

Santa Clara University
Leavey School of Business
FNCE 149: Financial Institutions and Services
Fall 2015

Instructor:	Gregory Perelman	Class Web site:	www.gperelman.com
Class Meetings:	Wednesdays, 3:30 pm	Contact e-mail:	gp36@yahoo.com
Office:	316Z		
Office hours:	2:30 pm on Wednesdays before class and by appointment		

Course Description:

This course will analyze the main functions of banking institutions and review the recent developments in the financial services industry. We will examine the functions performed by incumbent players in the following segments: payment processing systems, extension of credit to businesses and consumers, money management, investment banking and securities trading; attention will then turn to new industry players within each segment - those companies that are using digital technologies and big data to disrupt traditional players' business models. Potential market size, product pricing and profitability of the new players will be evaluated.

It is assumed that students have good working knowledge of the basic theoretical and practical concepts of economics, accounting, and corporate finance. 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.

Prerequisites: FNCE 121 or 121S, and FNCE 124

Reading: coursepack is available at <https://cb.hbsp.harvard.edu/cbmp/access/40994655>

Cases:

1. The U.S. Banking Panic of 1933 and Federal Deposit Insurance (HBS Case #9-799-077: Rev. January 23, 2008).
2. Santa Fe Trading Company (link on class website)
3. Zopa.com - From a hot idea to an established market player? (ESMT 314-0154-1), Aug. 15, 2014
4. Betting on Failure: Profiting from Defaults on Subprime Mortgages (Case KEL880), Jan. 5, 2015
5. HBS Case #9-309-001: *The Tip of the Iceberg: JP Morgan Chase and Bear Stearns* (A), Rev. Nov. 21, 2011

Notes:

1. HBS, #9-602-153: Economics of Retail Banking Note, , Rev. March 24, 2006
2. HBS #9-209-107: An Introduction to Consumer Credit. February 20, 2009.
3. HBS #9-291-026 Note on Bank Loans, Rev. October 29, 1993
4. HBS #9-909-006: Consumer Payment Systems – United States. Rev. July 20, 2011.
5. Note #910N27: Introduction to Credit Default Swaps, 2010.
6. Note #UV5662: The Dodd-Frank Act and Its Impact, Rev. March 5, 2012

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%
Quizzes:	25%
Individual project:	30%
Group cases:	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.

Quizzes

We will have several quizzes during the course (open book/notes). No makeup quizzes will be given, except as required by university policy.

Individual Project

Every student will choose a company in the financial industry and submit a research paper on new product/service offered. A company could be an incumbent or a new company in the industry. The following must be included in the paper:

- description of the proposed product/service;
- financial analysis of the project/service (estimate potential market size, company's value, product pricing, etc.);
- based on in-class discussions and your research on this project, provide your views on how financial industry is likely to evolve in the future;
- present a summary of your findings in class (prepare a short power point presentation)

More details about the project will be provided in the class discussions and on the class website.

Case Analysis (Groups)

In this class you will work with a team of 3-4 students on five case studies. 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.

COURSE SCHEDULE

Meetings	Topics, readings, and assignments
1	<p>Review of financial institutions and their functions:</p> <ul style="list-style-type: none"> ✓ Functions of financial intermediaries: maturity, liquidity and risk transformation; information asymmetry (adverse selection and moral hazard); screening and monitoring; <p>Recommended reading: Akerlof, George A., “The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism.” Quarterly Journal of Economics, 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 on class website)</p>
2	<p>History of the U.S. banking industry and the role of the FED:</p> <ul style="list-style-type: none"> ✓ historical review of U.S. banking industry ✓ deposit insurance: arguments for and against ✓ central banking: monetary policy and interest rates; <p>Case 1: <i>The U.S. Banking Panic of 1933 and Federal Deposit Insurance</i> Assignment: submit a write up where your group addresses all questions posted for this case on the class website</p> <p>Required readings:</p> <ul style="list-style-type: none"> • Money in the modern economy: an introduction. By Michael McLeay, Amar Radian and Ryland Thomas. • Money creation in the modern economy. By Michael McLeay, Amar Radia and Ryland Thomas. BoE Quarterly Bulletin, 2014 Q1 <p>Recommended reading: Bernanke, Ben, S. “Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression,” The American Economic Review. June 1983, 237-276.</p>
3	<p>Measuring financial performance of financial intermediaries;</p> <ul style="list-style-type: none"> • balance sheet and income statement analysis • Revenue and profit of key business components: <ul style="list-style-type: none"> ○ deposits and payments ○ lending ○ wealth management and other businesses • ROE decomposition analysis <p>Required reading:</p> <ul style="list-style-type: none"> • HBS, #9-602-153: Economics of Retail Banking Note, , Rev. March 24, 2006 • Bank funding costs: what are they, what determines them and why do they matter? Bank of England, Quarterly Bulletin, Q3, 2014 • JPMorgan Chase 2014 Annual Report (read Chairman’s letter to shareholders) • Financial statements: Fifth Third Bank annual report
4	<p>Traditional lending and product pricing:</p> <ul style="list-style-type: none"> ✓ Current bank lending practices ✓ Loan pricing ✓ Credit scoring

