UNIVERSITY OF LONDON | INTERNATIONAL PROGRAMMES

Course information 2019–20
FN1024 Principles of banking and finance

This is designed as the foundation banking and finance course on which subsequent and more specialised finance courses are based.

Aims and objectives

The specific aims of this course are to:

- Provide institutional features of financial systems.
- Identify key issues and problems arising in banking and finance.
- Introduce the key economic concepts required to analyse these key issues and problems.
- Illustrate how these economic principles can be applied to address the key issues identified.
- Show how the institutional features address the key issues identified.

Essential reading

For full details please refer to the reading list.

Mishkin, F. and S. Eakins *Financial Markets and Institutions.* (Addison Wesley)

Allen, F. and D. Gale *Comparing Financial Systems.* (MIT Press)

Brealey, R.A. and S.C. Myers *Principles of Corporate Finance.* (McGraw-Hill/Irwin)

Assessment

This course is assessed by a three-hour unseen written examination.

Learning outcomes

At the end of the course and having completed the essential reading and activities students should:

- ☑ discuss why financial systems exist, and how they are structured
- ☑ explain why the relative importance of financial intermediaries and financial markets is different around the world, and how bank-based systems differ from market-based systems
- ☑ understand why financial intermediaries exist, and discuss the role of transaction costs and information asymmetry theories in providing an economic justification
- ☑ explain why banks need regulation, and illustrate the key reasons for and against the regulation of banking systems
- ☑ discuss the main types of risks faced by banks, and use the main techniques employed by banks to manage their risks
- ☑ explain how to value real assets and financial assets, and use the key capital budgeting techniques (Net Present Value and Internal Rate or Return)
- ☑ explain how to value financial assets (bonds and stocks)
- ☑ understand how risk affects the return of a risky asset, and hence how risk affects the value of the asset in equilibrium under the fundamental asset pricing paradigms (Capital Asset Pricing Model and Asset Pricing Theory)
- ☑ discuss whether stock prices reflect all available information, and evaluate the empirical evidence on informational efficiency in financial markets.

Syllabus

This is a description of the material to be examined. On registration, students will receive a detailed subject guide which provides a framework for covering the topics in the syllabus and directions to the essential reading

Part 1 Financial Systems

1. Introduction to Financial Systems: Role of financial systems (role of households, government, and firms in terms of savings and investments). Financial intermediaries, securities and markets. Taxonomy of financial institutions. Nature of financial claims (debt versus equity, bonds and notes, fixed and floating interest rates, common and preferred stocks). Structure of financial markets (direct and indirect finance, dealers and brokers, banks, mutual funds, pension funds, and insurance companies).

2. Comparative Financial Systems: Bank-based systems against market-based systems. Legal aspects.

Part 2 Financial intermediaries

3. Role of Financial Intermediation: Nature and process of financial intermediation. Theories of financial intermediation (transformation of assets, uncertainty, reduction in transaction costs, reduction of problems arising out of asymmetric information). Implications of financial intermediation (Hirshleifer model, effect on economic development).

4. Regulation of Banks: Regulation of banks (free banking, arguments for or against regulation, traditional regulation mechanisms, alternatives to traditional regulation).

5. Risk Management in Banking: Market risks: Liquidity risk, interest rate risk, foreign exchange risk. Credit risk: Screening and monitoring, credit rationing, collateral.

Part 3 Principles of finance

6. Financial Securities: Risk and Return; Portfolio analysis: mean-variance portfolio theory. The portfolio selection process: the correlation of securities returns (single-index model and multi-index models). Asset pricing models: capital asset pricing models (CAPM) and arbitrage pricing model (APT).

7. Capital Budgeting; Pricing of bonds and stocks. Net present value. Project appraisal.

8. Financial Markets: Transmission of information; Efficient markets. theory and empirical evidence. Concepts of weak, semi-strong, and strong efficiency. Concepts of excess returns. Micro-structures.

Students should consult the appropriate *EMFSS Programme Regulations*, which are reviewed on an annual basis. The *Regulations* provide information on the availability of a course, where it can be placed on your programme's structure, and details of co-requisites and prerequisites.