

Assignment 1

The Risk Management Environment

Educational Objective (EO)

Describe risk management and the risk management environment.

Instructions

Activity 1—Describing Risk and Risk Management

Small Group Activity Followed by Large Group

Discussion

Divide participants into groups and ask the groups to answer the questions in **Activity 1—Describing Risk and Risk Management**. Allow 3-5 minutes for the groups to complete their answers.

Post a flipchart page at the front of the room and ask one group to write their answer to the first question on the flipchart page. Ask the other groups to comment on or expand on that answer before continuing to the next question.

Debrief:

Review the answers with the groups.

Activity 1—Describing Risk and Risk Management

Answer each of the following questions.

Topics
1. In 25 words or less, describe what the term "risk" means to you.
2. The risk management environment has changed in the last 20 years from an insurance-oriented approach to a more holistic approach that attempts to manage all types of risks facing an organization. What are the principle drivers that have led to this change in emphasis?
3. Identify five types of risk facing businesses face today that either did not exist or were relatively unimportant 10 years ago.

Benefits of Risk Management

Educational Objective (EO)

State the benefits of risk management for an organization and the economy.

Instructions

Activity 1 — Describing the Benefits of Risk Management for an Organization and the Economy

Group Activity Followed by Large Group Discussion

Divide participants into small groups (teams) and provide each group with a different colored marker. Label two flipchart pages with the benefits of risk management for an organization and the economy:

- Benefits: Organization
- Benefits: Economy

Post the flipchart pages on the wall or whiteboard. The game part of the activity is a “round robin tournament.” Call on a team participant in turn to write a fact below either of the benefits for organization or the economy. For example, a team participant might write “reduce long-term overall cost of risk” on the “Benefits: Organization” flipchart. You might need more than one sheet of paper for some of the steps in the process.

Team participants cannot duplicate what someone else has written. If a team participant cannot come up with anything to write, that team participant is eliminated from the tournament. Continue in this manner until you have only one team left and you can declare a winner, or count the responses from each team and the team with the most responses wins.

Debrief:

If necessary, review the answers provided with the class.

Risk Management Objectives and Goals

Educational Objective (EO)

Summarize various objectives and goals for managing risk.

Instructions

Activity 1 — Summarizing Risk Management Objectives and Goals

Group Activity Followed by Large Group Discussion

Divide participants into four groups and provide each group with flipchart paper if possible. Assign each group a set of typical goals for managing risk:

Group 1	<ul style="list-style-type: none"> • Tolerable uncertainty • Legal and regulatory compliance
Group 2	<ul style="list-style-type: none"> • Survival • Business continuity
Group 3	<ul style="list-style-type: none"> • Earnings stability • Profitability and growth
Group 4	<ul style="list-style-type: none"> • Social responsibility • Economy of risk management operations

Ask participants to summarize their assigned goals for managing risk. In addition, you might ask one group to summarize the risk management objectives.

Debrief:

Review the groups' summaries of their assigned risk management goals with the class by calling on each group leader in turn.

Basic Risk Measures

Educational Objective (EO)

Explain how basic risk measures apply to the management of risk.

Instructions

Activity 1 — Describing Basic Risk Measures

Large Group Activity—Tic-Tac-Toe Game

Using a flipchart or whiteboard, draw a table with nine squares. Divide participants into two teams—Team X and Team O. Ask each team to select a leader who will provide the final answer. Select a team to begin the game.

The game entails reading a description. The team then needs to state the answer. Team members can “briefly” discuss their answer, answer is provided by team leader. If correct, they get to select a square. If the answer is incorrect, the question goes to the other team. If the team correctly answers, they get the square.

Continue playing the game until the team gets three in a row, or five squares, and wins the round.

Alternative: Individual Activity followed by Large Group Discussion

Ask participants to complete the questions in **Activity 1—Describing Basic Risk Measures**.

Debrief:

Review the answers with the group.

Activity 1 — Describing Basic Risk Measures

Questions	Answers
1. Effective risk management should _____ risks and the results of risk management efforts to the extent possible.	
2. What is volatility?	
3. What is the mathematical principle stating that as the number of similar but independent exposure units increases, the relative accuracy of predictions about future outcomes (losses) also increases?	
4. What is a risk management strategy that can reduce the risk of correlation?	
5. How does ongoing measurement of an organization's risk management program benefit an organization?	
6. This is a measure that should be applied to the management of an organization's overall risk portfolio	
7. This is any condition that presents a possibility of gain or loss, whether or not an actual loss occurs.	
8. What is the effect of correlation on an organization's risk?	
9. This is the measure of the degree to which an occurrence could positively or negatively affect an organization.	

