



BUSFIN 4265 –FINANCIAL INSTITUTIONS
Professor Isil Erel
Spring 2019

Meeting Times and Classroom: Session 1 (4374): TuTh 12:45PM - 2:05PM, Schoenbaum Hall 305
Session 2 (4237): TuTh 2:20PM - 3:40PM, Schoenbaum Hall 220

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Office Hours: Mondays 2:00-3:00pm or by appointment

Course Webpage: on Canvas

Course Description

This course will introduce students to financial institutions and their important economic function. The course will examine the structure and operation of financial institutions in the U.S., with particular attention paid to the various risks and complex challenges facing these institutions. While there are no easy solutions to the challenges and problems faced by financial institutions, we will cover these issues in depth, with the objective of developing a solid understanding of them.

Prerequisites

There are no official prerequisites for this course. Students are expected to have a basic knowledge of finance, accounting, and statistics.

Required Reading

Course Packet [*referred to as "CP" below*], available at HBS Publishing. Please follow this link <https://hbsp.harvard.edu/import/587173> and follow the instructions below:

- Click "Register Now."
- Enter name, email, and educational program, and create a username and password.
- Click "Register."
- Login with the username and password you just created.
- Purchase the material.

Recommended Reading

Saunders and Cornett [*referred to as "SC" below*], *Financial Institutions Management: A Risk Management Approach*, 8th or 9th edition, McGraw-Hill (for the latest edition: ISBN 9781259717772). Textbook is not required but highly recommended. A few copies are available on the Closed Reserves at the Thompson Library.

Supplemental Readings

Articles are available on the course webpage [*referred to as "CW" below*]. Please see the tentative course outline below for a list. Also note that these readings are OPTIONAL.

Students are strongly encouraged to read financial press to reinforce the applicability of the topics that we cover in class.

Pedagogy

The course will be structured as a combination of lectures, discussions, and cases. I will post my PowerPoint slides on the course website on Canvas before each class to help you follow the lectures and take notes. Please remember that posted slides are not complete. For completeness, you should attend the lectures. Please also note that we will have a few guest lecturers throughout the semester. Please see the *tentative course outline* below for their names and affiliations.

Grading

The final course grade will be allocated as follows:

Individual Class Participation	5%
Individual Assignments	15% (5% each)
Group Case Write-ups	15% (5% each)
Exam I	30%
Exam II	35%

Class Participation: Students are expected to attend each class in a timely fashion and take part in discussions. Class participation will be graded based on my assessment of both the quantity and quality of an individual's contribution to case and lecture discussions.

Please *choose a seat for the entire term*, no later than the second-class session. This makes it easier for you to interact during class discussions and easier for me to facilitate grading for class participation.

Case Write-up: Cases are in the course packet [CP]. You will write a case report/executive summary for three of the cases in groups. Detailed instructions with questions for each case will be posted on Canvas. Please form a study group of **3 to 5 students** for the case write-up. You can work with students from the other section as well. You must give me a list of your group members by second week of classes (**by January 17 at the latest**). If necessary, I will assign students to groups already formed, starting with the smallest groups. However, **I would prefer that you find a team yourself** (please talk with friends in the same classroom as soon as you can).

All groups should come fully prepared to discuss their case solution with the rest of the class and should **hand in** a typed case write-up (one per team) **before the class discussion starts**. You should also retain a copy for yourself for class discussion.

Also, you will have the opportunity to evaluate your team members at the end of the quarter. Evaluation sheets with a detailed explanation will be posted on Canvas and they are **OPTIONAL**.

Individual Assignments: There will be three individual assignments. They will be posted on the course website on Canvas. **It is very important that you complete the assignment individually**. I will also post sample problems from the textbook with solutions on Canvas.

Exams: There will be two exams. Each exam will cover all material taught until the date of the exam. The second exam will be during Finals' Week. It will be comprehensive in scope, including materials from every part of the course. Both exams will be closed-book. You can use nonprogrammable functions of a calculator.

Absences and Late Assignments

Absence from the exams will not be excused, except for the most serious circumstances. Such circumstances must be validated in writing by an appropriately accredited professional (e.g. medical doctor). *Any unexcused absences in exams will result in a grade of zero*. Late assignments will not be accepted for credit. As a matter of professional courtesy, please notify me *in advance* if you are unable to attend a particular class.

Regrading Policy

Grading errors will be corrected. All regrade appeals must be submitted within *one week after the graded test is returned*. Any exam submitted for regrading of a question is subject to complete regrade. As a result, the regraded score may increase, stay the same, or decrease after a careful consideration. *I will not consider any regrade requests after the one-week deadline has passed.*

Disenrollment Policy

Fisher College of Business strongly enforces University attendance policies. As per University rule 3335-8-33 (<http://trustees.osu.edu/rules/university-rules/rules8/ru8-33.html>), any student may be disenrolled from a course for failure to attend by the first Friday of the term, or by the 3rd instructional day of the term, or by the second class meeting, *whichever occurs first*.

