

FIN 7400: Financial Risk Management
Spring 2009
Monday & Wednesday, 3:10 – 4:30, 215 Tureaud
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Instructor: Don M. Chance

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Course home page: Moodle

Office hours: Monday, 1:30 – 2:30 & Thursday, 1:30 – 3:00; I am available most every afternoon and can meet in the mornings if you make an appointment.

Catalog Description: *Risk management of corporations, financial institutions, governments, and non-profit organizations; characteristics of financial contracts and markets and applications of these contracts to risk management problems; the value of risk management, measuring exposures, financial contracts for managing risk, the enterprise risk management industry, and the accounting and regulatory framework. Market and credit risks are the primary focus, but some attention is also given to operational and other sources of risk.*

In this course we will examine different types of domestic and global financial risks facing corporations and financial institutions. The focus, however, is mostly on risk management in corporations, though much of what you learn will apply in financial institutions, government agencies, and nonprofit organizations. These risks arise from changes in interest rates, foreign currency rates, commodity prices and stock prices. The emphasis is on interest rate and foreign currency risk. The course takes the approach of identifying the risks and developing the financial contracts, often in the form of derivatives, that provide solutions. The course is taught at an applied, non-mathematical level. Several cases will be used to put you in the position of a firm with a financial risk management problem.

Here are some quotes from previous students in this class:

“Just thought you might want to know that yet again, I am using the skills I learned in your class.”

“I enjoyed your class thoroughly. I thought it was one of the most informative and useful courses I took during my graduate studies. ... I am working as a Financial Analyst for *****. It is going very well so far and just today I was doing some work with swaps for a client.”

“I recently accepted a position at a valuation and forensic accounting firm and sure enough swap valuation has already come up.”

“It’s probably the most beneficial class I have taken in college.”

What You Will Get from this Course

- A solid introduction to the practice of managing financial risk
- Knowledge of when to use risk management tools properly and how to avoid disaster
- A basis for further study

What You Need for this Course

- Completion of the first year of the MBA program or equivalent coursework.
- One graduate level course in finance or an equivalent course as approved by me
- The usual technology resources (calculator, email, spreadsheet, etc.)

Second-year MBA students and students in the MS program in finance, accounting, or economics have sufficient preparation. *First-year MBA students cannot take this course if they are currently taking BADM 7090. Students in non-business fields must see me for approval before continuing in this course.*

Course Materials

Text: There is no formal textbook. Your text, as such, is a set of lecture notes in pdf format and Powerpoint slides, both of which are available from the Moodle site. You do have a secondary book, which is a small casebook:

Risk Takers: Uses and Abuses of Derivatives, 2nd ed. by John Marthinsen. We will be using the cases called Orange County, Proctor and Gamble, and Barings. You will also need to download some appendices from the book web <http://www.aw-bc.com/marthinsen/>

Also you should purchase at the bookstore the following case:

State of Wisconsin Investment Board (CaseNet)

I cannot emphasize how important it is to get these cases now. Do not wait until shortly before the case is due. You might find them not available. I will not be able to help you obtain these materials if you wait until the last minute.

These cases will involve in-class discussion. Handouts containing guidelines, questions and issues are available on the Moodle site. You are responsible for questions from the cases and their appendix materials on the mid-term and final exams.

Teaching Notes: These are short write-ups. You have two assigned for this course, TN97-12 and TN01-01 (& TN97-01 and TN07-01, which are optional), which are available from links on Moodle.

Exams

There will be one in-class mid-term exam of 1 hour, 20 minutes and one comprehensive final exam. The exams are closed-book, but you can bring to the exam one 8 ½ x 11 sheet of paper with anything you want written on it (both sides). Also bring a calculator, but use of the text storage feature will be violation of the code of the Code of Student Conduct (see below).

If you miss the exam, you must have a legitimate, reasonable, and verifiable excuse and must inform me in advance. If you miss the exam with an accepted excuse, your final will count for your mid-term exam. Otherwise, you will get a zero.

Your Grade: the Universal Question

Your grade is determined as follows:

Mid-term exam	100
Final exam	100
Group project	100
Class participation*	<u>100</u>
	400

*Class participation will include specific in-class case discussions and general class participation on non-case days. If you miss class when a schedule case is discussed, you can make it up by turning in a short written analysis of the case. This offer is, however, not to be abused. It is not intended as an alternative to attending class on case discussion days but is designed to accommodate legitimate absences.

I have a simple grading system. Pretend the course has only two grades, a 100 point mid-term and a 100 point final. Assume an A is 90 on the mid-term and 85 on the final. That means you would need 90 + 85

= 175 points to get an A. Repeat that procedure to determine the minimum number for a B, C, D, etc. I do not compute averages. A 90 and an 85 may average to 87.5, but I do not look at averages. My system will produce the same results as one based on averaging and it cuts out one step, calculation of the average.

There are no possibilities for extra credit.

