# Adding Imagination to Experience in Risk Management

Risk professionals must count "imagination" as a professional skill.

Does expertise in risk management require experience? Absolutely! All else equal, more experience is better. But there's more to this discipline than experience and, fortunately, "growing older" is not the only method to gain experience.

## Living and Learning for Experience

Coursework, academic degrees, professional accreditations – they all help create "the expert you" as a risk manager. But living and learning on the job is necessary as well. How else do you know that "correlations go to 100%" in a crisis? It's best to have lived through that event. You get no real impression when a professor (or this author!) merely makes that statement.

Here's another lesson: you can't really use liquidity facilities. As a much younger risk manager for an investment division of a larger firm, the Operations guy told me we needed to send a $20 million wire to an investor. That struck me as a simple situation. We held more than enough Treasury securities that we could sell to generate the necessary cash. But my friend convinced me to draw on our liquidity line instead. He brought me the legal documents and convinced me we had the right to draw. We created a VERY ANGRY liquidity lender! I simply did not know that most liquidity facilities are not serious. The legal document says "draw funds with notice by 3 pm." The unspoken agreement says "never draw funds."

## Start (and Never Stop) Reading

If you've ever had an extraordinary experience or otherwise learned something that struck you as amazing and important, you probably felt like sharing that experience or learning with others. Writing a book or article is arguably the best way to teach your experience. Now paint this picture in reverse. There are many available books, articles, and information sources (including GARP Risk Intelligence!) that teach knowledge and tell stories that will make you a better risk manager. You gain the experience of others simply by investing *hours* in reading rather than *years* of your own life. Reading good material yields "experience" far in excess of your years on the job.

In this screen from a GARP video below, we show fascinating, readable (!) examples of valuable books.

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| **FIASCO: Blood in the Water on Wall Street** | Partnoy |
| **Conspiracy of Fools** | Eichenwald |
| **Big Bets Gone Bad** | Jorion |
| **Rogue Trader** | Leeson |
| **The Power of Gold: The History of an Obsession** | Bernstein |
| **Alexander Hamilton** | Chernow |
| **House of Cards: A Tale of Hubris and Wretched ....** | Cohan |
| **A Colossal Failure of Common Sense: The Inside ....** | McDonald with Robinson |
| **In Fed We Trust: Ben Bernanke's War on the Great Panic** | Wessel |
| **Too Big to Fail** | Sorkin |
| **Fooling Some of the People All of the Time** | Einhorn |
| **On the Brink** | Paulson |
| **When Money Dies** | Fergusson |
| **Reckless Endangerment** | Morgenson and Rosner |
| **Money and Power: How Goldman Sachs Came to ....** | Cohan |
| **House of Morgan** | Chernow |
| **This Time is Different: Eight Centuries of Financial Folly** | Reinhart and Rogoff |
| **The Lost Bank** | Grind |
| **A Primer on Money, Banking, and Gold** | Bernstein |
| **Lombard Street - a description of the money market** | Bagehot |

See [this video]() for a short discussion of the historical highlights of this reading list.

As just one colourful example, consider Nick Leeson's *Rogue Trader*. Leeson created the fraud that destroyed Barings Bank in 1995. Years later he wrote his book to tell us all how it happened. One lesson I learned is that many financial professionals don't (truly) understand futures trading! Leeson had told at least one colleague that he was wiring funds "as collateral" for the futures positions. In maintaining an open futures position, of course, what you're really wiring is "yesterday's losses" rather than "collateral!" Ignorance of a financial firm's business details on the part of key employees is a huge risk.

**Imagination as the Invaluable Ingredient**

It's not surprising to any of us that experience is valuable and that professional development through reading, attending lectures and conferences, and other self-study is critically important. This reminder of our common understanding prepares us for the next argument that "Risk Imagination" takes us further.

Here's a story I've never told. Twenty years ago, a Spring snowstorm delayed my morning commute to that job as a risk manager of an investment division. After shovelling the driveway and clearing a fallen tree, it was mid-morning by the time I arrived at the train station. Waiting for the next train, I had a few minutes to relax and appreciate the clear sky and bright sun over the white landscape.

As I peered out a large window from an elevated waiting area over the tracks and platform, something – I didn't know what – struck me as odd. It took me a heartbeat or two to realize that a foot of snow covering an upper, sloped portion of the large window had drawn my eye. After a few more heartbeats, my brain then registered that the snow extended beyond the edge of the window slope. Again, as more seconds went by, I realized the snow was "cantilevered" because it had been creeping imperceptibly down the slope of the upper window.

"Unique and beautiful!" I thought calmly, as I turned lazily to pace away from the window. A loud crashing noise then thundered behind me. It was that snow! It had all fallen in an instant to the platform below. Fortunately, nobody had been standing beneath it. Though the weight of the snow could not have injured anyone, it would have been dangerous to be startled while standing so close to train tracks.

The story's moral is that there is risk in any "new and interesting" situation. When confronting a situation that is new to you, think it through carefully! When direct experience and your professional learning are unhelpful in the present, use imagination! The eyes could not see the snow's ultra-slow motion - my brain should have imagined what might happen next!

Joe Pimbley

**Immediate Need for Risk Imagination**

On the one hand, the statement that "new situations are inherently risky" strikes one as trivial and obvious. Of course. With a new aircraft design, we hire test pilots to fly the new plane for thousands of miles rather than simply load the plane with paying customers on the first day. With new business ideas, we "start small" to test the market reaction and our firm's ability to execute.

In these two simple examples, an important feature is that the person or business at risk exercises some control over the introduction of the new situation. Yet there are times when we seemingly "wake up" and find ourselves in a new place. For whatever reason, there appears to have been no intelligent, cautious "test-pilot phase" prior to the introduction of the novel scenario.

Let's take "negative interest rate policy" (NIRP) as an example. Actions of global central banks have generated in excess of $10 trillion of negative-yield debt. There is no true precedent for such extreme bond yields on this scale. Hence, we do not have history to help persuade us that (i) this monetary policy will help re-build economies (as the central bankers presumably hope) OR that (ii) the damage to personal, pension, and insurance portfolios will destroy both wealth and economies of the future.

Most likely the NIRP outcome will be neither of these two possibilities. Clearly, *something* will happen going forward and people will bicker about what caused that *something*. Senior risk managers of banks, pension funds, and insurance companies must rely on imagination to determine what, if any, current actions and precautions will mitigate consequences of NIRP.

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