Disability Services

The Office of Disability Services verifies students with specific disabilities and develops strategies to meet the needs of those students. Students requiring accommodations based on identified disabilities should contact the instructor at the beginning of the quarter to discuss his or her individual needs. All students with a specific disability are encouraged to contact the Office of Disability Services to explore the potential accommodations available to them.

Academic Misconduct

All students are expected to abide by the Fisher College Honor Code: *“As a member of the Fisher College of Business Community, I am personally committed to the highest standards of behavior. Honesty and integrity are the foundations from which I will measure my actions. I will hold myself accountable to adhere to those standards. As a future leader in the community and business environment, I pledge to live by these principles and celebrate those who share these ideals.”* All students are also expected to adhere to the University’s Code of Academic Integrity. Academic misconduct will not be tolerated. According to the university rules, all suspected cases of academic misconduct will be reported to the Committee on Academic Misconduct.

Tentative Course Outline

This outline is tentative and subject to change. Please refer to the course website on Canvas for updates on readings, homework problems, and case assignments. It is the students’ responsibility to check the course website for updates and announcements.

Class 1 Course Overview

Jan 8

Topics: Course Organization and Requirements

Class 2 Introductions to Financial Institutions, Depository Institutions (Commercial Banks)

Jan 10

Topics: Introduction to Financial Institutions
 Functioning of the Commercial Banks

Recommended Readings:

Saunders & Cornett: *Financial Markets and Institutions: A Risk Management Approach* (“S&C”) Ch. 1-2

Supplemental Readings:**Some examples of recent academic research, on Canvas course website [CW]:**

A Theory of Risk Capital (Isil Erel, Stewart Myers, and James Read, Jr.), 2015, *Journal of Financial Economics*, 118/3, 620-635.

Why did Holdings of Highly-Rated Securitization Tranches Differ So Much Across Banks?, 2014, (Isil Erel, Taylor Nadauld, and Rene Stulz), 2014, *Review of Financial Studies*, 27/2, pages 404-453.

Governance, Risk Management, and Risk-Taking in Banks (Rene Stulz), 2014, Ohio State University Working Paper.

Classes 3 Commercial Banks (Cont.)

January 15

Topics:

Financial Statements and Analysis
Governance of Commercial Banks

Recommended Readings:

S&C Appendix 2A, and Appendix 2B

Supplemental Readings:

Lessons from the Great Credit Crisis, S&P [CW]

Corporate Governance and Banks: What Have We Learned from the Financial Crisis? (Hamid Mehran Alan Morrison Joel Shapiro), 2011, Working Paper.

Class 4 Federal Reserve System

January 17

**Guest Speaker: Greg Stefani, First Vice President and Chief Operating Officer
Federal Reserve Bank of Cleveland**

Class 5 Case: Hong Kong Disneyland Loan

January 22

Note: Case write-up is due at the beginning of the class.

Topics: Syndicated Lending

Required Readings:

Case: Chase’s Strategy for Syndicating the Hong Kong Disneyland Loan (A) [CP]

Supplemental Readings:

A Syndicated Loan Primer, April 2016, S&P [CW]

Classes 6 Other Lending Institutions

January 24

Topics: Saving Institutions
Credit Unions

Finance Companies

Recommended Readings:

S&C Ch. 2 and Ch.3

Supplemental Readings:

Savings and Loan Crisis (Ely), *The Concise Encyclopedia of Economics [CW]*

Class 7 Shadow Banking

January 29

Note: First Individual Assignment is due at the beginning of the class.

Required Readings:

Case: GE and the Shadow Banking Landscape [CP]

Supplemental Readings:

Shadow Banking, Background Note, Soley Sans and Sánchez de Leon, HBS Publishing [CP]

Thinking Critically about Nonbank Financial Intermediation (Tarullo), The Brookings Institution, 2015 [CW]

Classes 8&9 Bank Regulation (Deposit Insurance & Capital Requirements)

January 31 & February 5

Topics:

Creation of FDIC
Moral Hazard due to Deposit Insurance
Savings and Loan Crisis
Capital Requirements (Basel Capital Accords)

Recommended Readings:

S&C Ch. 19 and Ch. 20

Supplemental Readings:

Basel “IV”: What’s next for banks? *McKinsey&Company Global Risk Practice, April 2017 [CW]*

Class 10 A Case on Basel III

February 7

Note: Case write-up is due at the beginning of the class.

Required Readings:

Case: Deutsche Bank and the Road to Basel III [CP]

Supplemental Readings:

Deutsche Bank: Still Struggling on Capital, *WSJ [CW]*

Deutsche Bank: What to Know, *WSJ [CW]*

Class 11 Liquidity Creation

February 12

Note: Second Individual Assignment is due at the beginning of the class.

