

*Please note that this syllabus should be regarded only as a general guide to the course and is subject to change at the instructor's discretion.

ADEC735001 – ECONOMICS OF BANKING AND INSURANCE

Woods College of Advancing Studies

Spring 2019 Semester, January 15 – May 7, 2019

Tuesday 6:30pm – 9pm

Stokes Hall 141N

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Office Hours: By appointment, before or after the weekly lecture, or upon request. I will always be available by email and will respond within hours.

Boston College Mission Statement

Strengthened by more than a century and a half of dedication to academic excellence, Boston College commits itself to the highest standards of teaching and research in undergraduate, graduate and professional programs and to the pursuit of a just society through its own accomplishments, the work of its faculty and staff, and the achievements of its graduates. It seeks both to advance its place among the nation's finest universities and to bring to the company of its distinguished peers and to contemporary society the richness of the Catholic intellectual ideal of a mutually illuminating relationship between religious faith and free intellectual inquiry.

Boston College draws inspiration for its academic societal mission from its distinctive religious tradition. As a Catholic and Jesuit university, it is rooted in a world view that encounters God in all creation and through all human activity, especially in the search for truth in every discipline, in the desire to learn, and in the call to live justly together. In this spirit, the University regards the contribution of different religious traditions and value systems as essential to the fullness of its intellectual life and to the continuous development of its distinctive intellectual heritage.

Course Description

This course provides students with a broad understanding of (i) the main components and purposes of the financial system, (ii), how financial institutions, in particular banking organizations and insurance companies work and what purposes they serve, (iii) to what risks and challenges banks and insurance companies are exposed, and (iv) what risks and challenges the global financial system creates for policy makers. The role and importance of banks is generally understood, but insurance companies also carry out a significant role in providing risk mitigation capabilities across the financial landscape, accounting for some 9% of GDP.

Course will review theories of banking, payments, and credit instruments used by banks and insurance companies. It will also deepen our understanding of the insurance products (life, health, property and casualty). Emphasis will be placed on the risk measurement and management at these financial intermediaries: market volatility, corporate credit risk, retail credit risk, sovereign credit risk, trading, stress tests, etc. We will also investigate the macroeconomic consequences of externalities caused by bad risk management and the role of government, in particular the Federal Reserve, in promoting financial stability.

Textbooks & Readings (Required)

This list contains a set of seminal articles in Banking and Insurance and two books that are important references for a better understanding of modeling techniques applied to banks and insurance

companies:

Books:

Freixas, X. and J. Rochet (2008), *Microeconomics of Banking*, 2nd edition. MIT Press.

Plantin, G, and J. Rochet (2009). *"When Insurers Go Bust: An Economic Analysis of the Role and Design of Prudential Regulation"*, Princeton University Press.

Articles:

Akerlof, George A. (1970). *"The Market for 'Lemons': Quality Uncertainty and the Market Mechanism"*. Quarterly Journal of Economics 84 (3): 488–500

Cetorelli, Nicola, and Linda S. Goldberg, 2012. *"Follow the Money: Quantifying Domestic Effects of Foreign Bank Shocks in the Great Recession,"* American Economic Review, vol. 102(3), pages 213-18

Diamond, Douglas, and P. Dybvig (1983). *"Bank runs, deposit insurance and liquidity"*. Journal of Political Economy, 91(3):401–419.

Holmström, B., and J. Tirole (1997). *"Financial Intermediation, Loanable Funds, and the Real Sector,"* Quarterly Journal of Economics

Textbooks & Readings (Optional)

This list of readings is not comprehensive. Related recommended reading materials will be added during the semester as needed.

Books:

Allen, F., and D. Gale. 2000. *Comparing Financial Systems*. Cambridge, MA: MIT Press

Articles:

Allen, Franklin and Douglas Gale (1997), *"Financial Markets, Intermediaries, and Intertemporal Smoothing,"* Journal of Political Economy 105(3), 523-546.

Gorton, Gary, and Winton, A. (2002), *"Financial Intermediation"*, NBER Working Paper 8928.

