

**Syllabus: Enterprise Risk Management FINC 557  
Spring 2008**

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**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 integrates these into a single unified 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, to 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:**

There is one text to purchase: Carol Alexander and Elizabeth Sheedy, *The Professional Risk Manager's Handbook, Volume III*, Wilmington, DE: Professional Risk Manager's International Association Publications, 2004.

Other readings or links to them are available on the course web site: <http://www.RobertWKolb.com>.

**Note:** Because these are copyrighted, you will need the course password to access them.

## **Course Outline:**

### **February 26: Course Introduction; A World of Risks and Opportunities**

World Economic Forum, *Global Risks 2008*, January 2008.

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

### **March 11: The Enterprise Risk Management Framework and Corporate Governance**

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

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

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.

### **March 18: Economic Capital and Market Risk Management**

"Introduction," "Capital Allocation and RAPM," and "Market Risk Management," PRM Handbook, pp. 7-74.

### **April 1: Operational Risk**

"The Operational Risk Management Framework," PRM Handbook, Volume III, pp. 343-366.

"Operational Risk Process Models," PRM Handbook, Volume III, pp. 367-394.

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

### **April 8: Mid-Term Exam and Catastrophe Risk**

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.

### **April 15: Value at Risk, Fat Tails, and Black Swans**

"Introduction to Value at Risk Models," PRM Handbook, pp. 75-85.

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

"Stress Testing," PRM Handbook, pp. 157-173.

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

### **April 22: Scenario Analysis, Operational Risk, and Credit Risk Management**

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

"Credit Risk Management," PRM Handbook, pp. 193-210.

Kyle Brandon and Frank A. Fernandez, "Financial Innovation and Risk Management: An Introduction to Credit Derivatives," *Journal of Applied Finance*, 15:1, Spring/Summer 2005, pp. 52-63.

### **April 29: Presentations**

### **May 6: Final Exam**

**Grading:**

Mid-Term Exam: 20%

Final Exam: 20%

Course Project: 40%

Class Participation and Contribution: 20%

**Course Project--Research Project in ERM:**

Form a team of 3-5 students. Select a firm that is either the employer of at least one team member or a prominent Chicago company, ideally a company headquartered in Chicago, or at least one with major operations here. Choose some 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 8-10 page narrative about the risk and its significance. You may accompany these pages (about 2,500-3,000 words) 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.) Make sure that the delivered product is *Atight@Bwell* written, free of spelling errors, coherent, etc.

**Class Presentation:** Prepare a 20-minute presentation for class delivery. You will have exactly twenty minutes for your group presentation, and your classmates will be asked to rank/evaluate your presentation. Their evaluation will figure into your grade for the entire assignment. The exhibits in your presentation can be the same as those in your written report.

**Class Participation and Contribution:**

Meaningful contribution to class discussion is an essential requirement of this course. This requires reading and reflecting on the assignment before coming to class. For many of the readings, I will prepare study questions and post them on the course web site. I will also randomly assign these questions to members of the class as areas of their special responsibility for contributing to the class discussion. This information will be posted in a spreadsheet on the web at the top of the Study Questions page. It is your responsibility to check this spreadsheet in advance of class. This approach means that I will feel free to call on a particular student to speak about one of his or her assigned questions. Of course, you will also need to contribute to the discussion of other aspects of the assignment as well.