Risk Management Made Simple

Welcome to the FREE Online Newsletter about **Systematic Risk Management**

for **executives** and **management professionals**

from ***Risk Wise Inc.*** and **Diana Del Bel Belluz**

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BONUS RESOURCE: The Achilles' Heel of Risk Management

By Diana Del Bel Belluz, M.A.Sc., P.Eng.

Would you agree that house prices can only go up? In the present credit crunch era, that seems like a whopper of an assumption. But in the months and years leading up to last August's sub-prime mortgage meltdown, it was a widely held assumption shared by homebuyers, lenders, investors, and regulators.

In a *New York Times* article titled *What Happens If We're Wrong?*, author **Peter L. Bernstein reminds us that forecasts are wrong from time to time**, particularly when the underlying assumptions are faulty. (Read the full article at **www.nytimes.com**).

Bernstein warns that **when managers ignore the true definition of risk, they lose all power to actually manage risk**. He shares a simple definition of risk by **Elroy Dimson of the London Business School**, i.e., "more things can happen than will happen". Bernstein explains that "**if more things can happen than will happen**, we can devise probabilities of possible outcomes, but — and this is a big "but" — **we will never know in advance the true range of outcomes we may face**".

Bernstein pillories the assumption that home prices can *only* go up. He states that in this assumption "the word 'only' is ridiculous ... More things can happen than will happen. Under those conditions, risk management should concentrate either on limiting the size of the bet or on finding ways to hedge the bet so you are not wiped out if you take the wrong side — if home prices do start to go down, or even stop rising."

He concludes with this advice, **"Effective Risk Management starts with the recognition that any forecast can be wrong, then weighs the consequences of being wrong. Only then can we decide whether to make a bet, whether to hedge that bet and how to execute the hedge if needed."**

In my view, **assumptions are the Achilles' Heel of risk management**. We cannot avoid making assumptions. They underlie every decision and action we take. Therefore, **if we want effective risk management, we need to learn how to handle assumptions properly**.

Here are three simple strategies to deal with them:

1) **Recognize your assumptions for what they are — assumptions, not facts.** We know now that 'house prices can only go up' is an assumption.
2) **Document your assumptions** to demonstrate due diligence.
3) **Test your assumptions —** both when you first make them, and then again from time to time. Validate your assumptions when conditions change.

I recently heard a hospital administrator share lessons learned from a minor fire that shut down a major health care facility for nearly a year. As a result of the fire, **they discovered that many of their pre-crisis assumptions were wrong and routinely went unchallenged.**

For example, they thought they'd be able to return to the building within hours of extinguishing the fire; but it was uninhabitable. Since the crisis, **members of the leadership team engage in frank discussions about the assumptions that underpin their decisions**.

Do decision-makers in your organization identify and test their assumptions? Or **is it just a matter of time until a crisis reveals your Achilles' Heel?**

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Announcing the Risk Management 'Personal Trainer' program:

It solves a huge problem undermining virtually all risk management leaders.

The problem faced by the vast majority of people tasked with integrating risk management across their organizations is this: **they haven't implemented systematic risk management before.** Successful implementation of systematic risk management requires both solid knowledge of the risk discipline and the skill to shift organizational cultural. **Your *Risk Wise* 'Personal Trainer' bridges your experience gap.**

When you work with a *Risk Wise* 'Personal Trainer' you will:

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- **Learn to balance the strategic and the tactical** with an advisor who understands the challenges of implementing risk management in a complex business environment.
- **Gain access to a broad array of proven tools and techniques** for the assessment, management and communication of risk. **This includes powerful risk analytics that give your people the anticipation advantage!**
- **Benefit from the sounding board effect** created when you have the ear of a risk management expert who can help you develop your ideas into creative and feasible solutions.
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To find out how the *Risk Wise* 'Personal Trainer' program works and **how to qualify for the Earlybird Bonus (a $750 value) available only until July 31st, 2008, visit:**

https://www.riskwise.net/PersonalTrainer.html

About Us

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Diana Del Bel Belluz, M.A.Sc., P.Eng., is a risk management advisor who **helps executives in large organizations to implement systematic and sustainable risk management practices**. Since 1990, Diana has been doing **leading-edge risk work** for companies in a wide range of industries and government organizations.

In addition, Diana **advances the field of risk management** by **teaching** university courses and management training seminars, **speaking** at conferences and **authoring** publications on a wide range of risk management topics.

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