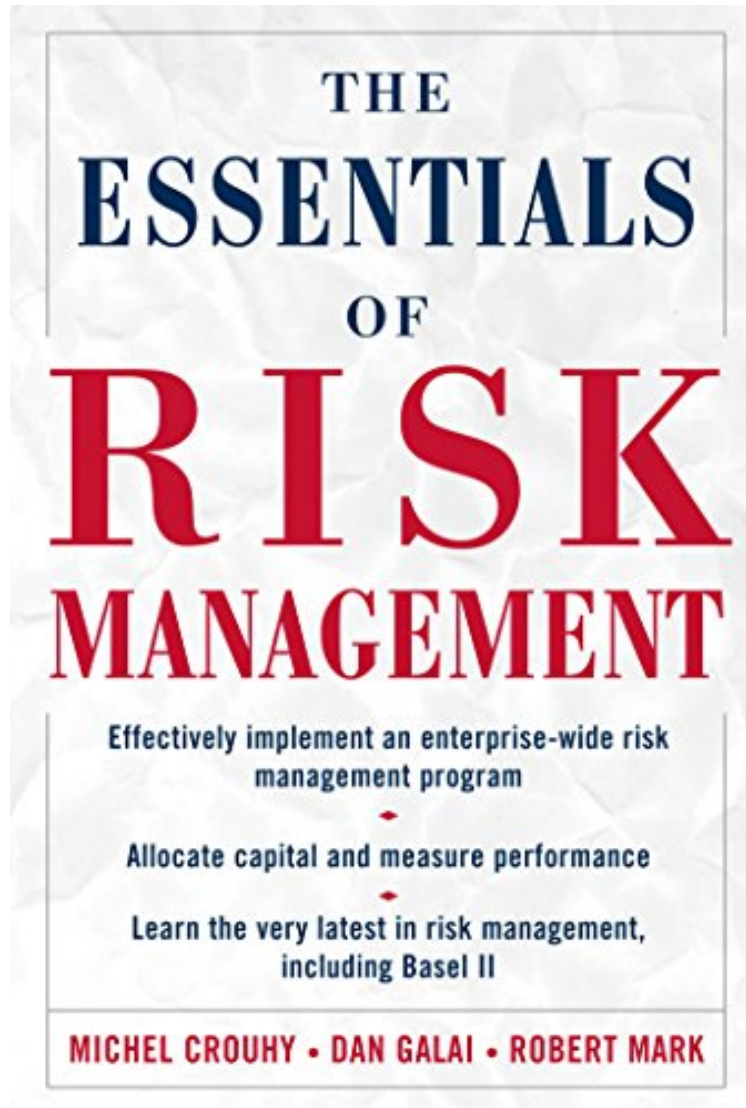


# The Essentials of Risk Management: The Definitive Guide for the Non-risk Professional

*Michel Crouhy, Dan Galai, Robert Mark*  
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**Michel Crouhy, Dan Galai, Robert Mark : The Essentials of Risk Management: The Definitive Guide for the Non-risk Professional** before purchasing it in order to gauge whether or not it would be worth my time, and all praised The Essentials of Risk Management: The Definitive Guide for the Non-risk Professional:

0 of 0 people found the following review helpful. Nice Post-Financial Crisis UpdateBy Familyman35Excellent update to the previous version with lessons learned from the 2008 financial crisis. As with earlier editions, this is written for an audience with genuine interest risk management primarily focused on financial firms. Well written, especially for those with some working knowledge of the subject. While not a textbook, it has gotten large and may

