

# Risk & the Human Condition - Assessing Psychological Capacity

Colm Fitzgerald

IFoA Risk & Investment Conference

Celtic Manor, Wales  
June 4<sup>th</sup> 2015



## Introduction

- Introduction
- Assessing the psyche/mind
  - Why do we want to assess it?
  - How do we currently assess it?
- Alternative approach
  - '*Human condition*'
  - Risk Personality Questionnaire
- Assessing group psychology
- Summary & Conclusions



# Assessing the Psyche

Why do we need to assess an individual's psyche/mind?

Examples

- Hiring a fund manager to manage pension fund investments
- Hiring a risk manager to manage pension fund investments
- Selecting a trustee for a pension fund
- When hiring an agent to work on our behalf
- Other examples



# Assessing the Psyche

How do we assess an individual's psyche/mind?

Examples

- IQ tests
- Personality and aptitude tests
- Interviews
  - Subjective assessments
- Other examples

How good are these?



# Alternative Approach

Existing theories:

- Rationality assumption
- Maximizing utility
- Heuristics & biases

Alternative (classical) approach

- Assume individuals are human rather than merely rational
- Assume that all individuals are subject to the same 'human condition'



## Human Condition – Nature of Life

Life is a hill and progress is always an uphill battle

- The hill is initially very steep but it flattens on ascent. The regressive forces pushing us down the hill are typically stronger than the progressive forces pushing us up the hill.
- *“Civilisations are created from what is required of people, not from what is provided for them.”* – Antoine de Saint-Exupery
- Our progressive force is what we require of ourselves. What we get and what is provided for us is only good if it helps us require more of ourselves. Progress, moving up the hill, is always an uncomfortable and difficult experience. The reward for moving uphill, to higher levels of the human condition, is that future ascent becomes less difficult.
- Difference with modern societal viewpoints.
- Hesiod, Democritus, Aeschylus, Euripides, Saint-Exupery



# Human Condition – Nature of Individual

We are human – we have constraints

- Numerous constraints on the psyche – so a proportionate degree of humility is always necessary, otherwise 'pseudodoxia' (distorted logic) arises.
- Socrates, Maslow, Lippmann

We are human – we have an 'ego'

- The 'self' as distinct from other selves.
- The ego's job is to keep us feeling good about our selves.
- The ego can use ego defence mechanisms
  - which distort 'reality' to aid handling difficulties and setbacks
- The ego is mostly a regressive force as it can distort the reality of the hill and distort what is required of us. Overcoming the ego is necessary for significant ascent of the hill.
- Erich Fromm, Anna Freud.



# Human Condition – Nature of the Psyche

Division of the psyche into '*Thought*' and '*Logical and Rational Thinking*'

- "*The intuitive mind is a sacred gift and the rational mind is a faithful servant. We have created a society that honours the servant and has forgotten the gift*" – A. Einstein
- Optimal alignment = a humility of the Ego, which balances:
  - Confidence, optimism, courage and patience in an individual's own thought ('E'), and
  - Ego-critical and pessimistic forms of rational and logical thinking ('Go').
- *Talent is nothing but "a lengthy patience"* – Guy de Maupassant
- To reach the psychological potential of the human condition - the psyche must be operating in this manner, and the degree that it reaches its psychological potential depends on the level of vitality in the psyche
- Einstein, Tesla, Anaxagoras, Tolstoy, Taoism



# Risk Personality Questionnaire

How do we assess an individual in the context of the human condition? How can we assess where they are on the 'hill'?

Different psychological perspectives are assumed to be associated with different levels of the human condition.

The extent to which an individual holds these perspectives is assumed to be an indication of the level of the human condition at which they are operating.

The perspectives are assessed using a method which uses the individual's ego against itself to reduce the potential for gaming.



# Risk Personality Questionnaire

Scores are awarded to answers based on the degree of adherence to various psychological perspectives.

