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

CLASS MEETS: Five Sundays, 9:00am to 4:00pm, beginning June 17, 2012
Note: the final exam will be held on Sunday July 22, 2012 at 9:00am

LOCATION: UC Davis Graduate School of Management – Gallagher Hall
One Shields Ave., Room 1213
Davis, CA 95616

UNITS: Three (3)

INSTRUCTOR: Steve Fleming

EMAIL: sfleming@rcbank.com

TEXT: 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 regulations and 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 housing bubble and 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 financial eco-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 one session will need to discuss their class status with the course instructor.

2. There will be a final exam which will occur on Sunday, July 22 from 9:00am to 11:00am.

3. Group Presentations - Class participants will form into teams of three or four, choose a topic from the list provided by the Instructor (or other topic agreed with Instructor), and make a 10 meeting presentation (followed by Q&A) to the rest of the class on the topic during Lecture #3. In addition, each group will be expected to submit (no later than July 15) a paper (maximum 500 words) which supports the presentation.

4. The basis for evaluating student performance to determine grades for this class will be the following:

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<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Class participation</td>
<td>20%</td>
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<tr>
<td>Class project</td>
<td>20%</td>
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<tr>
<td>Final Exam</td>
<td>60%</td>
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- COURSE SCHEDULE -

Class #1 – Overview of The Financial System - June 17, 2012

View (in class) documentary: Inside Job (2010), directed by Charles H. Ferguson, (108 minutes)

Lecture topics:

- Financial contagion and the Greek debt crisis
- Overview of money and capital markets
- Structure of the US commercial banking industry
- Financial intermediation
- Financial innovation
• Credit rating agencies
• Non bank financial institutions (the “shadow banking industry”)
  o Credit Unions
  o Savings & loan crisis
  o Mutual funds
  o Government sponsored enterprises
  o Asset securitization

Class #2 – Evaluating Bank Financial Statements & The Regulatory Framework - June 24, 2012

Evaluating Bank Financial Statements

Reading assignment: Bank of America 2011 10-K
Banking industry comparable financial ratios

Lecture topics:

• Asset composition and quality
• Liquidity
• Capital adequacy, loan loss reserves, and stress testing
• Earnings & operating efficiency
• Case studies – comparative analysis of northern CA bank financial ratios, and
  Evaluating Bank of America’s financial statements

The Regulatory Framework

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

Lecture topics:

• The Federal Reserve & Monetary Policy
• Office of the Comptroller of the Currency
• FDIC insurance
• State banking regulators & the dual banking system
• Safety & Soundness Exams – CAMELS Ratings
• Regulatory enforcement actions and bank failures
• Case Study: North Valley Bank Written Agreement with the Fed
• The Consumer Financial Protection Bureau
• Consumer protections & various regulations
• Fair Lending and Community Reinvestment Acts

Class #3 – Bank Management, Interest Rates, & Group Presentations - July 1, 2012

Bank Management

Reading assignment: River City Bank 2011 Annual Report

Lecture topics:

• Presidio Bank case study
  ➢ How do you start a bank?
  ➢ Lessons learned the hard way & why I got fired
• River City Bank case study
  ➢ Alignment with the board of directors
  ➢ Determining the bank’s strategy
  ➢ Assessing your management team
  ➢ Working with the regulators
  ➢ Changing organizational culture
  ➢ Building customer confidence during a financial crisis
  ➢ Managing problem loans
  ➢ Reducing expenses and improving the efficiency ratio

Interest Rates

Lecture topics:

• Yield to maturity & duration
• Bond pricing
• Real vs. nominal interest rates
• The behavior of interest rates
• Default risk & liquidity
• Term structure & yield curve
• Historical levels
• Expectations theory
• Loan pricing - various indices (“Prime”, LIBOR, US Treasuries, etc.)
• Interest rate risk management at banks
Group Presentations

10 minute presentations, followed by 5 minute Q&A

Class #4 – Commercial Lending & Commercial Real Estate Lending - July 8, 2012

Commercial Lending

Reading assignment: Case Study – Commercial & Industrial loan: Building Materials Company

Lecture topics:

- Types of commercial loans (term & structure)
- Evaluating business financial statements & projections
- Evaluating sources of repayment
- Due diligence
- Financial covenants
- Underwriting standards
- Collateral valuation
- Personal guarantees
- Problem loan workouts & bankruptcy

- Case Study: Building Materials Company
  - Commercial loan underwriting
  - Problem loan workout

Commercial Real Estate Lending

Reading assignment: Case Studies – Commercial real estate land loan (Bakersfield Land Loan)
& commercial real estate income producing property loan (Town Center Shopping Center)

Lecture topics:

- Types of properties which are financed
- CRE fundamentals – i.e. rents, vacancies, cap rates, location, condition of property
- Types of CRE loans
- Size of market and participants
- Underwriting standards
• Sources of repayment
• Key risks
• Asset valuation/Appraisals
• Problem loan workouts, including foreclosure process

• Case Studies
  ➢ Commercial real estate loan underwriting – Town Center Shopping Center
  ➢ Problem loan workout – Bakersfield Land Loan

Guest Lecture: Shane Tucker

Commercial Mortgage Backed Securities Market:

• Its brief history, including the force behind its creation
• Size of market and its participants
• 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


Written presentations for group assignment due at start of class.

Reading assignment: Complete The Big Short by Michael Lewis

Lecture topics:

• Bubble in house prices
• Near collapse of the global financial system
• Government programs and policies that promote home ownership
  ▪ Role of GSEs: FNMA, FRE, HUD, FHLBs
• The home mortgage market
  ▪ Prime, Alt-A, Subprime, Jumbo
  ▪ Private label mortgage backed securities
  ▪ Market participants (loan brokers, mortgage bankers, mortgage backed securities, etc.)
• Home loan underwriting standards
• Underwater home loans
  ▪ Strategic defaults – Case Study
• Financial innovation (home equity loans, asset securitizations, credit derivatives)
• Causes of 2008 financial crisis
• Government Response
  ▪ Troubled Asset Relief Program
  ▪ “Too Big To Fail” & systemic risk
  ▪ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
  ▪ Expansionary fiscal and monetary policies

• Discussion on the Big Short by Michael Lewis

Class #6 – Final Exam

July 22, 2012 (9:00am – 11:00am)