

education), a good portion of the book's first two sections will provide the foundations of derivatives study. Then, if time permits, the instructor can pick and choose from the array of advanced topics presented in the third section of the book.

The text balances the difficulties of writing about derivative securities. Many of the "introductory" derivatives texts in the market fall at two opposite ends of a spectrum. At one end, authors claim to be providing an introduction to the subject, but the presentation quickly resembles a dissertation on financial mathematics. The other end of the spectrum presents an overly abbreviated study of the complex issues that are an important part of the derivatives market. This text provides a good balance between these two extremes. The book initiates students to the subject of options and futures with an appropriate balance of fundamentals and rigor. In addition, the included specialized and advanced topics allow readers to gain further insight in the common application areas of currency and interest-rate risk. Anyone wanting to learn about derivatives will find the text a useful reference; and serious students of the area will find the author's presentation a firm foundation and helpful platform on which to pursue further studies.

*Operational Risk*, by Jack L. King, 2001, Chichester, England: Wiley.

Reviewer: James Kallman, School of Risk Management, Insurance, and Actuarial Science, St. John's University, New York City

This text is a nice review of managing financial risks for a bank. The author suggests that the book is appropriate for any organization and is written for those without prior knowledge of financial institution management. However, there is little that the nonfinancial institution manager can apply. Moreover, unless one is already familiar with the models and statistics presented in the text, the reading is quite rigorous. Compounding the pleasure is an assortment of typographical errors in the equations and illustrations. Finally, the author's style is different from the typical business style of writing. This difference frustrates the reader's ability to understand the models. One nice chapter does review error propagation (Chapter 10), but this chapter is intended to serve as an appendix or supplement to understanding the operational models. If you are a banker who already uses Extreme Value Theory (EVT) and Delta methodology, then you may find this a pleasant review.

In Chapter 1, the author asserts that financial firms pioneered risk management in the 1980s. These pioneers were effective at reducing the variability of financial risks such as interest rate risk, market risk, and credit risk. However, the variability of firm earnings continued because of, according to the author, operational risk. The purpose of this book is "to provide the motivation and appreciation for understanding what operational risk is, why it is important, and how to address it (p. 4)."

The author's basic premise is sound: By reducing operational risk, the manager reduces net income variability and consequently increases shareholder value. He alleges that the reason previous financial managers have been ineffective in managing operational risk is that their models were not objective, reliable, and accurate measures of operational risk. Thus he proposes a new model, the Delta-EVT. With this model, the variations in process activities are measured by the Delta model and the rare events are measured with the EVT model. Together, they can measure both risks for the financial firm.

The EVT model may be familiar to insurance actuaries, and the author states that it has recently been introduced to financial risk managers. Using several banking examples, the author provides a sketchy description of the EVT model, assuming that the reader is familiar with it.

Chapter 2 introduces some historical loss incidents as a means to appreciate the need for operational control systems.

Chapter 3 is a review of current banking regulations. The author suggests that current regulation is a function of the failures of previous bankers to manage their operational risk. This failure is ascribed to the lack of accurate models.

Section 2 (Chapters 4 through 6) is intended to provide the foundations for understanding the new Delta-EVT model. It is here that the writing style may frustrate understanding. For example, in attempting to describe the model variables, the author states, "[o]perational risk measurement uses risk factors, which are those causal factors that create losses with a random uncertainty, to measure the variability of earnings (p. 58)." The abundance of such compound sentences (with questionable grammar) permeates the entire book. Thus the material is presented in an overly complex way that hinders understanding. This is unfortunate because the general format and logic of the text are well conceived. The material is presented in a logical fashion, the assumptions are enumerated, and the advantages and disadvantages of each idea are clearly stated. The result is that unless the reader already understands the Delta and EVT models, this text does not serve as a source for learning the material.

Section 3 (Chapters 7 through 9) presumes that the reader is now completely familiar with the foundations of the Delta and EVT models, and the author builds upon that knowledge to apply the Delta-EVT to several banking situations. These examples use considerable unexplained banking jargon and concepts and contain numerous formulae with unexplained variables and a few errors. Some examples are unnecessarily complex applications of an otherwise fairly simple concept. Compounded by sentences such as "Building causal models for operational risk involves seven steps, which are presented in this section in two groups, namely those steps associated with building and training causal models and those for using the trained model (p. 160)." The overall result is less than optimal understanding.

Section 4, Mathematical Foundations, contains one well-written chapter. In contrast to the rest of the book, Chapter 10 (Error Propagation) is succinct and includes clear examples. Chapters 11 and 12 (Extreme Value Theory and Bayesian Methods) fail in their purpose of providing a clear definition of these fundamental concepts. While most readers may already be familiar with these ideas, the intent of these chapters was to serve as a foundation for those who need their knowledge refreshed.

I enjoyed many parts of the book. The application of risk management to banking operations was an enlightening read. However, if the reader's purpose is to learn the theory and application of the EVT, Delta, or Delta-EVT models, then the reader may be disappointed.

*Social Dialogue and Pension Reform*, edited by Emmanuel Reynaud, 2000, Geneva: International Labour Office.

Reviewer: William L. Ferguson, The University of Louisiana at Lafayette

