UNIT OUTLINE

2003

ECON335

THE ECONOMICS OF FINANCIAL INSTITUTIONS

Contents: 1. Course Overview  
2. Enquiries  
3. Course timetable  
4. Assessment  
5. Lecture topics  
6. Text book  
7. Reading list  
8. Essay topic  
9. Essay Cover Sheet

Dr Sean Turnell  
Lecturer-in-charge
ECON 335: ECONOMICS OF FINANCIAL INSTITUTIONS

I. COURSE OVERVIEW

Banking and finance institutions today have evolved into complex organisms that play a centrally important role in the modern economy. The management of financial corporations is a highly specialised task with many unique aspects. And the success (or failure) of banks carries the potential for significant ramifications in the markets for goods, services and labour across the wider macroeconomy.

This course:
- outlines the structure of the Australian finance industry
- studies the evolution of the payments system and the issues it raises
- analyses the risks of banking and how to manage them effectively
- examines banking theory, especially performance and productivity
- examines the role financial institutions can play in a country's development
- puts these in the context of official supervision and surveillance.

The course is designed to equip those who will work in banking, securities or government.

II. ENQUIRIES

The teaching staff in ECON 335 are:

Sean Turnell (C5C Rm 380; Tel: 9850 8493) Weeks 1-2, 9-13
Kim Hawtrey (C5C Rm 392; Tel: 9850-8504) Weeks 3-8

If you have general enquiries about the course, contact the Lecturer-in-charge (Sean Turnell). For specific enquiries about course notes, lectures, etc., contact the relevant lecturer for each part of the course. If the lecturer is not immediately available, it is best to leave a message with your name and telephone number so that staff can contact you. Students can receive help with study skills, lecture content, essay resources, assessment, etc.

III. COURSE TIMETABLE

Students attend three classroom hours per week, comprising lectures using a mix of theory and practical applications, delivered in Second Semester in the following session:

Thursday 6-9 p.m., W5A T1

Students are expected to attend the full quota of lectures; all the material covered in class is examinable.
IV. ASSESSMENT

Essay (25%) All students are required to submit an essay (on the set topic – see p.12) by 9.00 pm Tuesday, 14 October, 2003. The essay should be approximately 2500 words in length, neatly written or typed, using one side of the paper only, and properly annotated with supporting footnotes and bibliography. Standard academic presentation guidelines should be adhered to (if in doubt, consult a common essay-writing guide). Keep a dated, witnessed photocopy of your essay in case of misadventure. Late essays will be subject to penalty, and plagiarism will receive strict disciplinary measures. Essays submitted late may or may not be accepted, at the discretion of the lecturer-in-charge.

In grading the essay, students are judged on the understanding of the relevant theory and empirical work, clarity of exposition, and effort put in. The essay should be properly structured and divided into sections with appropriate headings. It should include a synopsis, footnotes and bibliography. Students are warned to guard against PLAGIARISM. All quotations and ideas must be properly acknowledged. A cover sheet for the essay is attached to this study guide and on the back of the cover sheet is a statement regarding plagiarism: the declaration regarding plagiarism following the statement is to be signed and the cover sheet, with all details completed, to be securely attached to your essay. Essays without completed plagiarism declarations will not be marked.

IMPORTANT: The essay should be submitted at the Economics Reference Room (ERIC) in the lodging box provided by 9.00 pm on the due date, using the cover sheet at the end of this handout, with declaration signed.

Exam (75%) The final examination will consist of essay-type questions.

V. LECTURE TOPICS: OVERVIEW

WEEK: 1. The Evolution and Rationale of Financial Institutions               Turnell
        2. The Evolution and Structure of the Australian Financial System      Turnell
        3. Payments System                                     Hawtrey
        4. Risk Management I: Portfolio risk                               Hawtrey
        5. Risk Management II: Interest rate risk                          Hawtrey
        6. Risk Management III: Credit risk                                Hawtrey

Lecturer:


7. Risk Management IV: Liquidity & other risks  
   Hawtrey

8. Investment Banking  
   Hawtrey

9. Off-Balance Sheet Business  
   Turnell

10. Financial Market Consolidation/Change  
    Turnell

11. Supervision I: Central Banking  
    Turnell

12. Supervision II: Capital Adequacy and Regulation  
    Turnell

13. Financial Institutions and Economic Development  
    Turnell

VI. USEFUL REFERENCES

There is no set text-book for Econ 335. Students should consult the following list of useful references, other references as indicated in lectures and other sources.

(a) Australian


(b) International


VII. **READING LIST BY LECTURE TOPIC**

1 & 2. **The Evolution and Rationale of Financial Institutions / The Evolution and Structure of the Australian Financial System**

Role of financial intermediaries
Changing pattern of financial institutions
History of banking
Commercial banking in Australia

*Saunders, A. and H. Lange (1996), Chs. 1, 2 and 3.

*Valentine, T., Ford, G. and R. Copp (2003), Ch. 4.


