Approved by Academic Subcommittee of
Master's Programme in Financial Economics
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Banking

Lecturers: Dr. Luca Gelsomini, Dr. Vladimir N. Sokolov

Abstract

Banking is an elective course for the master level students at ICEF. The course runs in the second semester and is divided into parts. The first part of the course (part A) is theoretical and is taught by Dr. Luca Gelsomini. The second part of the course (part B) is empirical and is taught by Dr. Vladimir Sokolov.

Prerequisites

For part A (taught by Dr. Gelsomini), some knowledge of game theory and the basic concepts of modern finance is recommended. For part B (taught by Dr. Sokolov), a good knowledge of panel data econometrics methods and bachelor's level of banking is recommended.

Methods of Instruction

The following methods and forms of study are used in the course:

- Interactive lectures
- Student presentations
- Self-study

Learning Objectives and Outcomes

Part A of the course aims to provide an overview of the theoretical aspects of banking. Part B will cover the main empirical contributions that have been recently published in the academic journals. This material will illustrate how banking theories introduced in the first part of the course stand against the empirical evidence. The chosen topics are also intended to advance the students' understanding of the main regulatory debates regarding the role of banking industry in the economy. The course starts with a review of the banks' financial statements and definitions of concepts that will be used in the following lectures. Then it covers the main activities of banks – lending and attracting deposits. The issues of credit rationing and relationship banking that have received a lot of focus in the academic literature will be highlighted. When covering the deposit attraction activities of banks the concept of bank runs and liquidity risk will be reviewed. This motivates assessment of the popular regulatory policy implemented in many countries - deposit insurance. We will discuss studies that investigate the moral hazard and risk shifting problems that arise due to deposit insurance policies. The last several lectures are related to the very active debate on prudent regulation of the banking industry that gained a lot of attention following the recent financial crisis. The banking theories often provide contradictory answers to the following questions that are very important to the regulators: Does policy of promoting higher competition among bank lead to banking sector stability? Do we need large or small banks? Do higher capital requirement imposed on banks lead to lower risk-taking by banks? What ownership structure leads to better corporate governance? The broad range of empirical papers that shed light on these questions will be discussed. In the end of the course each student will be present one academic paper on the issues covered in the course.

The student should be able to apply professional knowledge and skills acquired while studying the course in practical areas, including academic research, work in financial institutions, industry, state governance.

Grading System and Knowledge Assessment

Your performance will be evaluated on the basis of the following criterions:

- Attendance
- In-class performance
- Student presentations
- Exam

The mark assigned to the first component (part A) represents the 40% of the overall mark. The mark assigned to the second component (part B) represents the 60% of the overall mark. Specifically:

For what concerns part A (taught by Dr. Gelsomini):

- Weight of the attendance mark = (40%)x(15%) of the overall mark
- Weight of the in-class performance mark = (40%)x(20%) of the overall mark
- Weight of the final examination mark = (40%)x(65%) of the overall mark

For what concerns part B (taught by Dr. Sokolov):

- Class participation = (60%)x(5%)
- Student presentations = (60%)x(30%)
- Final exam = (60%)x(65%) of the overall mark

As indicated above, the final grade for the Banking course is the weighted sum of the final marks in each of the two components with weights for the first and second components being respectively 40% and 60%.

Sample materials for knowledge assessment are available in ICEF Information system at https://icef-info.hse.ru.

Required reading

- Degryse, H., Kim, M., Ongena, S., Microeconometrics of Banking: Methods, Applications and Results, Oxford University Press, 2009.

Optional reading:

- Mishkin, F. S., 1992. The economics of money, banking and financial markets. London: Scott, Foresman.
- Freixas X. and J.-C. Rochet, 2008. Microeconomics of Banking, Second Edition. Cambridge, Mass.: MIT Press.

Special Equipment and Software Support

Laptop, projector, Internet connection

MS Word, MS Excel

Course plan

Part A

- Why financial intermediaries exist.

Our first objective is to understand what a bank is, what banks do, and the role of banks in the resource allocation process. In particular, in order to assess why financial intermediaries exist, we will study what are the important features of reality that are overlooked in the Arrow-Debreu model of complete contingent markets.

- The asymmetric information justifications of financial intermediation.

Our second objective is to present the asymmetric information justifications of financial intermediation by exploring different theories of financial intermediation. In particular, we will focus on the model with adverse selection by Leland and Pyle (1977) to show that if borrowers form partnerships (which are interpreted as financial intermediaries), they are able to obtain better financing conditions than by borrowing individually.

- The equilibrium of the credit market.

We study credit market by focusing on the possibility of credit rationing (the demand from credit exceeds supply at the prevailing interest rate).

- Bank runs and the lender of last resort.

Bank runs may develop into a bank panic. We focus on how the Central Bank could prevent such contagion by playing the part of a lender of last resort.

- Regulation and its justifications.

We examine the justifications of banking regulation (fragility of banks and cost of bank failures; protection of depositors' and customers' confidence, cost of bank failures) and instruments of banking regulations.

Part B:

1. Overview of the bank's financial statements, measures of market power and bank's soundness

Non-performing loans, Bank reserves, Net interest rate margin, HirschmannHerfindahl index, CR3, Panzar-Rosse H-statistic, Lerner index, Z-score

2. Bank lending

Loan pricing, Credit rationing, Adverse selection, Relationship lending, Risk overhang

3. Bank funding and liquidity risk

Deposit contracts, Market discipline, Bank runs, Liquidity insurance, Deposit insurance

4. Deposit insurance and banks' risk taking

Moral hazard, Liquidity regulation, Liquidity risk management, Liquidity coverage ratio

5. Competition, risk taking, capital requirements

Competition-fragility hypothesis, Competition-stability hypothesis, Franchise or charter value of banks, risk-shifting problem, rationale for capital requirements, screening of borrowers

6. Banks' size, Too-Big-to-Fail

Economy of scale, Too-Big-to-Fail (TBTF)

7. Bank capital and regulation

Capital structure of banks, capital regulation, regulatory capital, Basel accords, riskweighted assets

8. Bank ownership and governance

Government ownership of banks, cooperative banks, corporate governance of banks

9-10. Student's presentations of academic papers