



BUSFIN 7260 - FINANCIAL INSTITUTIONS

Professor Isil Erel
Spring 2019 – Term 2

Meeting Times and Classroom: Session 1 (4287): MW 10:15AM - 11:45AM, GE 265
Session 2 (4049): MW 1:00PM - 2:30PM, GE 305

Professor: Isil Erel, David A. Rismiller Chair in Finance

<https://fisher.osu.edu/people/erel-koksall.1>

Office: 832 Fisher Hall

Email: erel@fisher.osu.edu

Office Hours: by appointment

Course Webpage: on Canvas

Course Description

This course is concerned with key problems that managers of financial institutions face, with a special focus on risk management. We will begin with an overview of financial institutions – how major types of institutions are structured, how this structure relates to their functions, and some industry trends. Next we will focus on managing different types of risks: interest-rate risk, credit risk, and off-balance-sheet risk; emphasizing basic ideas, tools, and business applications. Then we will have a case discussion on bank mergers. We will also discuss the evolution of the financial services industry, causes and consequences of the 2008 credit crisis, and the response of the regulators. The course is essential to anyone planning a career in financial services or in an area such as consulting or corporate treasury that works closely with financial institutions.

Prerequisites

Students are expected to have a basic knowledge of finance, accounting, and statistics. Assignments will involve the use of personal computers (especially MS EXCEL) and/or calculators. For the final exam, only non-programmable functions of your calculator are allowed.

Required Reading

Course Packet [*referred to as “CP” below*], available at HBS Publishing. Please follow this link <https://hbsp.harvard.edu/import/603903> and follow the instructions below:

- a. Click “Register Now.”
- b. Enter name, email, and educational program, and create a username and password.
- c. Click “Register.”
- d. Login with the username and password you just created.
- e. 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 before each class to help you follow the lectures and take notes. ***Please remember that slides are not complete.*** For completeness, you should attend the lectures and read the required readings.

Don Kimble (CFO, KeyBank) and Helga Houston (CRO, Huntington Bank) will be our guest speakers.

Grading

The final course grade will be allocated as follows:

Individual Class Participation	15%
Three Case Write-ups (in Groups)	45% (15% each)
Final Exam	40%

Class Participation: Students are expected to do readings before class, attend each class in timely fashion, and, above all, 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. I would appreciate your bringing the name cards to every class session.

Case Write-ups: Four cases (“GE and the Shadow Banking Landscape,” “Banc One Corporation: Asset and Liability Management,” “Chase Manhattan Corporation: The Making of America’s Largest Bank”, and “Deutsche Bank and the Road to Basel III”) are available in the course packet and three of them, as specified in the tentative course outline below, will be assigned for formal write-up. Students are strongly encouraged to form study groups to work on the cases that are assigned in the course. A study group may consist of **3 to 5 students**. You must give me a list of your group members by the beginning of the second week of class and groups may not be changed without my permission. If necessary, I will assign students to groups already formed, starting with the smallest groups.

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) at the ***beginning*** of class on the day we cover the case (you should also retain a copy for yourself for class discussion). Detailed instructions on each case write-up will be available on the course website at Canvas. Case discussions are very important and will only succeed if you put in a good effort. Also, you will have the opportunity (OPTIONAL!) to evaluate your team members at the end of the quarter. An evaluation sheet with a detailed explanation is posted on Canvas.

Optional Assignments: There will be problem sets, which will *not* be graded. They will be posted (with solutions) on the course website on Canvas. It is very important that you complete the homework problems in preparation for the exams. I will also post sample problems from the textbook and from old exams with solutions on Canvas.

Exam: There will be one final exam, which will be comprehensive in scope including materials from every part of the course. The exam will be closed book. You will be allowed one double-sided page of formulas (please see Canvas for an example) and a calculator.

Absences and Late Assignments

Absence from the exam or assignments 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 absence in exam will result in a grade of zero.* Late assignments will not be accepted for credit, except for the most serious reasons as described above. 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 or assignment is returned.*

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 changes. Please refer to the course website on Canvas for updates on readings, sample problems, and case assignments. It is the students’ responsibility to check the course website for updates and announcements.

Classes 1&2 Course Overview and Introduction to Financial Institutions
February 27 & March 4

Topics: Course Organization and Requirements
 Commercial Banks

Saving Institutions
Finance Companies

Recommended Readings:

Saunders & Cornett (referred to as “S&C” below) Ch. 2, Appendix 2A, 2B

Supplemental Readings:

Financial Intermediation as Delegated Monitoring: A Simple Example (Diamond), *RFB of Richmond Economic Quarterly*, 1996 [Link at Course Website (referred to as “CW” below)]

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.

For Some Examples of Recent Academic Research:

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), *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.

Class 3 Shadow Banking & Off-Balance-Sheet Banking

March 6

Topics: Shadow Banking
 Off-Balance-Sheet Assets/Liabilities
 Loan Commitments
 Loan Sales

Required Reading: *Case:* GE and the Shadow Banking Landscape [CP]

Recommended Readings:

S&C Ch. 16 and Ch. 26

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

Supplemental Readings:

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

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]

Class 4 Measuring Interest Rate Risk

March 18

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

Recommended Readings:

S&C Ch. 8, Ch. 9, and Appendix 9B

Supplemental Readings:

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

Classes 5&6 Hedging Interest Rate Risk

March 20&25

Topics: Duration GAP
 Hedging with Interest Rate Futures
 Hedging with Interest Rate Swaps

Recommended Readings:

S&C Ch. 22 (pg.691-707) and Ch. 24 (pg.766-778)

Interest Rate Derivatives (Tufano and Headley), *HBS Publishing*, 1994 [Course Packet (referred to as "CP" below)]

Class 7 Case I: Banc One Corporation

March 27

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

Topics: How Banks Measure and Control Their Interest-Rate Exposure
 Interest Rate Derivatives

Required Reading:

HBS Case: Banc One Corporation: Asset and Liability Management [CP]

Recommended Reading:

Interest Rate Derivatives (Tufano and Headley), *HBS Publishing*, 1994 [CP]

Class 8 Measuring Credit Risk

April 1

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

Recommended Readings:

S&C Ch. 10 and Appendix 11A

Recommended Reading:

LCD Loan Primer, 2019, S&P [CW]

Class 9 Practitioner's Perspective - I

April 3

Guest Speaker: Don Kimble, Chief Financial Officer, KeyBank

Class 10 Measuring Credit Risk (continued)

April 8

Topics: CreditMetrics of JP Morgan (VaR)

RAROC Models

Recommended Readings:

S&C Ch. 10 and Appendix 11A

Supplemental Reading:

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 11 Practitioner's Perspective - II

April 10

Guest Speaker: Helga Houston, Chief Risk Officer, Huntington Bank

Class 12 Case II: Chase Manhattan Corporation

April 15

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 13 Banking Regulation

April 17

Topics: Deposit Insurance
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]

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

Class 14 A Case on Basel III

April 22

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

Required Reading:

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]

FINAL EXAM: Monday, April 29th at 1:00pm!