Canvas

Canvas is the Learning Management System (LMS) at Boston College, designed to help faculty and students share ideas, collaborate on assignments, discuss course readings and materials, submit assignments, and much more - all online. As a Boston College student, you should familiarize yourself with this important tool. For more information and training resources for using Canvas, click [here](#). I expect active participation in online discussions about articles and class material. This participation will be taken into account in the "Class participation" part of the grade.

Course Objectives

1. Students will learn how to utilize economic models and econometric techniques in the context of economic analysis.
2. Students will gain an understanding of the basic models that economists use to study the choices made by consumers, investors, firms, and governments.
3. Students will demonstrate knowledge across cultural settings and will learn the impact of culture, gender, and age in the economics of banking and insurance.
4. Students will demonstrate ethical knowledge pertaining to the economics of banking and insurance.

Grading

Class participation	20%
Problem sets	10%
Class projects	40%
Presentation	20%
Final exam/project	10%

The graduate grading system for Woods College is as follows:

A (4.00), A- (3.67)

B+ (3.33), B (3.00)

B- (2.67), passing but does not count toward degree

C (2.00), passing but not for degree credit

F (.00)

All students can access final grades through Agora after the grading deadline each semester. Students who complete course evaluations can access grades earlier, as they are posted.

Deadlines and Late Work

The deadlines for problem sets and class projects will be communicated in class. Some problem sets will be weekly, class projects will require more than a week. Late submissions will not be accepted.

Course Assignments

It is expected that you will spend about 8 hours per week on out-of-class readings, assignments, and projects. Please note that some weeks will require more time and some weeks less time but the average is approximately 8 hours per week over the semester. Some of the assignments will consist of reading in advance of the lecture to discuss in a case study format during the first part of the class. There are two types of assignments: 1-week assignments and 2-week projects. The grading policy reflects the additional work that the projects require.

To provide you with an incentive to follow current events, every two weeks you will be asked to submit an article (or blog) you have read that relates to concepts we have discussed in class. You should attach a copy of the article to your brief explanation of how it relates to the course. Your choice may illustrate a concept we have discussed in class or it may raise questions about conclusions reached in class. In either case, you should type two concise paragraphs explaining the relationship between the article and the course material and why you think it is important. This exercise must be undertaken individually (not in

teams) and must be turned in electronically on (or before) the date specified. Some of the most interesting articles will be posted in the Current Events folder on Canvas and discussed in class. Please note I have designed this exercise to sharpen your writing skills as well as to enhance your understanding of current developments.

Course Schedule

Visit the course website for an up to date course schedule.

Date/Week	Topic	Reading/Assignment	Due Date
Jan 16 – Week 1	The role of Financial Intermediaries	Freixas and Rochet (Ch. 1) <i>Assignment on the Financial Crisis</i>	1 week
Jan 25 – Week 2	Radiography of a bank <ul style="list-style-type: none"> Banks assets Banks liabilities Bank capital Profits and losses 	FR Y-9C filings (bank holding companies' regulatory filings of their balance sheet) <i>Balance sheet analysis</i>	1 week
Jan 30 – Week 3	Banking theories (I)	Freixas and Rochet (Ch. 2), Freixas and Rochet (Ch. 3.1-3.3, Ch 4.1-4.4)	-
Feb 6 – Week 4	Banking theories (II) and bank runs	Freixas and Rochet (Ch. 7.1-7.4), Diamond and Dybvig (1983), Holmstrom and Tirole (1997). <i>Assignment on asymmetric information.</i>	2 weeks
Feb 13 – Week 5	Risk quantification: credit risk (theory and real world)	Posted articles	
Feb 20 – Week 6	Risk quantification: operational risk and off-balance sheet (theory and real world)	<i>Assignment on Risk measurement.</i>	2 weeks
Feb 27 – Week 7	Risk quantification: market risk – interest rate and liquidity (theory and real world)	Posted Articles	
Mar 6	SPRING VACATION		
Mar 13 – Week 8	Regulation: market failures and the need for regulation (theory)	Freixas and Rochet (Ch. 9) - case discussion <i>Assignment on Stress Testing results</i>	1 week
Mar 20 – Week 9	Regulatory framework (real world) <ul style="list-style-type: none"> Basel capital framework Stress testing, and systemic risk	Federal Reserve Stress Tests disclosure documents – 2 weeks. <i>Project on Stress Testing</i>	2 weeks
Mar 27 – Week 10	Global banks, foreign banks in the US, and international flows (theory and real world)	Cetorelli and Goldberg (2012)	
Apr 3– Week 11	Stress Test Group Presentations		-
Apr 10 – Week 12	Role of insurance companies in the economy (theory) <ul style="list-style-type: none"> Moral hazard 	Plantin and Rochet (Ch. 2) –case discussion	2 weeks

