FREE GUIDE

Managing Risk as a System

Why your process matters more than your trades.

The Ad Astra Options Risk Framework

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Options Risk Education

THE AD ASTRA OPTIONS RISK FRAMEWORK

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Why your process matters more than your trades.

Most options traders focus on finding better trades. This guide shows you why the traders who last are not the ones who find the best entries. They are the ones who build the best systems.

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Why Most Traders Focus on the Wrong Problem

Ask an options trader about their worst drawdown and you will rarely hear that they did not understand the trade. You will hear that the position was too big, that the market had already turned, that they knew better.

They are usually right. They did know better.

The losses did not come from ignorance. They came from the gap between what the trader knew and what the trader did: a position held too long, sized too large for the account, carried through a regime that had clearly changed, or kept open in spite of a rule written for exactly that moment.

This is not a knowledge problem. It is a systems problem.

Brokers and educators have spent two decades teaching traders what to trade and how to trade it. Far fewer ask the harder question: what governs whether you should be trading at all, in what size, with what structure, under what conditions? That governance layer is what separates traders who last from traders who do not, and it is exactly what enterprise risk management was built to provide inside every serious financial institution.

> **The Core Insight**
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> Every broker teaches you what to trade and how to trade it. Nobody teaches you how to build a system that governs whether you should be trading at all, and in what size, with what structures, under what market conditions. That governance layer is what this guide is about.

From Trade Risk to System Risk

Risk that appears to come from a single bad trade almost always originates somewhere else: in position sizing that was not anchored to defined limits, in a regime reading that ignored the current environment, or in the absence of a consistent review process.

This is a concept embedded in COSO Enterprise Risk Management, the globally recognized governance framework used by banks, insurance companies, and publicly traded corporations. The central insight is that risk is systemic, not episodic. It does not live inside individual transactions. It lives in the processes, structures, and governance mechanisms that produce those transactions.

Individual traders almost never think this way. They review trades. They do not review systems.

What a System Actually Is

A trading system, in the governance sense, is not a mechanical entry-and-exit algorithm. It is the complete set of structures and processes that govern how trading decisions are made. It has five dimensions:

System Dimension	What It Governs	Without It
Pre-Trade	Whether to enter and in what size	Position sizing driven by emotion, not criteria
Structure Selection	Which strategy fits the environment	Strategies mismatched to the volatility regime
Active Management	How positions are monitored and adjusted	Losses held too long; winners closed too early
Review Process	How decisions are evaluated after the fact	Outcome bias replaces decision-quality thinking
Governance	How the overall framework is maintained	Rules erode; exceptions become the norm

Most traders operate with informal, inconsistent versions of one or two of these dimensions. They have some kind of pre-trade thought process. They sometimes review losses. But the dimensions are not connected. They do not form a system.

A break in any one dimension creates vulnerability that propagates across the others. A trader without a defined pre-trade process will size positions inconsistently. Inconsistent sizing makes meaningful review impossible. Without reliable review, the governance dimension, the maintenance of rules over time, degrades. The system collapses from the inside.

The COSO Principle: Risk as an Organizational Reality

COSO defines enterprise risk management not as a set of controls but as "the culture, capabilities, and practices, integrated with strategy-setting and its performance, that organizations rely on to manage risk in creating, preserving, and realizing value." Risk is not managed by one person or one department. It is embedded in the structures, behaviors, and decision-making processes of the organization.

For a solo trader, the organization is you. But the principle is identical.

Term	Definition
COSO ERM	A globally recognized enterprise risk management framework that defines risk governance as an integrated system. Applied here to the individual trader's practice.
Risk Appetite	The types and amount of risk, on a broad level, that the organization is willing to accept in pursuit of value (COSO, 2017). In trading terms: the boundaries you define before you have exposure.
Control Environment	The foundation of discipline and structure within which risk is governed. For traders: the rules, review processes, and governance habits that constitute the trading framework.

What enterprise risk management knows that most traders don't

A single risk event is rarely caused by the event itself. It is caused by a failure of governance upstream: in identification, measurement, or control. The same is true in trading. The loss you took last month was almost certainly visible in your system before it happened. The system just did not catch it.

The Translation: What This Means for an Options Trader

Applying COSO to individual trading practice means building five things, in order. Each depends on the one before it.

