

**University of California, Davis**  
**Graduate School of Management**  
MGP 292: Banking and the Financial System  
Summer 2014

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**Instructor:** Gregory Perelman  
**Office Hours:** by appointment  
**Contact Information:** [gp36@yahoo.com](mailto:gp36@yahoo.com)

**Class Web site:** [www.gperelman.com](http://www.gperelman.com)  
**Class Meetings:** see GSM schedule

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### **Course Description**

This course is designed to introduce students to the functioning of financial institutions with special focus on the operations of commercial banks. The course covers issues related to bank risk management and will concentrate on credit, interest, and capital adequacy risk. Many topics in this course will be discussed in light of the recent financial crisis and, consequently, the functions of the central banks and their action during the crisis will be reviewed as well - we will concentrate on the Federal Reserve Bank in the U.S. and will briefly review other major central banks. It is assumed that students have good working knowledge of the basic theoretical and practical concepts of economics, corporate finance, and accounting. The course is intended not only for those interested in careers within financial institutions, but also for those who wish to extend their institutional and industry specific knowledge. The emphasis of the course is on practical application and, therefore, case discussions will take most of in-class time.

On successful completion of the course, students will be able to:

- Explain the most important reasons for existence of financial intermediaries
- Analyze financial performance of commercial banks
- Argue for (or against) the existence of deposit insurance
- Define the role of major central banks (U.S., Europe, Japan) and explain their functions
- Conduct basic evaluation of a commercial loan requests and calculate interest rate on a loan
- Identify key risks facing financial institutions and apply some of the risk management strategies, including the management of capital requirements (Basel international agreement)
- Understand U.S. shadow banking system and its role in the recent financial crisis

### **Recommended textbook:**

Saunders, A. and Cornett, M.M. *Financial Institutions Management: A Risk Management Approach*. McGraw Hill, 8<sup>th</sup> edition, 2014. (ISBN: 978-0-07-803480-0)

### **Cases and Notes:**

1. HBS Case #9-799-077: *The U.S. Banking Panic of 1933 and Federal Deposit Insurance*. Rev. January 23, 2008.
2. Santa Fe Trading Company Case (available at the class website)
3. HBS Case #9-294-079: *Banc One Corporation. Asset and Liability Management*. Updated 2008
4. HBS Case #9-111-041: *Citigroup 2007: Financial Reporting and Regulatory Capital*; Rev. October 6, 2010
5. HBS Case #9-309-001: *The Tip of the Iceberg: JP Morgan Chase and Bear Stearns (A)*, 2009
6. Note #W13369: *Crisis in Cyprus: Was It Different This Time?* Version 9-13-2013
7. Note #UV5662: *The Dodd-Frank Act and Its Impact*, Rev. March 5, 2012
8. Note #910N27: *Introduction to Credit Default Swaps*, 2010.
9. Note #9-902-168: *History of Investment Banking*, January 2002.

Other reading materials will be distributed in class or over the class web page.

## **Course Format**

Lectures, class discussions, problem solving and case studies.

Case analysis will involve building Excel models and conducting sensitivity analysis to assumptions in support of the final recommendation. Due to the labor-intensive nature of case preparation, it is strongly recommended that students work in groups to get ready for class.

## **Grading Policies:**

Individual participation:	10%
Group cases write ups (four graded cases):	40%
Quizzes:	15%
Final Exam:	35%

## **Class Participation**

This course is structured as a SEMINAR, which means you must come prepared for class discussions and actively participate in class to receive credit. If you expect to miss a class for any reason, send me an e-mail beforehand. In class discussions, entire groups may be asked to take stands and express their views on the case questions. At other times, individual students will be asked to do the same. Students can expect a mix of all approaches. Questions and discussions are encouraged throughout the course.

## **Case Analysis (Groups)**

In this class you will work with a team of 4-5 students on five case studies. The score on the lowest graded case will be dropped from calculating your final grade. For each case, every team must submit the following:

- a) 3-5 pages write up (excluding exhibits) where you address the questions posted in the course schedule section below. If you include exhibits, please refer to them in the text and make clear why they are included
- b) Power Point summary (a few slides) for in-class presentations – I will randomly call on groups to present their analysis
- c) Excel spreadsheet with your calculations, financial statements, data collected for your analysis, etc.

A few more comments on the write ups: no detailed background of the case is needed – a few lines will be sufficient. At the same time, do not assume that the reader knows every number in the case. The write up is a stand-alone document and should state major problems or opportunities facing the decision-maker, list alternative courses of actions and come up with specific recommendations. It is important to make your decisions given the available information provided within the cases. You are welcome to use outside sources, but, as in real life, you will never have complete information and unlimited time to make your decisions. If you make any assumptions, clearly state them. The write-up should be professional and addressed to the CEO/CFO as an internal or consulting report. Write in complete and grammatically correct sentences. Avoid bulleted presentations in the write ups.

All submitted files must follow naming conventions and include your name for individual work and team/case numbers for group submissions – more details are provided on the class website.

## **Exams**

We will have several quizzes and a final examination. You can use calculator and one sheet of paper (both sides) with your OWN notes during examination. No makeup quizzes or final exam will be given, except as required by university policy.