*McGrath, M. and C. Viney (2003), Chs. 1, 2, 3.


Sinkey, J.F. (2003), Ch.1.

3. **The Payments System**

   Payments system design and efficiency
   Payments risk
   Technological innovation


Australian Payments System Council (1997), *Annual Report* Sydney: APSC.


Felmingham, B. and W. Coleman (1995), Ch. 16.


Hunt and Terry (1993), Chs.1, 2, 3.
Kolb (1992), Part VI.


*Sinkey, J.F. (1992), Chs. 5, 8.


4. **Risk Management I: Portfolio Risk**

   - Balance sheet of a commercial bank
   - Measuring portfolio risk
   - Stochastic selection model
   - Application to bank balance sheet management
   - Diversification benefits


*Sinkey, J.F. (1992), Chs. 13, 15: (2003), Ch.11.


5. **Risk Management II: Interest Rate Risk**

   - Asset/Liability management
   - Measuring position risk
   - Gap analysis
   - Duration analysis and immunisation


   Hunt, B. and C. Terry (1993), Ch. 9.


   Kolb, R. W. (1992), Part V.


   *Sinkey, J. F. (1992), Chs. 12, 16; (2003), Ch.8.


6. **Risk Management III: Credit Risk**

   - Lender-borrower agency problems
   - Measuring credit risk
   - Qualitative credit assessment
   - Quantitative credit assessment


Kolb, R.W. (1992), Part III.


Sinkey, J.F. (1992), Chs. 17, 18, 19, 20; (2003), Ch.10, 11.


7. Risk Management IV: Liquidity and Other Risks

Measurement of bank liquidity
Liquidity management: assets and liabilities
Other banking risks: foreign exchange, operational, sovereign risks


8. **Investment Banking**

- Merchant banking vs commercial banking
- Mergers, acquisitions and LBOs
- Financial engineering
- Funding and advisory services


Cornett, M. & A. Saunders (1999), Chap. 5.


9. **Off-Balance Sheet Business**


See also APRA website, www.apra.gov.au

10. **Financial Market Consolidation/Change**


11. **Supervision I: Central Banking**


See also 'Mark Bernkopf's Central Banking Resource Centre', <http://patriot.net/~bernkopf/>.

12. **Supervision II: Capital Adequacy and Regulation**

*Valentine, T., Ford, G. and R. Copp (2003), Ch.6.


13. Financial Institutions and Economic Development


VIII. ESSAY TOPIC

What are some of the (domestic) causes and consequences of 'bank runs'. What policies should a central bank adopt once a systemic panic sets in? What are some of the devices that have been suggested to rehabilitate a banking system that has experienced such crises?

In your answer the following articles should provide an excellent starting point. These references are available in ERIC.


IX. ESSAY COVER PAGE: ECON335
(To be stapled to the front of your essay)

DIVISION OF ECONOMIC AND FINANCIAL STUDIES

UNIT: ECON335: THE ECONOMICS OF FINANCIAL INSTITUTIONS

DUE DATE: TUESDAY 14 OCTOBER 2003, 9.00PM

SUBMIT TO: LABELLED BOX IN ERIC

CONTRIBUTION TO FINAL ASSESSMENT: 25%

CHECKLIST:
1. Have you made a photocopy of your essay?
2. Have you included a synopsis and used section headings?
3. Have you stapled all pages together? Do not submit essay in a manilla or plastic folder.
4. Have you read, signed and attached the University statement against plagiarism (overleaf)? Plagiarism will be penalised.
5. Submission procedure is by hand, to the lecturer, in class.

NAME:__________________________________ STUDENT NO.:____________
(Surname) (Initials)

ESSAY SHORT TITLE: _____________________________________________________

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MARKS DEDUCTED (Maximum of 5) _____ (Lateness; No Synopsis; No Bibliography; No Acknowledgments; Incorrect Referencing; Illegibility)

FINAL MARK (out of 25): ............... 

MARKER’S COMMENTS:
DEFINITION OF PLAGIARISM

Plagiarism involves using the work of another person and presenting it as one’s own. Any of the following acts constitutes plagiarism unless the source of each quotation or piece of borrowed material is clearly acknowledged:

(a) copying out part(s) of any document of audio-visual material (including computer-based material);

(b) using or extracting another person’s concepts, experimental results, or conclusions;

(c) summarising another person’s work;

(d) in an assignment where there was collaborative preparatory work, submitting substantially the same final version of any material as another student.

Encouraging or assisting another person to commit plagiarism is a form of improper collusion and may attract the same penalties.

STATEMENT TO BE SIGNED BY STUDENT:

1. I have read the definition of plagiarism that appears above.

2. In my essay I have carefully acknowledged the source of any material which is not my own work.

3. I am aware that the penalties for plagiarism can be very severe.

..............................................  ..............................................  ..............................................
(signature)  (name)  (student number)

THIS PAGE MUST BE COMPLETED AND ATTACHED TO THE ESSAY