



EC/FI 380 BANKING AND FINANCIAL INTERMEDIATION
IES Abroad Milan

DESCRIPTION:

What are the economic functions of financial intermediaries (FIs), and in particular of commercial banks? The main objective of this course is to address this question by analyzing the imperfections that affect the smooth functioning of financial markets. These imperfections explain why and how FIs play a special role in the economy.

The course focuses on credit intermediation, one of the main functions of banks and other FIs. Our analysis of credit intermediation will require students to develop an in-depth understanding of on-balance and off-balance sheet lending as well as of the management of interest risk and credit risk. Students will also become familiar with the basic concepts of market-based interest risk and credit risk hedging strategies. This course concludes with a discussion of the regulation of commercial banks.

CREDITS: 3 credits

CONTACT HOURS: 45 hours

LANGUAGE OF INSTRUCTION: English

PREREQUISITES: Basic knowledge of calculus and at least one prior course in finance, such as investments or corporate finance, is required

ADDITIONAL COST: None

METHOD OF PRESENTATION:

Lectures and in-class activities, conducted either individually or in groups, which will include:

- Lectures
- Case-studies (presentation of a case by the instructor and class discussion/analysis on specific questions)
- In-class exercises (application of quantitative models presented during the lesson, including models for measuring interest risk or credit risk)
- Discussion

REQUIRED WORK AND FORM OF ASSESSMENT:

- Course Participation - 10%
- Midterm Exam - 35%
- Group Assignment - 20%
- Final Exam - 35%

Course Participation

Class participation is a key component of the course. Students' contributions should reflect their reading and thinking about the topics covered. The style of the discussion will be informal and participative. A rubric for participation will be distributed on the first day of class.

Midterm Exam

The mid-term exam will be closed-book. It will consist of questions in multiple choice, short answer, and short essay format. The midterm exam will cover the content of lessons from 1 to 10. Students will be expected to know the main theoretical concepts of these lessons and to be able to solve exercises similar to those presented in class.

Group Assignment

The group assignment will take up two class sessions. In the first session, students will be split into groups and asked to work collaboratively on a case problem related to Banking in Europe (example topics may include the impact of the sovereign debt crisis,



the role of non-performing loans, SME lending technologies, or banking culture). Topics will differ between groups and relevant supplementary materials will be provided by the instructor.

During the first session, students will have time to analyze and prepare their cases. During the second session, each group will present its response to the case problem in the form of a 15-minute oral presentation. Students should plan to work outside of class between the two class sessions to develop and finalize their case analysis and presentations. Students will also be expected to submit a short analytical report of their response (2 pages or 1,000 words, single spaced). All students in each group will receive the same grade on the assignment.

Final Exam

The final exam will be closed-book. It will consist of questions in multiple choice, short answer, and short essay format. The final exam will cover the content of lessons from 12 to 21 (excluding lessons 17 and 18). Students will be expected to know the main theoretical concepts of these lessons and to be able to solve exercises similar to those presented in class.

LEARNING OUTCOMES:

By the end of the course, students will be able to:

- Recognize the structure and items of a bank’s balance sheet
- Explain the main characteristics of several on-balance sheet and off-balance sheet credit products
- Apply the appropriate methodologies to measure and manage interest risk and credit risk
- Compare the design of different derivative products used for hedging interest risk and credit risk
- Review the implications of regulation and regulatory reforms on the credit intermediation of commercial banks and other FIs

ATTENDANCE POLICY:

Regular class attendance is mandatory. Students are expected to attend classes each day. IES Abroad Milano allows a maximum of TWO excused absences per course, to be used for emergencies related to health, family, and religion. Each further absence will automatically result in a penalty of 2 points off (2/100) on the final grade. Please note that this rule does not apply to exams: failure to attend your midterm and/or final exam will automatically result in an F grade on that paper/exam. SEVEN absences per course will result in a failing grade (2 excused absences included). Furthermore, absence on the date of scheduled tests, presentations or quizzes does not entitle to recover/reschedule such tests. If using absences for travel, students must be aware that they may remain with no excusable absence in case of illness.

CONTENT:

Session	Content	Assignments
Week 1 Session 1	Introduction <ul style="list-style-type: none"> • Functions of FIs in the financial and economic system and the importance of regulation. 	<ul style="list-style-type: none"> • Chapter 1, pp. 2-26
Session 2	Commercial banks <ul style="list-style-type: none"> • Size, structure, balance sheet and trends of commercial banks. 	<ul style="list-style-type: none"> • Chapter 2, pp. 26-39
Week 2 Session 3	Commercial banks <ul style="list-style-type: none"> • Regulation of commercial banks, performance, and impact of the financial crisis. 	<ul style="list-style-type: none"> • Chapter 2, pp. 39-49

