

The Hong Kong University of Science & Technology
Department of Finance
FINA 331: Management of Financial Institutions
Fall Semester 2009

Lecturer:

Prof. Jonathan A. Batten
Room 5472, Department of Finance
Office: +852-2358-8202
Fax: +852-2358-1749
Email: jabatten@ust.hk
<http://www.bm.ust.hk/fina/staff/jabatten.html>
Office Hours: Wednesday/Friday 13:30 – 14:30

Teaching Assistant:

Mr. Wade Ho
Room: 2391
Office: +852-2358-7675
Email: wadeho@ust.hk
Office Hours: TBA

Lectures: L2 (1500-1620) and L1 (1630-1750) Room 4503 Wednesday and Friday

Reuters Lab Times:

- a) October 7th, 2009, 15:00-17:50 (This comprises a basic introduction to the Reuters pricing system and is held in lieu of the Wednesday lecture in week 6.
- b) The Lab will be available for exclusive use by FINA 331 students at a time to be advised

Course Outline

The key focus of Finance 331 is on managing return and risk in modern financial institutions (FI). The central theme is that the risks faced by financial institutions managers and the methods and markets through which these risks are managed are becoming increasingly similar whether an institution is chartered as a commercial bank, a savings bank, an investment bank, or an insurance company.

Although the traditional nature of each sector's product activity is analyzed, a greater emphasis is placed on new areas of activities such as asset securitization, off-balance-sheet banking, and international banking.

The major theme of the course is the measurement and management of FI risks. In particular, although we might categorize or group FIs and label them life insurance companies, banks, finance companies, and so on, in fact, they face risks that are more common than different. Specifically, all the FIs described (1) hold some assets that are potentially subject to default or credit risk and (2) tend to mismatch the maturities of their balance sheets to a greater or lesser extent and are thus exposed to interest rate risk. Moreover, all are exposed to some degree of saver withdrawal or liquidity risk depending on the type of claims sold to liability holders. And most are exposed to some type of underwriting risk, whether through the sale of securities or by issuing various types of credit guarantees on or off the balance sheet. Finally,

all are exposed to operating cost risks because the production of financial services requires the use of real resources and back-office support systems.

Course Objectives:

Upon completion of this course a student should be able to:

1. Identify the principal assets, liabilities and sources of value creation for various financial institutions
2. Identify and describe the principal risks that financial institutions face and explain how they go about managing these risks
3. Calculate a financial institutions exposure to currency, interest rate and other market risks and explain how these risks could be managed
4. Describe and explain recent innovations in financial institutions
5. Explain why and how financial institutions are regulated, included regulations involving capital adequacy, liquidity, market structure and deposit insurance
6. Describe and explain how investment banks create value
7. Describe the financial markets of the Asia-Pacific region and identify the structural problems that may expose institutions and countries to risk.

Textbook:

“Financial Institutions Management: A Risk Management Approach” by Anthony Saunders (New York University) and Marcia Millon Cornett (Southern Illinois University – Carbondale). Edition 6e (International edition), McGraw-Hill Higher Education 2008.

ISBN: 978-007-126704-5.

Note a copy of the textbook has been placed on 2-hour closed reserve. PDF’s containing chapter summaries and all end-of-chapter problems will be placed on the LMES system.

Course Content:

PART ONE: Introduction

- 1 Why Are Financial Intermediaries Special?
- 2 The Financial Services Industry: Depository Institutions
- 3 The Financial Services Industry: Insurance Companies
- 4 The Financial Services Industry: Securities Firms and Investment Banks
- 5 The Financial Services Industry: Mutual Funds and Hedge Funds
- 6 The Financial Services Industry: Finance Companies
- 7 Risks of Financial Intermediation

PART TWO: Measuring Risk

- 8 Interest Rate Risk I
- 9 Interest Rate Risk II
- 10 Market Risk
- 11 Credit Risk: Individual Loan Risk
- 12 Credit Risk: Loan Portfolio and Concentration Risk
- 13 Off-Balance-Sheet Risk
- 14 Foreign Exchange Risk
- 15 Sovereign Risk
- 16 Technology and Other Operational Risks
- 17 Liquidity Risk

PART THREE: Managing Risk

- 18 Liability and Liquidity Management
- 19 Deposit Insurance and Other Liability Guarantees
- 20 Capital Adequacy
- 21 Product Diversification
- 22 Geographic Expansion
- 23 Futures and Forwards
- 24 Options, Caps, Floors, and Collars
- 25 Swaps
- 26 Loan Sales
- 27 Securitization

Assessment

1. Midterm Multiple Choice Exam: Friday 16th October 2009: worth 20 % (1 hour). Note a ONE-SIDED A4 page cheat sheet can be brought into the test.
2. Final exam: Date TBA: worth 40 % (2 hour). Note a ONE (both sides) A4 page cheat sheet can be brought into the final exam.
3. Group report (maximum of 5-students with cross-class groups allowed): Due Monday 7th December 2009 by EMAIL: worth 20%. Note a brief overview of the report findings will need to be presented in week 14 class commencing 30th November–maximum of 10 minutes for the presentation. This presentation will be worth 5 of the available 20 marks. The group report will be a maximum of 1200 words and should follow the style of an academic article (introduction, brief overview of literature-theory, literature-empirical evidence, analysis/discussion, conclusion, references), be 12 points font Times Roman. Late submissions will automatically be penalised 5-marks for 1-day late, 8-marks for 2-days late, 10-marks for 3-days late, 11-marks for 4-days late and 12-marks for 5-days late. Submissions later than 5-days will receive no marks at all.