	<p>Case 2: Santa Fe Trading Company Assignment: submit group case write up where you address all questions listed at the end of the case;</p> <p>Required reading:</p> <ul style="list-style-type: none"> • HBS #9-209-107: An Introduction to consumer credit. • HBS #9-291-026 Note on Bank Loans, Rev. October 29, 1993
5	<p>Innovations in lending and alternative finance</p> <ul style="list-style-type: none"> ✓ Big data and new loan underwriting techniques ✓ Marketplaces: Lending Club, Prosper, ✓ Alternative lenders: Kabbage, OnDeck; ✓ Economics of alternative lenders <p>Case 3: Zopa.com - From a hot idea to an established market player? Assignment: submit a write up where you address questions posted on the class website; include Excel spreadsheet with your work; Suggested reading: Understanding Alternative Finance. The UK Alternative Finance Industry Report 2014. University of Cambridge.</p>
6	<p>Payment function: from the bill of exchange to Visa/MasterCard to Bitcoin:</p> <ul style="list-style-type: none"> ✓ history: medieval fairs and bills of exchange, metallic money, gold standard ✓ economics of modern payment systems: checks in the U.S.; economics of credit cards, merchant services; ✓ key players and their financial performance: Visa, MasterCard, Discover, Amex ✓ key players: PayPal, Google Wallet, Apple Pay, Square, etc. ✓ bitcoin ✓ economics of challengers - estimating market potential and expected financial performance <p>Required reading:</p> <ul style="list-style-type: none"> • HBS: Consumer Payment Systems – United States. • Innovations in payment technologies and the emergence of digital currencies. By Robleh Ali, John Barrdear, Roger Clews and James Southgate • The economics of digital currencies. By Robleh Ali, John Barrdear, Roger Clews and James Southgate
7	<p>Investment and money management; financial information industry</p> <ul style="list-style-type: none"> ✓ history of financial instruments and stock exchanges (New York, London,) ✓ money management: mutual funds, retirement funds; ✓ speed trading: economics, efficiency and fairness; ✓ rating agencies ✓ innovations in money management business ('robo advisors,' etc.) <p>Case 4: Betting on Failure: Profiting from Defaults on Subprime Mortgages (Case KEL880) Assignment: submit a write up where you address questions posted on the class website; include Excel spreadsheet with your work;</p> <p>Suggested reading: High Frequency trading and dark pools: An interview with John Succo. <i>Business Horizons</i> (2013) 56, 715-722.</p>

8	<p>Investment banks, money market mutual funds, and the shadow banking system</p> <ul style="list-style-type: none"> ✓ securitization ✓ credit default swaps and other innovations in financial products ✓ innovation in finance vs. systemic risk (AIG story) ✓ TARP <p>Case 5: <i>The Tip of the Iceberg: JP Morgan Chase and Bear Stearns (A)</i>, 2009 Assignment: submit a write up where you address questions posted on the class website; include Excel spreadsheet with your work;</p>
9	<p>Post crisis environment in financial industry: regulation vs. innovation</p> <ul style="list-style-type: none"> • Basel I, II, III, stress testing • Dodd-Frank Act • Consumer protection agency • Large vs. small institutions in financial industry • Ongoing financial and banking crisis in Europe • (non?) regulation of financial start ups <p>Required reading:</p> <ul style="list-style-type: none"> • Note #UV5662: The Dodd-Frank Act and Its Impact, Rev. March 5, 2012 • Bank Capital and liquidity. Bank of England, Quarterly Bulletin, Q3 2013
10	<p>The Future of Financial Institutions</p> <ul style="list-style-type: none"> ✓ finance and society ✓ democratization of finance <p>Individual project presentation Course review and Q&A session</p> <p>Suggested reading: John Kay, <i>Other People's Money</i>, 2015 Robert Shiller, <i>Finance and the Good Society</i>, 2012</p>
	<p>Individual project due: <u>December 2</u></p>