



Finance 579 Banking and the Financial System

Spring 2017

<i>Instructor:</i>	Florian Schulz	<i>Class Hours:</i>	Thursday 6:00-9:20 pm
<i>Office:</i>	PCAR 450		
<i>Phone:</i>	206-543-6094	<i>Office Hours:</i>	Friday 1:30 – 3:00 pm
<i>Email:</i>	fschulz@uw.edu		(and by appointment)
<i>Teaching Assistant:</i>	Quentin Dupont (dupontq@uw.edu)		

COURSE OBJECTIVES:

This course is intended to provide an understanding of financial institutions and the banking industry more generally. Incentive conflicts and agency problems – prominent issues leading to the financial crisis – will be discussed throughout the course, as will be solutions to mitigate these problems, both from a regulatory as well as from a company’s or bank’s perspective. One of the course’s main goals is to build a strong intuitive understanding of these “informational problems”, which are not unique to banking but omnipresent in the business world, and to enhance the critical thinking ability of students. Large emphasis will also be given to measurement and management of risks (interest rate risk, credit risk etc.).

COURSE MATERIALS:

Textbook: (A) *Financial Institutions Management: A Risk Management Approach* by Anthony Saunders and Marcia Millon Cornett , 8th edition (McGraw-Hill).

(B) *Financial Institutions, Markets, & Money* by David Kidwell, David Blackwell, David Whidbee, and Richard Sias, 11th edition (Wiley).

Recommended textbook chapters (see course outline) are *optional* background readings. I do not require that students purchase a textbook, however those of you who consider a career-track in finance or banking will find any of these two books a good investment. The Saunders textbook has a stronger focus on risk management while I view the Kidwell book as being more comprehensive (and a somewhat lighter reading). Neither of the textbook provides a complete coverage of the material covered in this course. Both textbooks are placed on reserve at the Foster Library.

HBS Cases: There are a total of four Harvard Business School cases that are integral components of this course. The cases with links are listed below. Due to copyright issues, each student must purchase all of the cases (cost of ~\$10 each).¹ You may not copy the cases or share the pdf file. The cases with links are listed below. I have also combined the cases into a coursepack which can be accessed using the following link:

<http://cb.hbsp.harvard.edu/cbmp/access/63066183>

*⁽¹⁾ *Rosetree Mortgage Opportunity Fund* by Victoria Ivashina and Andre F. Perold²

(2) *UBS and Auction Rate Securities (A)* by Daniel Bergstresser, Shawn Cole, and Siddharth Shenai³

*⁽³⁾ *Banc One Corp.: Asset and Liability Management* by Peter Tufano and Benjamin C. Esty⁴

*⁽⁴⁾ *Basel II: Assessing the Default and Loss Characteristics of Project Finance Loans (A)* by Benjamin C. Esty and Aldo Sesia⁵

(Note: Asterisk indicates that a group write-up/presentation is required for the case.)

I will also occasionally post relevant articles that I expect you to read and that may be discussed at the beginning of the class.

COMMUNICATION:

Email is the preferred method of contact for this course. I will make every attempt to respond within 24 hours. Many, but not all, course documents will be made available on Canvas. You are responsible for frequently checking for announcements and updated course content on Canvas.

Note that a **discussion forum** on Canvas, monitored by the TA and myself, should be utilized to ask and answer questions about course-related content and general discussions about related topics. However, you are not allowed to discuss the cases on the forum.

¹ The HBR website experiences frequent scheduled maintenances which can affect the purchase of cases. It is therefore recommended that students purchase cases well in advance of the assigned class date.

² <http://hbr.org/product/Rosetree-Mortgage-Opportu/an/209088-PDF-ENG>

³ <http://hbr.org/product/ubs-and-auction-rate-securities-a/209119-PDF-ENG>

⁴ <http://hbr.org/product/banc-one-corp-asset-and-liability-management/an/294079-PDF-ENG>

⁵ <http://hbr.org/product/Basel-II--Assessing-the-D/an/203035-PDF-ENG>

EVALUATION AND COURSE GRADE:

There are a midterm exam, cases, occasional in-class quizzes, and a research project. The course grade will be calculated as follows:

	<u>Percentage</u>
Midterm Exam:	30%
Cases:	30%
Research Paper (“project”) [or Final Exam]	20%
<u>Participation (incl. quizzes):</u>	<u>20%</u>
Total:	100%

EXAMS: Exams are closed notes/book.

QUIZZES: I may occasionally give short 5-10-minute throughout the quarter (multiple choice and/or open question). *Quizzes are unannounced.* The main purpose of the quizzes – and the best way to prepare – is for you to review the material of the last sessions.

