

BADM 746
RISK MANAGEMENT
SPRING 2014

INSTRUCTOR: Ernest N. Csiszar

MEETING TIME: Monday @ 6:00pm – 9:00pm, Room 203

OFFICE HOURS: By Appointment

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The objective of this course is to explore managing under conditions of risk and uncertainty. Risk presents both threat and opportunity. Thus, the course will focus on how a business handles various categories of risks and uncertainties, how these risks interact and interrelate with each other, and how managers make decisions based on various tradeoffs.

Risk management has been blamed at least in part, for the recent financial crisis and both pre-crisis and new and emerging views of risk management will be addressed. Not only is risk management a relatively new and developing strategic approach to value creation, its execution also calls for a deep and thorough understanding of a firm's business and its environment as well as a capacity to identify, analyze, measure, manage, and monitor a variety of complex and interacting existing and emerging risks.

The course is intended to address risk management issues in both financial and non-financial firms. While a background in mathematical methods will be useful, especially an understanding of probabilities, it is not a prerequisite. The focus will be primarily on issues and assumptions that various quantitative and qualitative methodologies raise when applied to risk management.

While some commonalities exist, risk management requires an approach tailored to the particular businesses that a firm engages in. Thus, risk management is more about practice and less about theory. With some notable exceptions such as financial risks, it is as much about experience, judgment, talent and qualitative analysis as it is about rigorous quantitative analysis.

Classes will take the format of discussions among us largely based on the readings, case studies, and events as they occur. The expectation will be that you are thoroughly familiar with the various cases and readings and that you are prepared to participate fully when called upon. Students, as well as the instructor, are also expected to comply with the University's honors policy, more about which can be found at <http://sc.edu/academicintegrity>.

TEXTBOOKS:

Bernstein (1996) *Against the gods: The remarkable story of risk*. John Wiley & Sons, Inc., New York.

Hampton, J.J. (2009) *Fundamentals of enterprise risk management*. AMACOM, New York.

Various supplemental readings and cases accessible via the internet or available electronically through Harvard Business Publishing (HBP) are also assigned. Some of these readings may have to be purchased online before they can be accessed. Daily reading of the Wall Street Journal and/or The Financial Times is also recommended. The instructor reserves the right to add readings or cases as they may become available.

GRADES:

- **A final paper on a topic of your choice covered in the syllabus:** 40%. The paper is to be no longer than 20 double-spaced pages. You must obtain the approval of the instructor regarding your choice of topic.
- **A final exam:** 60%.
- **SPECIAL PROJECTS:** If anyone is interested in pursuing a special project of interest on a topic related to risk management, I am prepared to evaluate that project for an agreed upon percentage of your final grade.

SCHEDULE:

JANUARY 13	THE BASIC OF UNCERTAINTY, RISK AND RISK MANAGEMENT
JANUARY 20	MLK DAY – NO CLASSES
JANUARY 27	CONTRACTS AND INSURANCE
FEBRUARY 3	FINANCIAL INSTRUMENTS
FEBRUARY 10	RISK MANAGEMENT: CRISIS AND RESPONSE
FEBRUARY 17	OPERATIONAL RISKS
FEBRUARY 24	STRATEGIC RISKS
MARCH 3	THE CHALLENGES AHEAD

ABBREVIATIONS:

JEP = Journal of Economic Perspectives, available free online;

SIGMA = a journal published quarterly by Swiss Re Corporation, available free online;

ARTICLES marked “available online” can be found free of charge;

HBS = Harvard Business School cases are available for purchase online.

READINGS AND CASE STUDIES:

(1) THE BASICS OF UNCERTAINTY, RISK AND RISK MANAGEMENT

READINGS:

- Bernstein text
- Hampton text
- Thaler, R. (2000) *From Homo economicus to Homo sapiens*. JEP, Winter 14(1)
- Haldane, A. (2012) *The dog and the frisbee*. Bank of England Paper. Available online.

- Slovic, P. et al. (2010) *Risk perception and affect*. Current directions in psychological science. Available online.
- Tschoegl A. (2003) *The key to risk management: Management*. Wharton Financial Institutions Center, Working paper. Available online.
- Lindsey, H. (2006) *20 Questions directors should ask about risk*. 2nd. Ed. CICA. Available online.
- Simkins, B & Ramirez, S. (2008) *Enterprise-wide risk management and corporate governance*. 39 Loyola University Chicago Law Journal, 571 – 594. Available online.
- Bhide, A. (2010) *The big idea: The judgment deficit*. Available online.
- Dali, A. et al. (2009) *ISO31000: The gold standard*. Strategic Risk. Available online.
- Gilboa, I. et al. (2008) *Probability and uncertainty in economic modeling*. JEP, Summer 22(3).

