UC Davis Graduate School of Management  
MGP 292 – Banking, Credit Markets & the Financial System

CLASS MEETS: Ten Mondays, 6:00pm to 9:00pm, beginning June 13, 2011  
Note: there will be no class held on Monday July 4, 2011

LOCATION: UC Davis Sacramento Campus - Education Building  
4610 X Street, Room 2206  
Sacramento, CA 95814

UNITS: Three (3)

INSTRUCTOR: Steve Fleming

EMAIL: safleming@ucdavis.edu


The Big Short: Inside the Doomsday Machine by Michael Lewis  
Publisher: W. W. Norton & Company; Reprint edition (February 1, 2011)  

-COURSE DESCRIPTION-

This course will analyze the role of financial markets and financial institutions in allocating debt capital. Given the instructor’s 30 years of banking experience, the course will emphasize real world case studies and practical experience. The major focus will be on bank management, lending, debt securities and the impact of innovations in the financial markets. The functions of commercial banks and other financial intermediaries will be covered, as well as aspects of the regulation of these institutions. Considerable attention will be given to reviewing the causes of the recent financial crisis and the lessons learned. Case studies and guest speakers representing various elements of the financial system will be integral components of this course and will help in the understanding of the role of human behavior in explaining the gaps between theory and reality.

Each Student’s performance assessment will be based on his/her achievement and engagement in the course. Preparedness and involvement in each class, including timely and in-depth completion of all reading assignments will be critical to success.
It is expected that all students will maintain the highest standards of honest and ethical behavior. All electronic devices, other than personal computers for taking class notes, are expected to be turned off during class.

Financial markets, institutions and money touch our lives daily. At the conclusion of this course students will have an understanding of how these elements are meant to function and interact in our system, as well as insights into their failure during the recent financial crisis, and their evolving roles today and tomorrow.

**COURSE REQUIREMENTS**

1. Students will be required to attend all class sessions. Students are expected to have read the assigned reading for each class in advance and be fully prepared to participate in class discussion. Any student missing more than two sessions will need to discuss their class status with the course instructor.

2. There will be a mid-term exam that will take place during the second half of the class scheduled for July 18th, 2011. There will also be a final exam which will occur on August 29th.

3. The basis for evaluating student performance to determine your grade for this class will be the following:

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Class participation</td>
<td>25%</td>
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<tr>
<td>Mid-term</td>
<td>25%</td>
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<tr>
<td>Final Exam</td>
<td>50%</td>
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**COURSE SCHEDULE**

**Classes #1 & #2 – Overview of The Financial System**

**June 13 & 20**

- Course topics:
  - Overview of money and capital markets
  - Types and functions of financial intermediaries
  - Structure of the US commercial banking industry
  - Financial intermediation
- Financial innovation
- Asymmetric Information: adverse selection and moral hazard
- Non bank financial institutions (the “shadow banking industry”)
  - Credit Unions
  - Life insurance companies
  - Pension plans
  - Investment banking
  - Mutual funds
  - Private equity
  - Government sponsored enterprises
  - Asset securitization

Class #3 – Evaluating Bank Financial Statements

June 27, 2011

Reading assignment: Bank of America 2010 10-K
Banking industry comparable financial ratios

- Course topics:
  - Asset composition and quality
  - Liquidity
  - Capital adequacy & loan loss reserves
  - Earnings & operating efficiency
  - Comparative analysis
  - Case study – analysis of comparable financial ratios

Class #4 - The Regulatory Framework

July 11, 2011

Reading assignment: Case Study: North Valley Bank Written Agreement with the Fed
Summary of Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

- Course topics:
  - The Federal Reserve & Monetary Policy
  - Office of the Comptroller of the Currency
  - FDIC Insurance
  - State banking regulators
- Course topics:
  - Yield to maturity
  - Bond pricing
  - Real vs. nominal interest rates
  - The behavior of interest rates
  - Default risk & liquidity
  - Term structure & yield curve
  - Historical levels
  - Loan pricing - various indices
  - The credit rating agencies
  - Interest rate risk management at banks

Midterm – Exam

Class #6 – Bank Management

July 25, 2011

Reading assignment: River City Bank 2008 Annual Report
Presidio Bank 2010 Annual Report
Complete Dead Bank Walking by Robert Smith

Course topics:
  - River City Bank case study
    - Alignment with the board of directors
    - Assessing your management team
    - Determining the bank’s strategy
Working with the regulators
Changing organizational culture
Building customer confidence during a financial crisis
Managing problem loans
- Presidio Bank case study
  - How do you start a bank?
  - Lessons learned the hard way & why I got fired
- Discussion on Dead Bank Walking by Robert Smith

Class #7 – Commercial Lending

August 1, 2011

- Reading assignment: Case Study – C&I loan: Aggregates Company
- Course topics:
  - Evaluating business financial statements
  - Types of commercial loans (term & structure)
  - Financial covenants
  - Corporate bonds and commercial paper
  - Size of market and participants
  - Underwriting standards
  - Collateral valuation
  - Problem loan workouts & bankruptcy
  - Case Study: Aggregates Company
    - Commercial loan underwriting
    - Problem loan workout

Class #8 – Commercial Real Estate Lending

August 8, 2011

- Reading assignment: Case Studies – Commercial real estate land loan & commercial real estate income producing property loan
- Course topics:
  - Commercial RE finance
  - Size of market and participants
- CMBS market
- Underwriting standards
- Asset valuation/Appraisals
- Problem loan workouts, including foreclosure process

- Case Studies
  - Commercial real estate loan underwriting – shopping center
  - Problem loan workout – land loan

– Guest Lecture: Shane Tucker

Commercial Mortgage Backed Securities Market:

- Its brief history, including the force behind its creation
- The structure of a typical CMBS deal – i.e. the various tranches, the servicer
- The nature of the underlying collateral
- How pricing was determined and the role of the rating agencies
- The profile of the investors
- What happens when the underlying loans perform poorly
- Where does the market go from here

**Classes #9 & #10 – The Housing based Financial Crisis of 2007 – 2008 and Regulatory Response**

**August 15 & 22, 2011**

- Reading assignment: Complete The Big Short by Michael Lewis

- Course topics:

  - Government policies that promote home ownership
    - Role of GSEs: FNMA, FRE, HUD, FHLBs
    - Federal income tax deductions
  - The home mortgage market (see chapter 18 of How Markets Fail)
    - Prime, Alt-A, Subprime
    - Private label mortgage backed securities
    - Market participants (loan brokers, mortgage bankers, mortgage backed securities, etc.)
    - Guest speaker
  - Underwriting standards
    - Loan amount/household income
    - Stated income loans
    - LTVs
- FICO Scores
- Underwater home loans
  - Strategic defaults – Case Study
- Causes of 2008 financial crisis
  - Lax monetary policy in 2001 – 2005
  - Poor regulatory oversight of the financial industry
  - Massive increase in leverage (Financial institutions, municipalities, households, and corporates)
  - Financial innovation (home equity loans, asset securitizations, credit derivatives)
  - Congressional pressure on FNMA and FRE to relax underwriting standards to promote home ownership
  - Poor judgment and greed
- Auto lending
  - Role of credit unions and captive finance companies
  - Asset backed securities
- Regulatory Response
  - “Too Big To Fail” & systemic risk
  - Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

- Discussion on the Big Short by Michael Lewis

Class #11 – Final Exam

August 29, 2011