Report Topic: “Recent articles investigating financial market development highlight the interlocking funding relationships between corporations, banks and governments. Investigate the *liability* positions of Asia-Pacific (non-Japan) banks generally (i.e. from a regional and specific country perspective). Where possible discuss any currency and maturity mismatches that may be evident (termed the “double mismatch” problem) and the implications that this may have for banking regulation and financial market development more generally. Can you offer any solutions to problems that arise? In conclusion discuss what is critical for the next stage of development of Asia-Pacific financial markets. Explain your answer using specific examples of policy that could be adopted by governments in the region”.

4. Group assignment on bond switching (liability strategies) using the Reuters Modelling software. (Note you should use the same group as in 3.) The assignment is worth 10%. You will first be required to attend a Workshop (Wednesday 7th October 2009) in the Financial Laboratory to learn and then utilize the Reuters Fixed Income system. After this Workshop a group assignment will need to be completed. The assignment must be handed in on the 4th November. Late assignments will not be accepted. (To ensure pricing is current specific details will be provided in Week 4)

5. Class participation 10% (Note a class roll will be taken at random times during the semester and will contribute to this score).

The course will comprise various topics that will be delivered over the 13 week period 1/10/2009 to 4/12/2009. Note the exam period is 10-19th December and usually FINA 331 exams are held at the END of the Exam Period. If students need to travel prior to the end of the exam period they will need to make arrangements to sit a supplementary exam. The decision as to the time of the final and supplementary exam is made by the Administration and will require a physical presence in Hong Kong.

IT WOULD BE VERY, VERY HELPFUL (ESPECIALLY FOR CLASS PARTICIPATION MARKS) IF STUDENTS PROVIDED A PHOTO (CAN BE A COPY) WITH NAME AND ID ON A CARD AS FOLLOWS:

Miscellany

Each student is required to hand in a name card with a recent photo in the following format by the end of the third week.

<p>Your Photo</p>	<p>HKUST, FINA361, Spring 2005, L1 Name (English): Law Suet-Ming, Lisa Name (Chinese): ID number: 98000001 E-mail Address: fn smlaw@stu.ust.hk Major: Finance</p>
-------------------	---

Week	Monday	Class (Wed)	Class (Friday)	Review Questions	Other Events/Comments
Week 1	31-Aug	Chapter 1	Chapter 2	1.1-1.9, 1.35, 2.1-2.4,2.9	
Week 2	07-Sep	Chapter 3/4	Chapter 5	3.1-3.5, 4.1-4.8, 5.1-5.5, 5.13	
Week 3	14-Sep	Chapter 6	Chapter 7	6.1-6.5, 7.1-7.6, 7.21	
Week 4	21-Sep	Chapter 8	Chapter 9	8.1-8.5, 8.12, 8.18, 9.1, 9.2, 9.17	
Week 5	28-Sep	Chapter 10	No Class	10.1-10.5	
Week 6	05-Oct	Finance Lab Session	Chapter 11	11.1-11.5,11.14,11.18,11.19	
Week 7	12-Oct	Chapter 12	Test Chapters 1-10	12.1-12.4, 12.6, 12.16,12.22	1-hour MC Test Friday 16th October (20-marks)
Week 8	19-Oct	Chapter 13	Chapter 14/15	13.1-13.2, 13.10, 13.12, 14.1-14.4, 15.1-15.5	
Week 9	26-Oct	Chapter 16/17	Chapter 18	16.1-16.3, 17.1-4, 17.11, 18.1-18.3	
Week 10	02-Nov	Chapter 19	Chapter 20	19.1, 19.4, 19.5-19.7, 20.1-20.4	Reuters Lab Project Due 4th November (10 marks)
Week 11	09-Nov	Chapter 21/22	Chapter 23/24	21.1-21.4, 22.1-22.5, 23.1-23.4, 24.1-24.6	Note: Derivative products will not be discussed in detail
Week 12	16-Nov	Chapter 25	Chapter 26	25.1-25.5, 26.1-26.3	
Week 13	23-Nov	Chapter 27	Review	27.1-27.6	Note: Securitisation will not be discussed in detail
Week 14	30-Nov	Presentations	Presentations		Group Project Presentations Wed/Fri (5 marks)
Week 15	07-Dec	End of Class			Group Project Due (Email) 07 December (15 marks)
Study Break Ends	09-Dec				Exam 10-19th December (40 marks)
Exams End	19-Dec				
					Total Marks 100:
					Multiple Choice 1-Hour test 20 marks
					Reuters Assignment 10-marks
					Group Project 20 marks
					Final Exam 40 marks
					Class Participation Mark 10 marks