(2) CONTRACTS AND INSURANCE

READINGS:

- *Insurability and its limits*. Swiss Re, Sigma 4/2005
- *Non-life claims reserving*. Swiss Re, Sigma 2/2008
- Vigdor, J. (2008) *The economic aftermath of Hurricane Katrina*. JEP, Fall 22(4)
- Michel-Kerjan, E. (2010) *Catastrophe Economics: The National Flood Insurance Program*. JEP, Fall 24(4)
- *Commercial liability*. Swiss Re, Sigma 5/2009
- *Life insurance*. Swiss Re, Sigma 1/2012
- *Annuities*. Swiss Re, Sigma 3/2007
- *Credit insurance and surety*. Swiss Re, Sigma 6/2006
- *An introduction to reinsurance*. Swiss Re booklet.
- *The role of indices...Swiss Re*, Sigma 04/2009
- *Insuring commercial risks...Swiss Re*, Sigma 05/2012
- *Lloyd's of London: Does it have a future*. RECORD, Volume 22, No. 1*Marco Island Spring Meeting, May 29–31, 1996, Session 32PD
- *Securitization*. Swiss Re, Sigma 7, 2006

CASE STUDIES:

- *Petrolera Zuata, Petrozuata C.A.* HBS 9-299-012 purchase.
- *BP's Macondo: Spill and response*. HBS 9-711-021 purchase.
- *Nephila: Innovation in catastrophe risk insurance*. HBS Case 9-206-130 purchase.

(3) FINANCIAL INSTRUMENTS

READINGS

- Duffie, D. (2010) *The failure mechanics of dealer banks*. JEP, Winter 24(1).
- Stulz, R (2010) *Credit Default Swaps and the credit crisis*. JEP, Winter 24(1).
- Coval, J. et al (2009) *The economics of structured finance*. JEP, Winter 23(1)
- White, L. (2010) *Markets: The credit rating agencies*. JEP, Spring 24(2).
- Omarova, S. (2013) *The merchants of Wall Street: Banking, Commerce, and Commodities*. Minnesota Law Review, 98. Available online.

- Stulz, R. (2004) *Should we fear derivatives*. JEP, Summer 18(3).
- Jorion, P. (2000) *Risk management lessons from Long Term Capital Management*. Working paper. Available online.

CASE STUDIES:

- *The fall of Enron*. HBS 9-109-39 purchase.
- *The Barings collapse A and B*. Two HBS cases purchase.

(4) RISK MANAGEMENT: CRISIS AND RESPONSE

READINGS:

- Reinhart, C.M. et al. (2008) *This time is different: A panoramic view of eight centuries of financial crises*. (April) NBER Working paper. Available online.
- Lo, A. (2011) *Reading about the financial crisis: A 21 book review*. Working paper online.
- Poszar, Z. et al. (2010) *Shadow banking*. Federal Reserve Bank of New York Staff Report No. 458, July 2010. Available online.
- Written presentation by Richard Koo, Nomura Securities at the Institute for New Economic Thinking, April 2010 *The age of balance sheet recessions: What post-2008 U.S., Europe and China can learn from Japan 1990 – 2005*. A video to accompany the presentation is available at YouTube *Richard Koo at INET Inaugural Conference*. Approximate time 25 minutes.
- Davis Polk (2010) *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010*.
- Derman, E. (2011) *Metaphors, models & theories*. Available on the Web.

CASE STUDIES:

- *Lehman Brothers and Repo 105*. HBS 9-112-050 purchase.
- *AIG: Blame for the bailout*. HBS case purchase.

(5) OPERATIONAL RISKS

READINGS

- Wise, J. (2011) *What really happened aboard Air France 447*. Popular Mechanics. Available online.
- Judge Rothstein, B. (2008) *Perspectives on asbestos litigation: Keynote address*. Available online.
- Osnos, E. (2011) *Letter from Fukushima: The fallout*. The New Yorker, October 17, 2011. Available online.

CASE STUDIES:

- *Merck: Managing Vioxx A*. HBS 9-109-080 purchase.
- *Societe General (A): The Jerome Kerviel affair*. HBS 9-110-029 purchase.

(6) STRATEGIC RISKS

CASE STUDIES:

- *Random House: Shifting to e-books in a globalized world.* HBS purchase.
- *McKesson.* HBS 9-312-022 purchase.
- *Petrobras in Ecuador (A).* HBS – 9- 309-107 purchase.
- *What happened at Citigroup (A) and (B).* HBS 9-310-004 and 9-312-018 purchase.
- *AOL Time Warner (B): Recognition of good will impairment.* HBS purchase.

(7) THE CHALLENGES AHEAD

READINGS:

- Buitter, W. et al. (2010) *Sovereign debt problems in advanced industrial countries.* Citibank Global Economics View, April 26, 2010. Available online.
- Eichengreen, B. (2012) *When currencies collapse.* Available online.
- Wolf, Martin (2006) *Debt becomes us?* American Interest. Available online.
- Bernstein, P. (2009) *The moral hazard economy.* Available online.
- Schwarcz, S. (2010) *Leverhulme Lecture: The future of securitization.* Oxford University. Available online.

CASE STUDIES:

- *KPMG (A): A near-death experience.* HBS 9-408-073 purchase.