not be the best choice for a curious first timer. 61 of 65 people found the following review helpful. An excellent introduction by Dr. Lee D. Carlson. This book provides an introduction to the field of risk management for readers who do not yet want to get deeply involved in the mathematical formalism that is typically used. The authors wrote the book so that it is "accessible to everyone", and they have done a fine job. Those readers who need a more quantitative treatment will have to consult another book or the vast research literature on the subject. Risk management, as they see it, is an attempt to estimate both the 'expected' losses and the 'unexpected' losses, and being able to differentiate between these two concepts goes to the core of the subject. Thus the book emphasizes the "intuition" behind risk management, and not the formalism. However, one must not conclude from this that "intuition" and "formalism" are distinct, and the belief that they are has resulted in a lot of confusion (and financial losses) in recent years. The authors clearly do not believe that they are, but have merely emphasized "intuition" from a pedagogical point of view. The authors classify risk into eight categories, namely market, credit, liquidity, operational, legal and regulatory, business, strategic, and reputation risk. Financial risk, as they see it, is composed of two of these, namely market and credit risk. Their discussion of corporate risk management is very interesting, in that it begins with the observation first made almost forty years ago that the value of a firm is not altered solely by financial transactions. This is due to their assumption of the perfect market hypothesis, which effectively suppresses the ability of the firm to gain significant advantages over an individual investor. Therefore with this assumption a firm should not concern itself with risks outside of the ones that all other firms face. This is an interesting conclusion, particularly in the context of using hedging via derivatives, as it implies that it cannot compete with ordinary self-insurance, due to the presence of transaction costs. The authors discuss in fair detail why the perfect market assumption is faulty, and therefore why managing risk with hedging is a viable strategy. The regulatory environment, particularly in the banking industry, has enormous ramifications for risk management, as the authors discuss in the book. This is due in part to the Basel Accords of 1988 and 1996, and Basel II which is due to be in place at the end of 2007. The Basel accords are essentially a standardization for capital reserves, defining a 'assets-to-capital' multiple and a 'risk-based capital' ratio. The authors review the 1988 Accord and discuss the elementary relationships involved, including the 'Cooke ratio' and how to obtain the credit equivalent for the off-balance-sheet exposures. They also discuss the reasons for the 1996 amendment, which essentially were the result of the new trading activities that banks were indulging themselves in. It would have been interesting if the authors had included a (historical) discussion on the efficacy of the Basel Accords in suppressing banking failures. They do mention the fiasco with Barings Bank, claiming that its demise would have been averted if it were prohibited from racking up huge exchange-traded futures positions. This is certainly true, but any regulation needs to be validated by historical data, to the extent that this is possible, and this requires of course tracking of the financial institutions that are under the umbrella of the regulation. In this regard though, the authors do view bank regulation as a 'research lab' for risk management, implying that they are aware of the need for validation of any regulations that are actually put in place. It will be fascinating therefore to see the impact of the new Basel II accords when they become active, and indeed observe, if possible, any 'regulatory arbitrage' that occurs. This also brings up the question of how to assess the quality of the risk management strategies of a particular financial institution. The authors spend a little time discussing this, with one of them referring to a method analogous to credit scoring. No book on risk management could be complete without discussion of academic research on the topic, for the reason that much of this research has found practical application and has greatly influenced portfolio management and risk valuation. The authors review four theoretical models, namely modern portfolio theory, the capital asset pricing model, the Black-Scholes option-pricing model, and the Modigliani-Miller theory of corporate finance. Even though the discussions are very short, one has to admire the authors' ability to avoid complicated mathematics in discussing all of these theories without sacrificing clarity. The more mathematically-mature reader may perhaps be annoyed with the omission of mathematical formalism, but a natural question that might arise for such a reader is whether or not risk can indeed be put in a general axiomatic framework that will encompass all of its different manifestations, such as credit risk, operational risk, etc. Such a framework would allow a complete mathematical characterization of risk, and would allow various general and quantitative statements to be made about it. Due to the extent of mortgage portfolios in the United States at the present time, and due to the sensitive dependence of their values on interest rates, the authors spend a fair amount of time discussing interest-rate risk and how to hedge it with derivatives. Thus they speak of the 'sensitivity' of financial instruments to certain risk factors, and study the case of fixed-income products via the 'DV01' risk measure, which is the change in value of a security after a change in interest rate of 1 basis point. This measure gives a 'first-order' approximation to the change in yield, but the authors show how to obtain a 'second-order' approximation using the 'convexity' adjustment. For complex portfolios, the most popular method for risk management has been the value-at-risk or VAR, and so it is not surprising that the authors devote an entire chapter to it in the book. The authors view it as a more sophisticated method because of its ability to deal with volatilities and correlations. However, they point out that its efficacy is restricted to relatively short time scales and under 'normal' market conditions. The fiasco at LTCM (Long Term Capital Management) is discussed as an example of the failure of VAR to measure risk over long time scales and under abnormal market conditions. They do not however give any detailed evidence for this claim, but a perusal of the research literature (surprisingly rather slim) reveals that LTCM made