The main output is in the form of three coefficients:

- Potentiality Coefficient (indicating - where on the 'hill')
- E-Coefficient (indicating - quality of thought)
- Go-Coefficient (indicating - quality of logical & rational thinking)

Tested using focus groups.

Statistical testing has shown moderate to strong indications of validity and reliability.



## RPQ - Examples

Which do you agree with most? (Honestly!)

- A) *There is no freedom without responsibility*
- B) *I accept my responsibilities prudently*
- C) *It'd be great to have a few less responsibilities so that I could enjoy life more*
- D) *I would love to win the Lotto and be completely free*



## RPQ - Examples

Which is more important?

- A) *To thine own self be enough*
- B) *To overcome yourself*



## RPQ - Examples

When you have been successful in an enterprise?

- A) *You feel good and proud of your achievement*
- B) *You regard that success as nothing compared to what you will do next*



## RPQ - Examples

When you come across a new idea, opinion or experience:

- A) *I consider it important to consider it from my perspective to make the best judgment*
- B) *I would consider it without asserting my own particular claim on the experience*
- C) *Both of the two answers above are important*
- D) *I don't have a strong opinion*



# RPQ - Examples

Which is most true?

- A) *I think it's important to be positive and optimistic in my thinking*
- B) *I think it's more important to think as I might during times of misfortune*



## RPQ - Results

	<i>Potentiality -Coefficient</i>	<i>E- Coefficient</i>	<i>Go- Coefficient</i>
Highest result	97	45	52
90 <sup>th</sup> Percentile	77.6	38.6	41
70 <sup>th</sup> Percentile	66	34	35
50 <sup>th</sup> Percentile	58	28	32
30 <sup>th</sup> Percentile	53.1	25	28.4
10 <sup>th</sup> Percentile	49.2	20.4	23.4
Lowest result	40	13	14
Average	61.63	29.23	32.40
Max possible	120	60	60
Min possible	0	0	0



# Group Risk Personality Questionnaire

## Group Risk Personality Questionnaire

- Quantitatively measures the degree to which the psychological capacity of a group of individuals is greater or less than the sum of the individual members' psychological capacities
- Compares the '*Group-Potentiality-Coefficient*' with the sum of each individual member's '*Individual-Potentiality-Coefficient*'
- If the '*Group-Potentiality-Coefficient*' is greater/less than the sum of each individual member's '*Individual-Potentiality-Coefficients*' then the group is greater/less than the sum of its individual members – from a psychological perspective.



## GRPQ - Example

### Individual Question & Group Question:

The group invested a significant amount into a particular investment – albeit less than its peer group. The investment has performed very poorly, losing >50% of its value. Which do you most agree with?

- A) *The group did well to invest less than their peer group.*
- B) *The group made a very bad investment.*



# Applications

Are you hiring somebody for a risk or investment role? Do you want to quantitatively assess their psychological capacity?

Are you reviewing and looking to enhance the performance of existing risk and investment personnel?

Are you on a board of directors or risk committee and would like to improve the management of the risk culture?

Before hiring or re-hiring an investment manager, do you want to assess the psychological capacity of their key staff?

If you answer 'yes' to any of the above, then the RPQ or the GRPQ might be exactly what you need.



# Summary & Conclusions

How adequate are current methods of assessing the psyche?

Are we rational robots? Or are we human?

Should we be using models based on the human condition rather than assuming rationality (and denying the existence of the ego)?

Should actuaries be using the Risk Personality Questionnaire to assess the individuals who are investing their funds?

- Fund managers
- Risk managers
- Others



# Thank you for your attention

Comments?

Questions?

If you want more information about using the Society of Actuaries in Ireland's Risk Personality Questionnaire:

Please email: [colmfitzg@gmail.com](mailto:colmfitzg@gmail.com)  
or [paragonresearchltd@gmail.com](mailto:paragonresearchltd@gmail.com)

