

Syllabus: Enterprise Risk Management FINC 557 Winter 2009-2010

This revision: October 27, 2009

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Office hours: Monday and Wednesday 5-6 p.m. and 9-10 p.m.; or by appointment

Course Overview:

This course explores the emerging practice of “enterprise risk management” (ERM) or “integrated risk management”—a new managerial outlook on managing risk. Enterprise risk management considers all the risks faced by the firm and attempts to integrate these disparate risks into a single unified analytical framework. Traditionally, risk has been managed in the compartments of financial risk, operating risk, and credit risk. Rather than allowing risk to remain in such “silos,” ERM insists that these must be brought together into one system of risk management. As we will see, the methods of ERM are very much a work in progress.

We begin by considering the global risks that are extrinsic to the firm and that constitute the “world of risk” inhabited by all enterprises, no matter which country or industry they call home. We then turn to an analysis of the ERM framework and consider it as an element of corporate governance. As we will see, the emergence of the Chief Risk Officer (CRO) is a critical part of ERM. We then turn to the various risks that firms face and show how these dimensions of risk can be brought into the ERM framework.

Throughout the course, we will keep in view the broadest dimensions of risk both as threats to human welfare and as opportunities for enriching human life. That is, we will constantly refer to the ethical, social, and environmental dimensions of risk management, ranging from world food security, to global climate change, the effect of systemic risk and financial crises on the lives of individuals, and the treatment of individuals within the firm. In sum, the normative elements of risk and its management will be a theme that runs through the entire course.

Texts:

All readings or links to them are available on the course web site: <http://www.RobertWKolb.com>. There is no text to purchase. **Note:** Because some of these are copyrighted, you will need the course password to access them. This will be provided by the instructor separately.

Course Outline:

November 9: Course Introduction; Introduction to Enterprise Risk Management

Lisa Meulbroeck, "A Senior Manager's Guide to Integrated Risk Management," *Journal of Applied Corporate Finance*, 14:4, Winter 2002, pp. 56-70.

Brian W. Nocco and René Stulz, "Enterprise Risk Management: Theory and Practice," *Journal of Applied Corporate Finance*, 18:4, Fall 2006, pp. 8-20.

Tom Aabo and Betty J. Simkins, "The Rise and Evolution of the Chief Risk Officer: Enterprise Risk Management at Hydro One," *Journal of Applied Corporate Finance*, 17:3, Summer 2005, Fall 2006, pp. 62-75.

November 16: Techniques of Enterprise Risk Management

John R. S. Fraser, "How to Prepare a Risk Profile," forthcoming in John R. S. Fraser and Betty J. Simkins, *Enterprise Risk Management*, John Wiley & Sons, Inc., 2009.

Ken Mylrea and Joshua Lattimore—"How to Create and Use Corporate Risk Tolerances," forthcoming in John R. S. Fraser and Betty J. Simkins, *Enterprise Risk Management*, John Wiley & Sons, Inc., 2009.

November 23: Global Risk, Systemic Risk and the Role of Complexity

World Economic Forum, *Global Risks 2009*, January 2009.

Association of British Insurers, "Financial Risks of Climate Change," June 2005.

Guest Lecture: Tom Bugnitz, President, Beta Group and Vice President, Coolerado Corporation

November 30: The Enterprise Risk Management Framework and Corporate Governance

Stephen Gates, "Incorporating Strategic Risk Into Enterprise Risk Management," *Journal of Applied Corporate Finance*, 18:4, Fall 2006, pp. 81-90.

René M. Stulz, "Risk Management Failures: What Are They and When do They Happen?" *Journal of Applied Corporate Finance*, Fall 2008, 20:4, pp. 39-48.

December 7: Financial Derivatives and Risk

Presentations of Small Project

John E. Marthinsen, "Derivative Scandals and Disasters," forthcoming in Robert W. Kolb and James A. Overdahl, *Financial Derivatives*, John Wiley & Sons, Inc., 2009.

January 25: Risk Management Topics and Techniques

Erwann Michel-Kerjan and Burkhard Pedell, "How Does the Corporate World Cope with Mega-Terrorism? Puzzling Evidence from Terrorism Insurance Markets," *Journal of Applied Corporate Finance*, Fall 2006, 18:4, pp. 61-75.

Diana Del Bel Belluz, "Operational Risk Management," forthcoming in John R. S. Fraser and Betty J. Simkins, *Enterprise Risk Management*, John Wiley & Sons, Inc., 2009.