Session	Content	Assignments
Session 4	On-balance sheet activities: loans <ul style="list-style-type: none"> Introduction to the credit quality problem and the characteristics of the different types of loans (C&I, real estate, consumer and other). 	<ul style="list-style-type: none"> Chapter 10, pp. 279-289
Week 3 Session 5	On-balance sheet activities: loans <ul style="list-style-type: none"> The contractual and expected returns on a loan. Differences between retail and wholesale loans and the credit decision of FIs. <i>In-class exercises</i>: return on a loan 	<ul style="list-style-type: none"> Chapter 10, pp. 289-296
Session 6	Case Study <ul style="list-style-type: none"> <i>Case study</i>: asset-based lending in Italy. 	<ul style="list-style-type: none"> Case Study: <i>Credem: Banking on cheese</i> (25 pages)
Week 4 Session 7	On-balance sheet activities: loans <ul style="list-style-type: none"> Introduction to the measurement of credit risk. Qualitative and quantitative models of default risk. <i>Case study</i>: factoring environmental and climatic risks into corporate ratings. 	<ul style="list-style-type: none"> Chapter 10, pp. 296-304 Case Study: <i>How Environmental And Climate Risks And Opportunities Factor Into Global Corporate Ratings - An Update</i> (18 pages)
Session 8	On-balance sheet activities: loans <ul style="list-style-type: none"> Newer models of credit risk measurement and pricing. In-class exercises: measuring credit risk. 	<ul style="list-style-type: none"> Chapter 10, pp. 304-321
Week 5 Session 9	On-balance sheet activities: loans <ul style="list-style-type: none"> Loan portfolio and concentration risk. In-class exercises: measuring concentration risk. 	<ul style="list-style-type: none"> Chapter 11, pp. 331-345
Session 10	Off-balance sheet activities <ul style="list-style-type: none"> Types, risks and returns of off-balance activities. 	<ul style="list-style-type: none"> Chapter 16, pp. 485-508
Week 6 Session 11	MIDTERM	

Session	Content	Assignments
Session 12	Measuring interest risk <ul style="list-style-type: none"> Introduction to interest rate risk. Analysis of the interest rate risk with the repricing model. <i>In-class exercises</i>: measuring interest rate risk. 	<ul style="list-style-type: none"> Chapter 8, pp. 200-215
Week 7 Session 13	Hedging <ul style="list-style-type: none"> Introduction to forward and futures contracts. Hedging interest risk with forward futures contracts. 	<ul style="list-style-type: none"> Chapter 22, pp. 698-715
Session 14	Hedging <ul style="list-style-type: none"> Hedging credit risk with forward and futures contracts. 	<ul style="list-style-type: none"> Chapter 22, pp. 722-727
Week 8 Session 15	Hedging <ul style="list-style-type: none"> Introduction to caps, floors and collars. Hedging interest risk and credit risk with caps, floors and collars. 	<ul style="list-style-type: none"> Chapter 23, pp. 757-765
Session 16	Hedging <ul style="list-style-type: none"> Introduction to swaps. Hedging interest risk and credit risk with swaps. 	<ul style="list-style-type: none"> Chapter 24, pp. 773-783 and 786-791
Week 9 Session 17	Group Assignment <ul style="list-style-type: none"> “Banking in Europe” In-class presentations 	
Session 18	Group Assingment <ul style="list-style-type: none"> “Banking in Europe” In-class presentations 	
Week 10 Session 19	Loan sales and securitization <ul style="list-style-type: none"> Loan sales market and introduction to asset securitization. 	<ul style="list-style-type: none"> Chapter 25, pp. 803-813 and chapter 26, pp. 819-823

Session	Content	Assignments
Session 20	Regulation <ul style="list-style-type: none"> Introduction to deposit insurance and capital adequacy in commercial banks. Case study: Running on Northern Rock. 	<ul style="list-style-type: none"> Chapter 19, pp. 576-579 and chapter 20, pp. 619-625 Case Study: <i>Reflections on Northern Rock: The Bank Run That Heralded the Global Financial Crisis</i> (19 pages)
Week 11 Session 21	Regulation <ul style="list-style-type: none"> Capital adequacy: calculating risk-based capital ratios. 	<ul style="list-style-type: none"> Chapter 20, pp. 625-643
Session 22	Summary Lecture	
	FINAL EXAM	

REQUIRED READINGS:

- Anthony Saunders & Marcia Cornett, *Financial Institutions Management: A Risk Management Approach*, McGraw-Hill Education, 9th Edition (2018)
- Nikolaos Trichakis, Gerry Tsoukalas & Emer Moloney (2015), *Credem: Banking on Cheese*, HBS No. 9-615-046, Boston, MA: Harvard Business School Publishing
- S&P Global Ratings (2017), *How Environmental And Climate Risks And Opportunities Factor Into Global Corporate Ratings - An Update*, Standard & Poor's Financial Services LLC.
- Hyun Song Shin, "Reflections on Northern Rock: The Bank Run That Heralded the Global Financial Crisis", *The Journal of Economic Perspectives*, Vol. 23, No. 1 (Winter, 2009), pp. 101-120.