"major" errors in terms of their risk management, if viewed from the standpoint of VAR. This still leaves open the question as to whether it made "major" errors from the standpoint of some other method for measuring and evaluating risk that is possibly radically different from VAR. 0 of 0 people found the following review helpful. Five Stars By dan dunifergood book

Risk management is no longer confined solely to risk management specialists. Stakeholders ranging from employees to investors must understand how to quantify the tradeoffs of risk against the potential return. The failure to understand the essential nature of risk can have devastating consequences. Globally renowned risk and corporate governance experts Michel Crouhy, Dan Galai, and Robert Mark have updated and streamlined their bestselling professional reference Risk Management to introduce you to the world of risk management without requiring you to know the intricate formulas and mathematical details. The Essentials of Risk Management is the first book to make even the most sophisticated risk management approaches simultaneously accessible to both risk and non risk professionals. It will help you to: Increase the transparency of your risk management program to satisfy shareholders, employees, regulators, and other important constituencies Keep on top of the continuing evolution of best-practice risk policies and methodologies and associated risk infrastructures Implement and efficiently communicate an organization-wide Enterprise Risk Management (ERM) approach that encompasses market, credit, liquidity, operational, legal and regulatory, business, strategic and reputation risks Navigate thorny areas including risk policies, risk methodologies, economic capital, regulatory capital, performance measurement, asset-liability management, and more Efficiently allocate limited corporate resources to comply with the new generation of risk regulation and corporate governance regulation As a non-risk professional or board member, you are being called on more than ever before to make sophisticated assessments of your organization's risk exposures as well as play a critical role in its formal risk management process. The Essentials of Risk Management tells you what you need to know to succeed in this challenging new environment.

From the Back Cover Learn powerful corporate governance and risk strategies to control both financial and non financial risks Risk is an integral component of every forward looking transaction. Now more than ever before, it is essential to understand the multiple dimensions of risk as well as how to best manage risk to gain a competitive advantage. The Essentials of Risk Management offers a strikingly clear picture of how to construct a superior risk management program. The Essentials of Risk Management provides you with a practical, non-ivory tower approach that is necessary to effectively implement a superior risk management program. Written by three of the leading figures with extensive practical and theoretical experience in the global risk management and corporate governance arena, this straightforward guidebook features such topics as: Corporate governance, compliance and risk management How to implement integrated risk management Measuring, managing and hedging market, credit (retail and corporate), operational and model risk The roles of board members and senior management in managing risk As corporate scandals continue to make headlines and erode shareholder confidence, risk becomes everyone's responsibility. The Essentials of Risk Management will empower both the technical and non technical reader with the essential knowledge necessary to understand and manage risks in any corporate or economic environment. About the Author Michel Crouhy, Ph.D., is the head of research and development and financial engineering at IXIS Corporate and Investment Bank (Groupe Caisse d'Epargne). He has the bankwide oversight on all quantitative research and the development of new products and applications supporting the trading and structuring businesses. Dan Galai, Ph.D., is the Abe Gray Professor of Banking and Finance at The Hebrew University. He is a co-CEO of Sigma PCM, an investment banking firm. Galai has consulted for the Chicago Board Options Exchange and the American Stock Exchange, and for many major banks and corporations. Robert M. Mark Ph.D., is the Chief Executive Officer of Black Diamond, which provides corporate governance, risk management consulting, and transaction services. He is the chairperson of The Professional Risk Managers' International Association's (PRMIA) Blue Ribbon Panel. He was awarded the Financial Risk Manager of the Year by the Global Association of Risk Professionals (GARP).