewards encountered in the pursuit of resilience. Figure 3 proffers a cartoon version of a typology of commonly encountered responses to risk developed in a branch of

anthropology called Cultural Theory. The Hierarchist represents the institutional risk manager, the maker and enforcer of the rules to which society is expected to conform. The ultra-cautious Egalitarian in the guise of defender of the environment, or its vulnerable inhabitants, commonly argues that the hierarchy is not doing enough to protect us, while the Individualist complains that the hierarchy is over-regulating and suffocating enterprise and individual liberty. The risk management strategy of the poor benighted fatalist – who is most of us most of the time – is to duck if he sees something about to hit him, and carry on buying lottery tickets.

Figure 3. A typology of perceptual filters.



### The chief risk officer

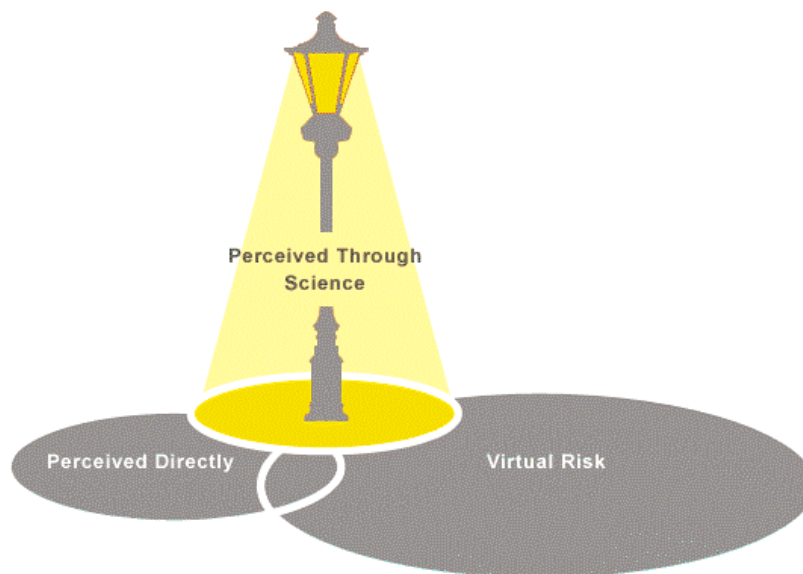
There is a spreading fashion amongst large companies to appoint CROs - Chief Risk Officers. This new office appears to have been created in response to the perceived failings of other Chiefs: Chief Financial Officers, Chief Compliance Officers and Chief Audit Executives. Collectively these predecessors in financial institutions failed spectacularly to prevent the recent sub-prime crunch – despite the demands and exhortations of Turnbull, the Basle Accords, Sarbanes Oxley and an army of regulators. Will Chief Risk Officers fare any better?

All the previous Chiefs have been charged with reducing or preventing “accidents” – mostly in the form of non-compliance with the rules. They have been bottom-loopers. Who is in charge of the overall balancing act depicted in Figure 2? There appears to be growing agreement on CRO websites that their job should be to “manage risk within the organisation’s risk appetite”. This sounds remarkably like the job of the Board and the CEO – whose twin responsibilities are the preservation of the company and maximizing shareholder value. The CEO becomes the CRO – Chief *Resilience* Officer.

This leaves a severely diminished role for mathematical risk specialists who deal only with the bottom loop of Figure 2 and who treat risk as an equation: Risk = Magnitude of Consequence X Probability.

As with companies, so with all of us; the most resilient amongst us are those with the best sense of balance. Some choose to perform on a high wire where risk is greater but success is more generously rewarded; others prefer to stay closer to the ground where the rewards are more modest. There is no magic formula that can ensure success. We must – CEO/CRO and all the rest of us – avoid behaving like the drunk of mythology who looks for his keys not where he dropped them but under the lamppost because that is where there is light to see.

Figure 4. The pursuit of resilience. Where are the keys?



Let there be no illusions. Resilience is not calculable. Unquantifiable, disputable, and disputed *judgment* will remain central to its pursuit.