	<ul style="list-style-type: none"> Adverse selection 		
Apr 17	NO CLASS (WCAS Senior Dinner)		
Apr 24 – Week 13	Insurance Companies and Products (real world) <ul style="list-style-type: none"> Life insurance Property and casualty Health Catalogue of life insurance products and risks embedded 	<i>Project on Insurance risks</i>	
May 1 – Week 14	Insurance Companies and Regulation (theory and real world)		-
May 8 – Week 15		FINAL PROJECT DUE	

Written Work

Woods College students are expected to prepare professional, polished written work. Written materials must be typed and submitted in the format required by your instructor. Strive for a thorough yet concise style. Cite literature appropriately. Develop your thoughts fully, clearly, logically and specifically. Proofread all materials to ensure the use of proper grammar, punctuation and spelling. For writing support, please contact the [Connors Family Learning Center](#).

Attendance

Attending class is an important component of learning. Students are expected to attend all class sessions. When circumstances prevent a student from attending class, the student is responsible for contacting the instructor before the class meets. Students who miss class are still expected to complete all assignments and meet all deadlines. Many instructors grade for participation; if you miss class, you cannot make up participation points associated with that class. Makeup work may be assigned at the discretion of the instructor. If circumstances necessitate excessive absence from class, the student should consider withdrawing from the class. **Attendance is essential for this course, and 20% of the grade will be determined by class participation.** I take attendance very seriously and I take class participation very seriously too. The learning comes from both lecturer and students, and there are no wrong answers. You will find that the more you participate in the class, the more easily you will master the course material.

Consistent with BC's commitment to creating a learning environment that is respectful of persons of differing backgrounds, we believe that every reasonable effort should be made to allow members of the university community to observe their religious holidays without jeopardizing their academic status. Students are responsible for reviewing course syllabi as soon as possible, and for communicating with the instructor promptly regarding any possible conflicts with observed religious holidays. Students are responsible for completing all class requirements for days missed due to conflicts with religious holidays.

Accommodation and Accessibility

Boston College is committed to providing accommodations to students, faculty, staff and visitors with disabilities. Specific documentation from the appropriate office is required for students seeking accommodation in Woods College courses. Advanced notice and formal registration with the appropriate office is required to facilitate this process. There are two separate offices at BC that

coordinate services for students with disabilities:

- [The Connors Family Learning Center \(CFLC\)](#) coordinates services for students with LD and ADHD.
- [The Disabilities Services Office \(DSO\)](#) coordinates services for all other disabilities.

Find out more about BC's commitment to accessibility at www.bc.edu/sites/accessibility.

Scholarship and Academic Integrity

Students in Woods College courses must produce original work and cite references appropriately. Failure to cite references is plagiarism. Academic dishonesty includes, but is not necessarily limited to, plagiarism, fabrication, facilitating academic dishonesty, cheating on exams or assignments, or submitting the same material or substantially similar material to meet the requirements of more than one course without seeking permission of all instructors concerned. Scholastic misconduct may also involve, but is not necessarily limited to, acts that violate the rights of other students, such as depriving another student of course materials or interfering with another student's work. Please see the [Boston College policy on academic integrity](#) for more information.