CASES: There will be case assignments for this course. You are required to **read all the cases** in advance of the class and come prepared for a class discussion. ***For three of the four cases (indicated by asterisk above), you are also asked to prepare a written analysis which will be due on the date we discuss the case in class.*** You are allowed to work in groups of up to 2 students. You should provide a 3-page executive summary of your recommendations and supporting analysis. Relevant tables, figures, or computations may be included in an appendix. To guide your analysis, I will post a set of questions to the course website to accompany each case. You should bring a hard copy of your report to class to turn in for grading. Late reports will not be accepted. In addition, you should prepare a ***15-minute presentation*** of your analysis. For each case, one or two groups will be randomly selected to present their analysis to the class.

The cases are an important opportunity to practice your skills as a financial analyst by applying the concepts we will cover in class to real world problems. Thus, I ask that you not research the outcomes of the cases or search for external studies or articles concerning the issues raised by the case.

PROJECT: An integral part of this course is the completion of a “**research paper**” of a (banking-related) topic of your choice. Possible topics could include but are certainly not limited to:

- What happened in a specific sector during a financial crisis
- Any current policy or regulatory issue
- New products or services, industry disruptions, and challenges
- etc.

The research paper is an opportunity for you to branch out and become an expert in subjects that we have not (or have only marginally) covered in this course. Your paper should not exceed 15 pages. If time allows, you will also be given an opportunity to present your main findings to your peers.

A one-page description should be submitted by the end of April and the chosen topic must be approved by me. Final papers must be submitted by **June, 8**.

The project may be replaced by a **final exam**.

Attendance and being actively engaged in class is expected in the business world and it is expected in this course. I will routinely ask questions to the class. I am *not* a video-tape so please err on the side of participating. Your active participation on the discussion forum (such as answering questions of your peers) will also count positively.

ACADEMIC INTEGRITY:

By being a student in this course, you acknowledge that you are a part of a learning community at the Foster School of Business that is committed to the highest academic standards. As a part of this community, you pledge to uphold the fundamental standards of honesty, respect, and integrity, and accept the responsibility to encourage others to adhere to these standards. The Student Conduct Code outlines the expectation of academic conduct and the consequences of misconduct.⁶

I view cheating as an offense against your fellow students in the course, against the professor, and against the university as a whole. Because it is a large part of my responsibility to ensure that all students are treated fairly and to uphold and build the reputation of the university, I take all forms of cheating very seriously. Please don't cheat.

POLICY REGARDING LAPTOP USE AND CELL PHONES IN THE CLASSROOM:

Off-line use of laptops is allowed (e.g., for note taking). Please do not use your laptop or cell phone to surf the web or email others and make sure that your cell phone is kept on silent during class.

⁶ See the following document for a definition of academic misconduct and the procedures for dealing with misconduct: <http://depts.washington.edu/grading/pdf/AcademicResponsibility.pdf>

TENTATIVE COURSE SCHEDULE⁷

Week	Class	Date	Req.	Topics/Readings
Part I: General Concepts				
1	1	Mar 30	Th	Welcome and Course Overview Introduction: Issues in financial intermediation
2	2	Apr 6	Th	Types and functions of financial intermediaries Basic Principles of Finance (and their issues/limitations) Measurement of bank financial performance <i>Read chapter 1 and appendix 2A and 2B (SC).</i>
3	3	Apr 13	Th	A special bank: The Federal Reserve and monetary policy <i>Read appendix 1A (SC) or Ch. 3 (Kidwell).</i> Information Economics: Moral Hazard
4	4	Apr 20	Th	Information Economics: Adverse Selection Deposit Banking and Models of Bank Runs
Part II: Measuring and Managing Risk				
5	5	Apr 27	Th	* Case 1: Rosetree Mortgage Opportunity Fund The risks of banking. <i>Read textbook Ch. 7 on the risks of financial intermediation (SC).</i>
6	6	May 4	Th	* MIDTERM EXAM Continue with risks of banking Discussion of Case 2: UBS and Auction Rate Securities (A)
7	7	May 11	Th	The duration model of interest rate risk. <i>Read textbook Ch. 9 including appendix (SC) or Ch. 5 (Kidwell).</i> Introduction to Market Risk: The Value at Risk Model <i>Read textbook Ch. 15 (SC).</i>
8	8	May 18	Th	Introduction to hedging using financial derivatives. <i>Read textbook Ch. 22. Futures and forwards and Ch. 24 "Swaps" (SC) or Ch. 11 (Kidwell).</i> * Case 3: Banc One Corp.: Asset and Liability Management
9	9	May 25	Th	Introduction to Credit Risk: Credit Spreads and Ratings
Part III: Regulation & Supervision, Financial Crisis				
10	10	Jun 1	Th	* Case 4: Basel II: Assessing the Default and Loss Characteristics of Project Finance Loans (A) <i>Prepare by reading textbook Ch. 20 on capital adequacy (SC) or Ch. 15 (Kidwell).</i> The Securitization System and Financial Crisis <i>Read "Did Securitization Lead to Lax Screening - Evidence from Subprime Loans" (Keys et al., QJE (2010))</i> Review and catch-up

⁷ This syllabus and course schedule will be revised from time to time over the course of the quarter and be reposted on the class website. Students are responsible for keeping up on changes, which will be announced in class and/or on Canvas.