Group Project

The class will be divided into teams of (hopefully) no more than five. Each team will create a fictional company, write a report, and make a 20-30 minute Powerpoint presentation in the SMART Lab that will make the case to the Board of Directors that the company faces certain risks and should implement a risk management program. A few days before the presentation, one of the other teams will be assigned the role of the Board of Directors. That team will be given advance information on the company, will be required to ask questions during the presentation, and will provide an evaluation. The report will be graded on the basis of the oral presentation, the written report, the evaluation of the “Board,” and the evaluations of the team members by each other. Each group will be required to turn in the presentation and report at the same time. A write-up with more detail is available on the Moodle site.

Note: Before writing anything, read “The 10 Most Common Writing Mistakes,” which is available at <http://www.bus.lsu.edu/academics/finance/faculty/dchance/Instructional/TenMistakes.htm>.

Do not make these mistakes, and your writing will be better, both in here and on your job.

Class Schedule and Assignments

The course is divided into four parts:

- I: Concepts of Risk Management
- II: Tools and Applications of Market Risk Management
- III: Managing Non-Market Risks
- IV: Implementing a Risk Management Program

The week-to-week schedule is as follows. See the item below the table for the assigned readings for each unit. This schedule is subject to change. I expect that we will be a little ahead of the schedule but cases and the exam are expected to be on the scheduled dates.

Date	First Half Material	Second Half Material
M 1/12	Course Overview	Unit IA: What is Risk? & TN07-01 (optional)
W 1/14	Unit IA (continued)	Unit IA (continued)
M 1/19	No class (MLK holiday)	
W 1/21	Unit IB: Basic Concepts of Financial Risk	Unit IB (continued)
M 1/26	Unit IC: The Risk Management Environment	Unit ID: The Value of Risk Management
W 1/28	Unit ID (continued)	Unit IIA: Basic Concepts in Measuring Risk; also read TN01-01: Zero Coupon Bond Prices and Interest Rate Quotation Conventions
M 2/2	Unit IIA (continued)	Unit IIA (continued)
W 2/4	Unit IIA (continued)	Unit IIA (continued)
M 2/9	Unit IIA (continued)	Unit IIB: Forward and Futures Contracting
W 2/11	IIB (continued)	Unit IIB (continued)
M 2/23	Orange County case (Marthinsen, Ch. 6 and	Appendices 6.1, 6.2, 6.3, & 6.4 online)
W 2/25	Unit IIB (continued)	Unit IIC: Swap Contracting
M 3/2	Unit IIC (continued)	Unit IIC (continued)
W 3/4	Unit IID: Option Contracting; also read	Unit IID (continued)

	TN97-12: Calculating the Black-Scholes Value and, if you feel it necessary, TN97-01: The Normal Probability Distribution	
M 3/9	Proctor and Gamble case (Marthinsen, Ch. 5 and Appendices 5.1, 5.2, 5.4, & 5.5 online)	
W 3/11	Unit IID (continued)	Unit IID (continued)
M 3/16	Exam	Exam
W 3/18	Unit IID (continued)	Unit IID (continued)
M 3/23	Unit IID (continued)	Unit IIIA: Credit Risk
W 3/25	Barings case (Marthinsen, Ch. 7)	
W 3/30	Unit IIIA: Credit Risk	Unit IIIA: Credit Risk
M 4/1	Unit IIIA: Credit Risk	Unit IIIB: Operational and Other Risks
M 4/6	No class (Spring Break)	
W 4/8	No class (Spring Break)	
M 4/13	Unit IVA: Accounting and Disclosure of Risk Management Activity ; also download Appendix 5.3 of Marthinsen and UPS 2007 Annual Report (see below)	IVB: Corporate Governance and Risk Management
W 4/15	IVB: Corporate Governance and Risk Management	IVB: Corporate Governance and Risk Management
M 4/20	State of Wisconsin Investment Board case	
W 4/22	Group Project Presentations	Group Project Presentations
M 4/27	Group Project Presentations	Group Project Presentations
W 4/29	Group Project Presentations	Group Project Presentations
W 5/6	Final Exam (5:30 – 7:30 pm)	

Unit IVA: The UPS 2007 Annual Report is available at

<http://www.shareholder.com/ups>

We will use the sections called “Market Risk,” pp. 37-38, and “Note 15: Derivative Instruments and Risk Management,” pp. F41-F43.

Practice Problems

This course contains a mixture of conceptual and quantitative material. Students typically require practice problems for the quantitative material. There are practice problems at the end of each unit of the lecture notes. Working these problems will help you prepare for the exams.

Conduct Expectations

Cell Phones. Cell phones are one of the greatest conveniences but one of the greatest annoyances as well. A classroom setting requires uninterrupted concentration. Your cell phone must be turned off or on vibrate in class unless you would prefer to write an essay on the annoyances of cell phones.

Dress Code. You are expected to adhere to the Flores MBA program dress code. I will not enforce this policy, but you should view it as a sign of your maturity and professionalism. If you are not in the MBA program, please use good judgment on this matter.