1. A Defined Risk Appetite

Before you open a position, you need documented answers to three questions: How much of my account can be at risk at any given time? What is the maximum I am willing to lose in a single week? What categories of trades fall within my defined practice versus outside it? These are not preferences. They are boundaries. The difference matters. A preference is something you consider. A boundary is something you enforce.

2. A Consistent Pre-Trade Process

Every trade should pass through the same evaluation before entry. Not a mental checklist, but a documented one. The evaluation should cover the seven risk dimensions of any options position: behavioral risk, directional risk, volatility risk, time risk, structural risk, concentration and correlation risk, and liquidity risk. The companion workbook, Trade Like a Risk Manager, turns this evaluation into a Pre-Trade Diagnostic you complete before every entry: a two-minute quick version for routine trades and a full version for everything else.

3. Explicit Controls for Each Risk Type

A control is any deliberate response to an identified risk. A stop rule is a control. A delta hedge is a control. A position limit is a control. The discipline is not having controls in general; it is matching specific controls to specific risks, and documenting what triggers them.

4. A Review Process Separated from P&L

Most traders review results. Very few review decisions. These are not the same thing. A trade that loses money may have been a sound decision. A trade that makes money may have been a reckless one. Decision-quality review asks: was this the right decision given what I knew at entry? That question is independent of outcome. This is perhaps the most difficult discipline to establish, and the most valuable.

5. A Governance Structure That Maintains the Framework

Rules erode. Exceptions become habits. The system works until a losing streak makes it feel too restrictive, and then the rules get quietly abandoned. Governance is the practice that prevents this: a structured, periodic review of whether the framework is being followed and, if not, why not.

The framework in one sentence

Define your risk appetite before you trade. Evaluate every position against your defined risk dimensions. Apply explicit controls. Review decisions, not results. Maintain the system through governance.

The Practice: Your First Framework Audit

Before building a system, you need to know where you currently stand. The following five questions are a short version of the Trader's System Audit. Answer them honestly. Not as you intend to operate, but as you actually operate today.

- ☐ Do you have a documented, consistent pre-trade process, or does your evaluation vary by trade?
- ☐ Have you defined a maximum portfolio risk limit and a maximum single-position limit in writing?
- ☐ Can you identify the specific control that governs each type of risk you carry in open positions?
- ☐ When you review a closed trade, do you evaluate the quality of the decision, or only the P&L?
- ☐ Have you reviewed your trading rules in the past 90 days to assess whether they are still being followed?

If you answered no or unclear to more than two of these questions, you are managing individual trades, not a system. The goal of this framework is to change that. The full version, twelve questions with an automatic score and your three biggest gaps, is the free Options Risk Scorecard at adastratrading.org.

> **What you should do next**
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> Write down your current answer to each of the five questions above. This becomes your baseline. You are not grading yourself. You are establishing where the system gaps are so you can close them one at a time.

What This Framework Is and Is Not

This is not a trading strategy guide. It does not tell you which options structures to trade, when to sell premium, or how to select strikes. That knowledge is widely available and valuable, but it is not where a durable edge is built.

This framework is a governance layer. It sits beneath every trading decision and defines the conditions under which those decisions are made. It is built on COSO ERM, a framework developed to govern risk inside the most complex financial institutions in the world, translated for the individual practitioner.

The traders who last are not the ones who find better signals. They are the ones who build better systems. This is how you build yours.

The foundation of the Ad Astra Options Risk Framework spans six modules: the system audit, risk appetite and loss tolerance, the seven risk dimensions of every options position, matching controls to risks, market regimes, and the rules and governance that sustain the practice long-term.

Ready to Build Your Framework?

This guide introduced the system thinking behind risk governance. The next step is applying it to your own trading.

Your next resources at Ad Astra Trading:

→ The Options Risk Scorecard: twelve questions, your score, and your three biggest gaps in about five minutes. Free.

→ Trade Like a Risk Manager, the options risk management workbook (Modules 1–6): six governance documents and a companion spreadsheet. $59, or included with a paid subscription to the Ad Astra Substack.

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Continue the Conversation

Follow the ongoing essay series on applying COSO enterprise risk management to individual options trading at chrislandry2025.substack.com. Every essay is also published at adastratrading.org.