



Course code	GRAE020
Course title	<i>Financial Intermediation</i>
Type of course	<i>Compulsory</i>
Level of course	<i>Advanced</i>
Year of study	2 nd
Semester	3 rd
Number of credits	6 ECTS (4 national credits)
Course coordinator	<i>Dr. Gregory Perelman</i>
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Other lecturers	<i>Žygimantas Mauricas, Simonas Krėpšta</i>

Objective of the course:

The aim of this course is to develop understanding of the theories of financial intermediation and provide insights into the best practices of risk management processes and techniques used by banks and other financial intermediaries. Recent developments in regulatory framework and crisis prevention and management techniques will also be discussed in the context of the recent global financial crisis.

Learning outcomes:

Upon successful completion of this module, students will:

- Be familiar with the main theories of financial intermediation and the functions performed by financial institutions;
- Understand the need for financial regulation and be aware of the recent changes in regulatory framework;
- Be aware about the various types of risks to the financial intermediaries and understand how those risks are measured and managed;
- Understand the need and importance of stress testing;
- Understand the causes and consequences of financial crises and be familiar with contemporary crisis management techniques.

Prerequisites:

Fundamentals of Finance, Financial Economics.

Teaching Style:

Lectures, class discussions, problems solving and case studies.

Tentative Schedule and Topics (subject to change)

	Topics	Class hours	Reading/Assignments
1. GP	Introduction: overview of financial institutions Raison d'être and history of financial intermediaries: <ul style="list-style-type: none"> • Economies of scale and scope, pooling and netting • Information asymmetry: screening and monitoring Functions performed by financial intermediaries: <ul style="list-style-type: none"> • Maturity, liquidity and risk transformation 	4	Required: Textbook Ch. 1-3 Recommended: Akerlof, George A., "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," <i>Quarterly Journal of Economics</i> , August 1970, 488-500. Diamond, D., 1984, "Financial intermediation and delegated monitoring," <i>Review of Economic Studies</i> 51, 393-414.

2. GP	<p>Depository institutions: commercial banks, savings banks and credit unions.</p> <ul style="list-style-type: none"> • Deposit insurance • Analysis of financial performance <p><u>HBS case discussion</u></p>	4	<p>Required: Ch. 10. HBS Case: The U.S. Banking Panic of 1933 and Federal Deposit Insurance. 2008 (<u>group assignment</u>).</p> <p>J.P. Morgan Chase 2009 Annual Report (Letter to shareholders and selected financial statements).</p> <p>Recommended: 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. Diamond, D., and P. Dybvig, 1983, "Bank runs, deposit insurance, and liquidity," <i>Journal of Political Economy</i> 91, 401-419.</p>
3. GP	<p>Bank lending:</p> <ul style="list-style-type: none"> • Five C's of credit, credit analysis • Lending to individuals • Lending to businesses <p><u>Lending case discussion</u></p>	4	<p>Required: Ch. 5-6 Case (<u>group assignment</u>): Southwest Trading Company and excel spreadsheets (available on class website)</p> <p>Recommended: Rose, Peter S. and Hudgins Sylvia C., Bank Management & Financial Services. McGraw Hill, 7th Edition, 2008. Chapters 16-18, pp. 511-612</p> <p>Stiglitz, J., and A. Weiss, 1981, "Credit rationing in markets with imperfect information," <i>American Economic Review</i> 71, 393-410.</p>
4. GP	<p>Management of risk: credit, interest rate, market, operational risk; capital management and Basel I, II (and III) <u>Banc One case discussion</u> (using swaps in risk management)</p>	4	<p>Required: Ch. 4, 13.</p> <p>HBS Case: Banc One Corporation. Asset and Liability Management. Updated 2008. (<u>group assignment</u>)</p>
5. GP	<p>Non-depository institutions:</p> <ul style="list-style-type: none"> • Parallel (shadow) banking system and current financial crisis. <p><u>J.P. Morgan case discussion</u></p>	4	<p>Required: Ch. 15 HBS Case, The Tip of the Iceberg: JP Morgan Chase and Bear Stearns (A), 2009 (<u>read only and be ready to discuss – no group write up required</u>)</p> <p>Recommended: Gorton, Gary B. The Subprime Panic. <i>NBER Working Paper 14398</i>, October 2008.</p>
6. GP	<p>Regulation of banking; Federal Reserve system.</p>	4	<p>Required: Ch. 11-12. Review the new U.S. banking regulation (passed by Congress in June 2010) – <i>source TBD</i></p> <p>Recommended: The Federal Reserve System: Purposes and functions (particularly chapters 1-3) http://www.federalreserve.gov/pf/pf.htm</p>
7. ŽM	<p>Systemic risk in banking:</p> <ul style="list-style-type: none"> • Macro-prudential regulation and financial system stability • Causes and consequences of financial crises • Initiatives in macro-prudential supervision • System-wide stress testing exercises 	4	<p>Recommended: The Supervisory Capital Assessment Program: Overview of Results, <i>Federal Reserve Board of Governors</i>. May 9, 2009. EU-wide stress test results. <i>CEBS, July 2010–source TBD</i></p>