Richard Brealey, "Basel II: The Route Ahead or a Cul-de sac?" *Journal of Applied Corporate Finance*, 18:4, Fall 2005, pp. 34-43.

February 1: Value at Risk, Stress Testing, Scenarios, Fat Tails, and Black Swans

Markus Leippold, "Don't rely on VaR," *Euromoney*, November 2004, pp. FA2-FA6.

Valérie Chavez-Demoulin and Armin Roehrl, "Extreme Value Theory Can Save Your Neck," January 8, 2004.

Illing and Ying Liu, "Measuring Financial Stress," *Financial System Review*, December 2003, pp. 43-48.

Bearing Point, "Scenario Analysis for Basel II Operational Risk Management," pp. 1-8.

February 8: Rethinking Risk

Robert F. Bruner and Sean D. Carr, "Lessons from the Financial Crisis of 1907," *Journal of Applied Corporate Finance*, Fall 2007, 19:4, pp. 115-124.

Shigeyuki Goto, "The Bounds of Classical Risk Management and the Importance of a Behavioral Approach," *Risk Management and Insurance Review*, 2007, 10:2 pp. 267-282.

Alex J. Pollock, "The Human Foundations of Financial Risk," American Enterprise Institute for Public Policy Research, May 2008.

February 15: Presentations of Big Project

February 22: Final Exam

Grading:

Firm Description: 10%

Small Project and Presentation: 25%

Big Project and Presentation: 40%

Final Exam: 25%

Projects—General:

Students shall form teams of not more than five persons, and the team shall choose a company as the basis for both the small and the big project. Select a firm that fits one or both of two models. The first model is a company that is publicly-traded and well-known. This approach has the advantage of your audience having useful background knowledge about the firm, but has the disadvantage of your having to rely on only publicly available information. As a second model, you might choose a more local firm, such as a Chicago-based firm where you work. In this case you may be able to draw on your own familiarity with the firm and the issues that it faces. Of course, the firm you choose may fit both models.

Make sure that the delivered products are airtight, well-written, free of spelling errors, coherent, etc. These features matter and will affect your grade. For example but only as an example, if the submitted work contains errors that spell-check could find, that tells me that the work is slovenly and not deserving of serious consideration.

Firm Description:

Due Date—November 23, 2009 by 6:00 p.m.

As a preliminary to both the small and big projects, each team shall prepare a description of its firm and its lines of business. This will be background information provided to the class so they will know the nature of the firm you have chosen. This report should not exceed 1,500 words. This report should be a simple well-crafted narrative with no visuals. Submit it as a single-spaced pdf in a simple style (e.g.,

Times New Roman, 12 pt., 1” margins all around). These reports will be distributed to the class.

Small Project and Presentation:

Due Date—December 7, 2009 by 5:30 p.m.; Presentations to be made in class that evening

You will be given a specific risk scenario that applies to your firm. Your report and presentation should present an analysis of how that risk affects your firm and how your firm might act to anticipate such a risk and/or how it can respond to the event should it occur. The report should be no more than 2,500 words accompanied by no more than four PowerPoint slides. Please embed the slides in the document and submit it as a single pdf file. You will have a short time to present your analysis to the class. (The exact time will be determined based on the number of teams we have in the class, but the best guess is you will have about seven minutes per team.)

Big Project and Presentation—Research Project in ERM:

Prepare a risk analysis of the firm that covers the general risks of the firm. Be sure to cover globalized risks that present issues for the firm. In addition, choose a particular risk exposure that the firm faces, **but not a financial risk**. Examples: Is there something that threatens the market for the firm’s products? Might the firm face special risk to some of their key inputs? Please choose a major and *interesting* risk. Prepare two deliverables:

Written Report: A narrative report not exceeding 4,000 words explaining the risk posture of the firm and the risk analysis of the additional single risk exposure you have analyzed. You may accompany these pages with as many tables and graphs as contribute to the final product. (Advice: Don’t go overboard on the tables and graphs. Use as many as you wish, but only if they count in telling your story.)

Class Presentation: Prepare a presentation for class delivery. (The length will depend on how many groups we have. You will probably be limited to exactly 12 minutes.) This presentation is for the benefit of the class, so it should give the class a comprehensive understanding of the risks faced by the firm you have chosen. The exhibits in your presentation should be the same as those in your written report.

Final Exam

The final exam will cover the readings and will consist of fairly objective short answer and very short essay questions. The exam aims to ensure that you read and understand the course assignments, which are necessary to understand and apply to the projects as well.