Answers to Activity 1 — Describing Basic Risk Measures

Questions	Answers
1. Effective risk management should _____ risks and the results of risk management efforts to the extent possible.	Quantify
2. What is volatility?	Frequent fluctuations, such as in the price of an asset.
3. What is the mathematical principle stating that as the number of similar but independent exposure units increases, the relative accuracy of predictions about future outcomes (losses) also increases?	Law of large numbers
4. What is a risk management strategy that can reduce the risk of correlation?	Diversification
5. How does ongoing measurement of an organization's risk management program benefit an organization?	Provide benchmarks to monitor and evaluate the success of an organization's risk management program.
6. This is a measure that should be applied to the management of an organization's overall risk portfolio	Correlation
7. This is any condition that presents a possibility of gain or loss, whether or not an actual loss occurs.	Exposure
8. What is the effect of correlation on an organization's risk?	Correlation is a measure that should be applied to the management of an organization's overall risk portfolio. If two or more risks are similar, they are usually highly correlated. The greater the correlation, the greater the risk.
9. This is the measure of the degree to which an occurrence could positively or negatively affect an organization.	Consequences

Risk Classifications

Educational Objective (EO)

Explain how the following classifications of risk apply and how they help in risk management:

- Pure and speculative risk
- Subjective and objective risk
- Diversifiable and nondiversifiable risk
- Quadrants of risk (hazard, operational, financial, and strategic)

Instructions

Activity 1 — Describing Risk Classifications and Quadrants of Risk

Individual Activity Followed by Large Group Discussion

Ask participants to complete the questions in **Activity 1—Describing Risk Classifications** by selecting the correct risk classification for each question.

In the appropriate column, use the first letter of the classification to indicate the type of risk. For the quadrants of risk, use the first letter of the risk quadrant (H=hazard, O=operational, F=financial, and S=strategic). *For example*, for the statement “A chance of loss or no loss, but no chance of gain.” The participant would identify the risk as “Pure and Speculative,” and would then enter a “P” to indicate that it was “pure risk.”

Alternatively, this activity could be assigned as pre-work. If used as an assignment, have participants come prepared to share their answers.

Debrief:

Reconvene the large group and ask for volunteers to share their answers. After reviewing the answers, engage the participants in discussion using these questions:

- How can classifications help with assessing risks?
- How does classification help with the administrative function of risk management?
- What is the classification of hazard and operational risks?
- What is the classification of financial and strategic risks?
- Explain the difference of focus between classifications of risk and the four quadrants of risk.

Activity 1 — Describing Risk Classifications and Quadrants of Risk

Questions	Answers			
	Pure and Speculative	Subjective and Objective	Diversifiable and Nondiversifiable	Quadrants
1. This type of may be quite different from the actual underlying risk that is present.				
2. Although a credit risk is particularly significant for banks and other financial institutions, it can be relevant to any organization with accounts receivable.				
3. These risks arise from trends in the economy and society, including changes in the economic, political, and competitive environments, as well as from demographic shifts.				
4. The perceived amount of risk based on an individual's or organization's opinion.				
5. This risk is not highly correlated and can be managed through diversification, or spread, of risk.				
6. These risks fall outside the hazard risk category and arise from people or a failure in processes, systems, or controls, including those involving information technology.				
7. This risk is correlated—that is, their gains or losses tend to occur simultaneously rather than randomly.				
8. A chance of loss or no loss, but no chance of gain.				
9. Systemic risk is the potential for a major disruption in the function of an entire market or financial system.				
10. Uncertainty over the size of cash flows resulting from possible changes in the cost of raw materials and other inputs (such as lumber, gas, or electricity), as well as cost-related changes in the market for completed products and other outputs.				
11. This risk arises from property, liability, or personnel loss exposures and is generally the subject of insurance.				
12. A chance of loss, no loss, or gain.				
13. These risks arise from the effect of market forces on financial assets or liabilities and include market risk, credit risk, liquidity risk, and price risk.				
14. The measurable variation in uncertain outcomes based on facts and data				