Classroom behavior. Consider a class meeting to be a business meeting. Participation is important. Professional and respectful behavior toward your classmates and me is expected. Although it is common in the business world to arrive “fashionably late” for or leave early from a meeting, it is not acceptable in this class, barring an outright emergency, for which you should clear it with me. I also expect the utmost in professional behavior at all times, which means that whining, complaining, and arguing with me are inappropriate and immature. Treat me as you would your boss.

Integrity. My heavy emphasis on this matter is motivated by the fact that there has been cheating in graduate courses in business here and where I previously taught. According to a study released in 2008, 56 percent of business school students admit to having cheated, making business the professional school with the most (admitted) cheating. Enron, Arthur Andersen, WorldCom, Tyco, HealthSouth, Refco, ... These names have become synonymous with corporate scandals of the last few years. Regardless of whether these companies and its executives are legally guilty, the hint of dishonesty has stained all involved and the financial world as a whole. Moreover, we cannot expect a financial system to function properly without honesty. If you cheat as graduate business students, you will cheat as business leaders. Others will cheat when dealing with you. Resolve to be honest. Here are a few things to remember about people who cheat:

People who cheat in school set an example for their children. Do you want your children to cheat?

People who cheat in school set an example for the employees who work under them. Do you want your employees to cheat?

Some of today's doctors and lawyers cheated in school. Are you ok with that?

If you have any questions about the LSU Code of Student Conduct, consult the division of Judicial Affairs at

<http://appl003.lsu.edu/slas/judicialaffairs.nsf/index>

Remember, if you lose your honor, it is almost impossible to get it back.

Other Items

Students with special dispensation from the Office of Disability Services should see me immediately to discuss your situation. I will be glad to work with you to help you, but I expect you to be proactive in a very timely manner.

A class session is a private meeting between the students in this class and me. If you take this course, you are agreeing not to use any electronic recording device in class unless you receive permission from me.

About Me

Since I am going to ask you some things about yourself, here is some information about me.

I was born in and grew up in Alabama and after obtaining my B.S. from the University of Montevallo in Alabama and MBA from Ole Miss, I spent four years in banking for a predecessor of Regions Bank. I received my PhD from LSU and joined the Virginia Tech faculty in 1980. I spent 23 years at Virginia Tech in Blacksburg, interrupted only by a semester sabbatical at the University of North Carolina at Chapel Hill and a semester at the Virginia Tech Northern Virginia Graduate Center near Washington, DC. (My allegiance is split between LSU and Virginia Tech.) My position here is called the William H. Wright, Jr. Endowed Chair for Financial Services. My specialization is risk management, and I teach an MBA elective on this subject (FIN 7400) in the spring term. My research is on derivatives and risk management, and I have authored three books on this subject. I also hold the CFA charter. I consult and conduct training programs for a number of companies, organizations, and law firms and am frequently quoted in the media. I recently began working as an advisor to IndexIQ, a New York-based ETF firm for whom I help develop new financial products. My web site is <http://www.bus.lsu.edu/academics/finance/faculty/dchance/>.

First Assignment

Send me an email (dchance@lsu.edu) with the following information as a one-page Word file attachment. Name the file "yournameFIN7400". Give your answer to each item below with the item number shown (do not type the questions). Insert a photo somewhere in the file. Do not send the photo as a separate attachment. If you do not follow these instructions, you will have to re-do it.

Except for obvious questions I have provided my own answers in italics. (Some of this information is in "About Me" above.)

1. Your name (what you want to be called by) and hometown (or wherever you say you're from)
2. Previous degrees held (degree, major field, university, year awarded)
3. Previous work experience
4. The program you are in and any specialty or concentration
5. Why you chose LSU for your graduate program (*I came here for graduate school because I wanted to stay in the south and also my wife was working for a company that offered her a transfer to Baton Rouge. Unfortunately, they closed down the office about a year after we got here.*)
6. Your current job (employer, title, responsibilities)
7. Your career plans
8. The name of the last book you read other than a textbook or a book required for a course. "A Bold Fresh Piece of Humanity" by Bill O'Reilly.
9. Something interesting or unusual about yourself. This could be an unusual experience in life, a hobby, an unusual goal, or just anything out of the ordinary you're willing to tell me about yourself. *I play guitar (any guitarists should check out my guitar page on my web site) and own six of them. I also play banjo fairly well, some piano, and a little mandolin. Three other business professors and I have recently started a band. Another unusual item would probably be that I have a large collection of Madonna memorabilia, although I am not much of a fan or hers anymore. I am also a cancer survivor (13 years this summer).*
10. A statement indicating that you have read the syllabus, agree to its terms, and pledge to abide by the LSU Code of Student Conduct.

Remember: Attach your photo. And do not send a separate file attachment. Put these answers and your photo directly in the email.

This assignment is obviously not hard and will not take much time. Do it before the next class. Delays will affect your class participation grade.