8. SK	<p>Crisis management:</p> <ul style="list-style-type: none"> • General principles of crisis management • Crisis prevention and contingency planning • Bank resolution techniques • Cross-border crisis management 	4	<p>Recommended: Geneva Report on the World Economy 12 - A Safer World Financial System: Improving the Resolution of Systemic Institutions Report on Financial Crisis Management, Economic and Financial Committee, 2001.</p>
9. SK	<p>Redesigning the financial system:</p> <ul style="list-style-type: none"> • Evolution and failures of a safety net • New ideas enhancing financial regulation <p><u>Resolution of Fortis VS Dexia</u></p>	4	<p>Required: Case: Resolution of Fortis VS Dexia (group assignment).</p> <p>Recommended: Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability, <i>Report of the Financial Stability Board to G20 Leaders, June 2010.</i> Andrew G Haldane, Banking on the state, <i>Bank of England.</i></p>
	Final exam		

Task	Final grade, %
Four case studies (group)	40
Quizzes	10
Final exam	50
Total:	100

Exams:

We will have two or three (unannounced) quizzes and a final examination. You can use calculator and one sheet of paper (both sides) with your OWN notes during quizzes and the examination.

Group projects:

As part of a group of 4-5 students you will prepare and submit four cases to be discussed in class. A 3-4 page write up on each case is due before the class discussion. More details about the cases and specific questions to be addressed will be provided during class meeting and on the course web site.

Required text:

Greenbaum S. I., Thakor A. V. Contemporary Financial Intermediation (2nd edition), Academic Press Advanced Finance. 2007. Textbook chapters will serve as background readings; however most of in-class time will be spent on applications (group case discussions).

Course Reader: HBS Cases. Other required and recommended reading materials will be available on the class web page.

Supplementary textbooks

- Kohn M. (2004), Financial Institutions and Markets (2nd edition), Oxford University Press.
- Bergen A. N., P. Molyneux, and J. Wilson (2009), The Oxford Handbook of Banking, Oxford University Press.
- Freixas X. and J.-Ch. Rochet (2008), Microeconomics of Banking (2nd edition), Massachusetts Institute of Technology Press.
- Neftci S. N. (2008). Principles of Financial Engineering, (2nd Edition), Academic Press Advanced Finance.
- Stulz R. (2003). Risk Management and Derivatives, South-Western/Thomson Learning.
- Sironi, A. and A. Resti (2007) Risk Management and Shareholders' Value in Banking: From Risk Measurement Models to Capital Allocation Policies (The Wiley Finance Series), John Wiley & Sons.

Supplementary readings:

- Hopkins, Elisabeth; Linde, Jesper; Soderstrom, Ulf; , The transmission mechanism and the financial crisis. Economic Review , Sveriges Riksbank, 2009 , p. 50–72
- Wellink N. Beyond the crisis: the Basel Committee's strategic response. Financial Stability Review (FSR) , Banque de France, 2009, September
- Kambhu, John; Schuermann, Til; Stiroh, Kevin. Hedge funds, financial intermediation, and systemic risk. Economic Policy Review , Federal Reserve Bank of New York, 2007, December , Vol. 13 , No. 3 , p. 1–18
- Allen, Franklin; Carletti, Elena. Financial system: shock absorber or amplifier? Bank for International Settlements. Monetary and Economic Department.