Topics:

Liquidity Creation
Managing Liquidity
1998 Liquidity Crises

Recommended Readings:

S&C Ch. 12

Supplemental Readings:

How do Banks Manage Liquidity Risk? Evidence from the Equity and Deposit Markets in the Fall of 1998 (Gatev, Schuermann, and Strahan), *NBER*, 2005 [CW]

Class 12 Consumer Lending, Recent Changes in Banking and Bank Regulation

February 14

Guest Speakers: Monique Riccobelli (Commercial & Consumer Loan Servicing Director)

and Todd Householder (Securities Marketing & Risk Management Director), Huntington Bank

Supplemental Readings:

Dodd-Frank Act Stress Test 2018 [CW]

Class 13 Review

February 19

Class 14 IN-CLASS MIDTERM EXAM

February 21

Classes 15&16 Off-Balance-Sheet Banking & Loan Securitization

February 26 & February 28

Topics: Off-Balance-Sheet Assets/Liabilities
Loan Commitments
Securitization of Mortgages
Fannie Mae and Freddie Mac

Recommended Readings:

S&C Ch. 16 and Ch. 26

Supplemental Readings:

The Economics of Structured Finance (Coval, Jurek, and Stafford), 2009 [CW]

Understanding the Securitization of Subprime Mortgage Credit (Ashcraft and Schuermann), 2008 [CW]

Fussing and Fuming over Fannie and Freddie: How Much Smoke, How Much Fire? (Frame and White), 2005 [CW]

Classes 17&18 Measuring Interest Rate Risk

March 5 & 7

Topics: The Case of Homeside Lending
Repricing GAP
Duration and Convexity

Recommended Readings:

S&C Ch. 8&9

Supplemental Readings:

NAB Lesson in How to Burn \$3 billion (Hooper), *Radio National*, 2001 [CW]

Classes 19&20 Measuring Credit Risk

March 19&21

Topics: Calculating Return on a Loan
CreditMetrics of JP Morgan (VaR)
RAROC Models

Recommended Readings:

S&C Ch. 10 and Chapter 11 (only the VaR calculation)

Supplemental Readings:

Cycles and the Credit Culture (Henry Mueller) [CW]

Optional Reading:

If you want to learn about Moody's KMV, which is not covered in this class: Modeling Default Risk (Crosbie and Bohn), *Moody's KMV*, 2003 [CW]

Class 21 Credit Risk from a Practitioner's Perspective

March 26

Guest Speakers: Jeff Weaver, Executive VP & Director Qualitative Risk Assessment, KeyBank

Class 22 Insurance Companies

March 28

Topics: Risk and Insurance

Recommended Readings:

S&C Ch. 6

Supplemental Readings:

A Lively Market in 'Death Bonds' (Pleven and McDonald), *WSJ*, 2007 [CW]

Class 23 Trends and Challenges in the Insurance Industry

April 2

**Guest Speakers: Jillian Froment, Director Ohio Department of Insurance
Phil Renaud, Executive Director, Risk Institute**

Recommended Readings:

Risk Finance Challenge

Classes 24 Mutual Funds, Hedge Funds, Private Equity

April 4

Recommended Readings:

S&C Ch. 5

Supplemental Readings:

Investment Company Fact Book, *Investment Company Institute*, 2018 [CW]

Class 25 Investment Banks

April 9

Note: Third Individual Assignment is due at the beginning of the class.

Topics: Investment Banks and Securities Firms
 Securities Underwriting
 Bookbuilding
 Underpricing of IPOs

Recommended Readings:

S&C Ch. 4

Role of the Investment Bank (Connelly, Fox, and Klausner), UBS, 2005 [CW]

Initial Public Offerings: Going by the Book (Benveniste and Wilhelm), *Journal of Applied Corporate Finance*, 1997 [CW]

Optional Readings:

IPO Statistics (Ritter), 2018 [CW]

Secondary Market Stabilization of IPOs (Wilhelm), *Journal of Applied Corporate Finance*, 1999 [CW]

SEC Sues Morgan Stanley and Goldman Sachs for Unlawful IPO Allocation Practices, 2005 [CW]

Class 26 Pension Funds

April 11

Guest Lecturer: Brian Grinnell, Chief Actuary, STRS Ohio

Class 27 Case Discussion: Chase Manhattan Corporation

April 16

Note: Case write-up is due at the beginning of the class.

Topics: Bank Mergers
 Value Creation in Corporate Restructurings

Required Reading:

Case: Chase Manhattan Corporation: The Making of America's Largest Bank [CP]

Class 28 Review Session

April 18

Review of the Past Exams

Final Exam

Session 1 (4374): Thursday Apr 25, 2:00pm-3:45pm in class

Session 2 (4237): Wednesday Apr 24, 2:00pm-3:45pm in class