**COURSE SCHEDULE**  
(Tentative – subject to change)

Meeting	Topics, readings, and assignments
1 Wed Jul 23	<p>Raison d'être of financial intermediaries</p> <ul style="list-style-type: none"> <li>✓ maturity, liquidity and risk transformation</li> <li>✓ information asymmetry - adverse selection and moral hazard</li> <li>✓ screening and monitoring</li> </ul> <p>Recommended reading: Chapter 1 Akerlof, George A., "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism." <i>Quarterly Journal of Economics</i>, August 1970, 488-500. <i>The Future of finance and the theory that underpins it</i>. London School of Economics, 2010. Chapter 1 – What do banks do? (link provided at the class website)</p>
2 Mon Jul 28	<p>Banking industry overview</p> <ul style="list-style-type: none"> <li>✓ historical review of U.S. banking industry</li> <li>✓ deposit insurance: arguments for and against</li> <li>✓ deposit insurance and modern banking – banking crisis in Cyprus (2013)</li> </ul> <p>HBS Case: <i>The U.S. Banking Panic of 1933 and Federal Deposit Insurance</i> <b>Assignment:</b> write up and presentation are due before class – see questions posted on the class website. Recommended reading: Chapter 2 Bernanke, Ben, S. "Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression," <i>The American Economic Review</i>. June 1983, 237-276.</p>
3 Wed Jul 30	<p>Functions of central banks</p> <ul style="list-style-type: none"> <li>✓ history of the Federal Reserve</li> <li>✓ monetary policy and interest rates;</li> <li>✓ FED activity during financial crisis and analysis of its balance sheet; review of other major central banks (European Central Bank, Bank of England, Bank of Japan)</li> </ul>
4 Mon Aug 4	<p>Analysis of financial statements and bank financial performance</p> <ul style="list-style-type: none"> <li>✓ balance sheet</li> <li>✓ income statement</li> <li>✓ ROE decomposition</li> <li>✓ key performance ratios (net interest margin, efficiency, etc.)</li> <li>✓ capital requirements</li> </ul> <p>Required reading: -JPMorgan Chase 2013 Annual Report - link on the class website - read Chairman's letter to shareholders (about 20 pages) -Fifth Third Bank SEC filings (distributed via class website) Recommended reading: Chapter 19</p>
5 Wed Aug 6	<p>Bank lending to businesses and consumers</p> <ul style="list-style-type: none"> <li>✓ credit analysis</li> <li>✓ lending policies</li> <li>✓ pricing of traditional bank products</li> <li>✓ estimating expected credit losses</li> </ul> <p>Case: <i>Santa Fe Trading Company</i> <b>Assignment:</b> submit group case write up where you address all questions listed at the end of the case; Recommended reading: Chapter 10</p>

<p>6 Mon Aug 11</p>	<p>Risk management</p> <ul style="list-style-type: none"> <li>✓ management of credit, interest rate, market, and other risks (operations, compliance, reputations, etc.)</li> <li>✓ financial instruments (swaps) and asset/liability management;</li> </ul> <p>HBS Case: <i>Banc One Corporation. Asset and Liability Management</i>. Updated 2008.  <b>Assignment:</b> submit group case write up where you address all questions posted on the class website, Excel spreadsheet and Power Point file for your in-class presentation  Recommended reading:  -Chapters 8-9, 24  -Note #910N27: Introduction to Credit Default Swaps, 2010.</p>
<p>7 Wed Aug 13</p>	<p>Capital management</p> <ul style="list-style-type: none"> <li>✓ review of capital requirements (Basel I, II, III)</li> <li>✓ fair market accounting rules and bank performance</li> <li>✓ post crisis - additional liquidity requirements</li> </ul> <p>HBS Case: <i>Citigroup 2007: Financial Reporting and Regulatory Capital</i>, 9-111-041; Rev. October 6, 2010  <b>Assignment:</b> submit group case write up where you address all questions posted on the class website, Excel spreadsheet and Power Point file for your in-class presentation  Recommended reading: Chapter 20</p>
<p>8 Mon Aug 18</p>	<p>Review of other financial institutions</p> <ul style="list-style-type: none"> <li>✓ investment banks</li> <li>✓ mutual funds</li> <li>✓ money market mutual funds</li> <li>✓ retirement funds</li> <li>✓ insurance companies</li> </ul> <p>Recommended reading:  -Chapters: 3-6  -Note #9-902-168: History of Investment Banking, January 2002.</p>
<p>9 Wed Aug 20</p>	<p>M&amp;A in banking during financial crisis</p> <ul style="list-style-type: none"> <li>✓ innovation in finance</li> <li>✓ shadow banking</li> <li>✓ valuation of banks</li> <li>✓ financial crisis of 2007-2009 - timeline, major events, causes and consequences;</li> </ul> <p>HBS Case: <i>The Tip of the Iceberg: JP Morgan Chase and Bear Stearns (A)</i>, 2009  <b>Assignment:</b> submit group case write up where you address all questions posted on the class website, Excel spreadsheet and Power Point file of your in-class presentation  Recommended reading: Chapter 26</p>
<p>10 Mon Aug 25</p>	<p>Regulation of financial institutions and the future of banking</p> <ul style="list-style-type: none"> <li>✓ Dodd-Frank Act</li> <li>✓ Consumer protection agency</li> <li>✓ ongoing financial and banking crisis in Europe</li> <li>✓ stress testing</li> </ul> <p>Required reading: Note #UV5662: The Dodd-Frank Act and Its Impact, Rev. March 5, 2012  Course review and Q&amp;A session</p>
<p>11</p>	<p style="text-align: center;"><b>Final Exam</b> Wed, Aug 27</p>