Answers to Activity 1 — Describing Risk Classifications and Quadrants of Risk

Questions	Answers			
	Pure and Speculative	Subjective and Objective	Diversifiable and Nondiversifiable	Quadrants
1. This type of may be quite different from the actual underlying risk that is present.		S		
2. Although a credit risk is particularly significant for banks and other financial institutions, it can be relevant to any organization with accounts receivable.	S			
3. These risks arise from trends in the economy and society, including changes in the economic, political, and competitive environments, as well as from demographic shifts.				S
4. The perceived amount of risk based on an individual's or organization's opinion.		S		
5. This risk is not highly correlated and can be managed through diversification, or spread, of risk.			D	
6. These risks fall outside the hazard risk category and arise from people or a failure in processes, systems, or controls, including those involving information technology.				O
7. This risk is correlated—that is, their gains or losses tend to occur simultaneously rather than randomly.			N	
8. A chance of loss or no loss, but no chance of gain.	P			
9. Systemic risk is the potential for a major disruption in the function of an entire market or financial system.			N	
10. Uncertainty over the size of cash flows resulting from possible changes in the cost of raw materials and other inputs (such as lumber, gas, or electricity), as well as cost-related changes in the market for completed products and other outputs.	S			
11. This risk arises from property, liability, or personnel loss exposures and is generally the subject of insurance.				H
12. A chance of loss, no loss, or gain.	S			
13. These risks arise from the effect of market forces on financial assets or liabilities and include market risk, credit risk, liquidity risk, and price risk.				F
14. The measurable variation in uncertain outcomes based on facts and data		O		

Enterprise Risk Management

Educational Objective (EO)

Describe the concept of enterprise risk management (ERM).

Instructions

Activity 1 — Describing Enterprise Risk Management

Large Group Activity—Tic-Tac-Toe Game

Using a flipchart or whiteboard, draw a table with nine squares. Divide participants into two teams—Team X and Team O. Ask each team to select a leader who will provide the final answer. Select a team to begin the game.

The game entails reading a description. The team then needs to state the correct answer. Team members can “briefly” discuss their answer, answer is provided by team leader. If correct, they get to select a square. If the answer is incorrect, the question goes to the other team. If the team correctly answers, they get the square.

Continue playing the game until the team gets three in a row, or five squares, and wins the round.

Debrief:

Review the answers with the group.

Alternative: Individual Activity followed by Large Group Discussion

Ask participants to complete the questions in **Activity 1—Describing Enterprise Risk Management**.

Debrief:

Review the answers with the group.

Activity 1 — Describing Enterprise Risk Management

Questions	Answers
1. Defined by some as the discipline by which an organization in any industry assesses, controls, exploits, finances, and monitors risks from all sources for the purpose of increasing the organization's short- and long-term value to its stakeholders?	
2. What is the responsibility of the chief risk officer?	
3. In an ERM context, this is a combination of risks.	
4. Who are the stakeholders in an organization and who are the external stakeholders?	
5. An organization with a fully integrated ERM program develops this that to move information throughout the organization. It includes dialogue and discussions among the different units and levels within the organization.	
6. What are the three main theoretical concepts that explain how ERM work?	
7. What is perhaps the single largest impediment to successful implementation of ERM?	
8. What parties may be on a board risk committee?	
9. What is represented by the acronym COSO?	

Answers to Activity 1 — Describing Enterprise Risk Management

Questions	Answers
1. Defined by some as the discipline by which an organization in any industry assesses, controls, exploits, finances, and monitors risks from all sources for the purpose of increasing the organization's short- and long-term value to its stakeholders?	ERM
2. What is the responsibility of the chief risk officer?	The CRO's responsibility includes helping the enterprise to create a risk culture in which managers of the organization's divisions and units, and eventually individual employees, become risk owners.
3. In an ERM context, this is a combination of risks.	A portfolio.
4. Who are the stakeholders in an organization and who are the external stakeholders?	<ul style="list-style-type: none"> • Organization—employees, management, the board of directors, and shareholders • External—customers, regulators, and the community.
5. An organization with a fully integrated ERM program develops this that to move information throughout the organization. It includes dialogue and discussions among the different units and levels within the organization.	Communication matrix
6. What are the three main theoretical concepts that explain how ERM work?	<ul style="list-style-type: none"> • Interdependency • Correlation • Portfolio theory
7. What is perhaps the single largest impediment to successful implementation of ERM?	The traditional organizational culture with its entrenched silos
8. What parties may be on a board risk committee?	<p>May consist of:</p> <ul style="list-style-type: none"> • The full board • Audit committee, or a dedicated risk committee • Some public companies have formed an executive-level risk committee to assist the board in its risk oversight function
9. What is represented by the acronym COSO?	Committee of Sponsoring Organizations of the Treadway Commission