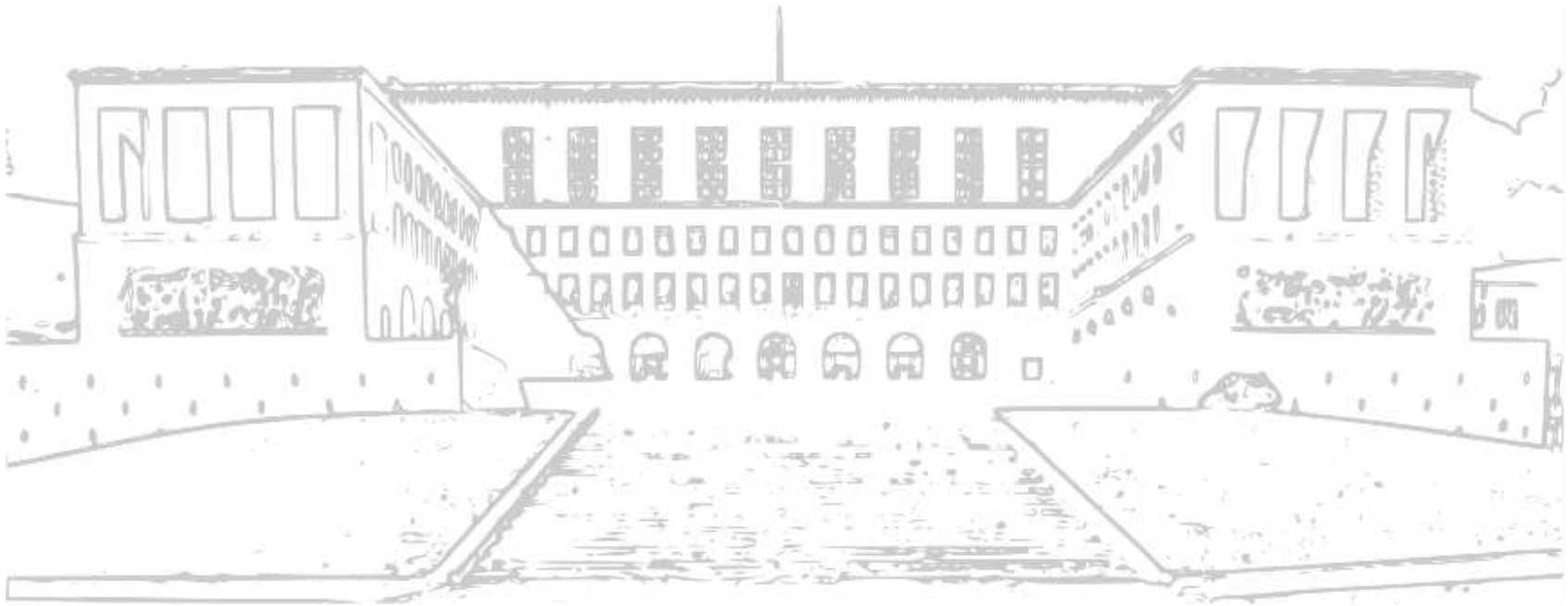


FINANCIAL MARKETS AND INSTITUTIONS

BANKS

A.Y. 2020/2021

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DEAMS
University
of Trieste

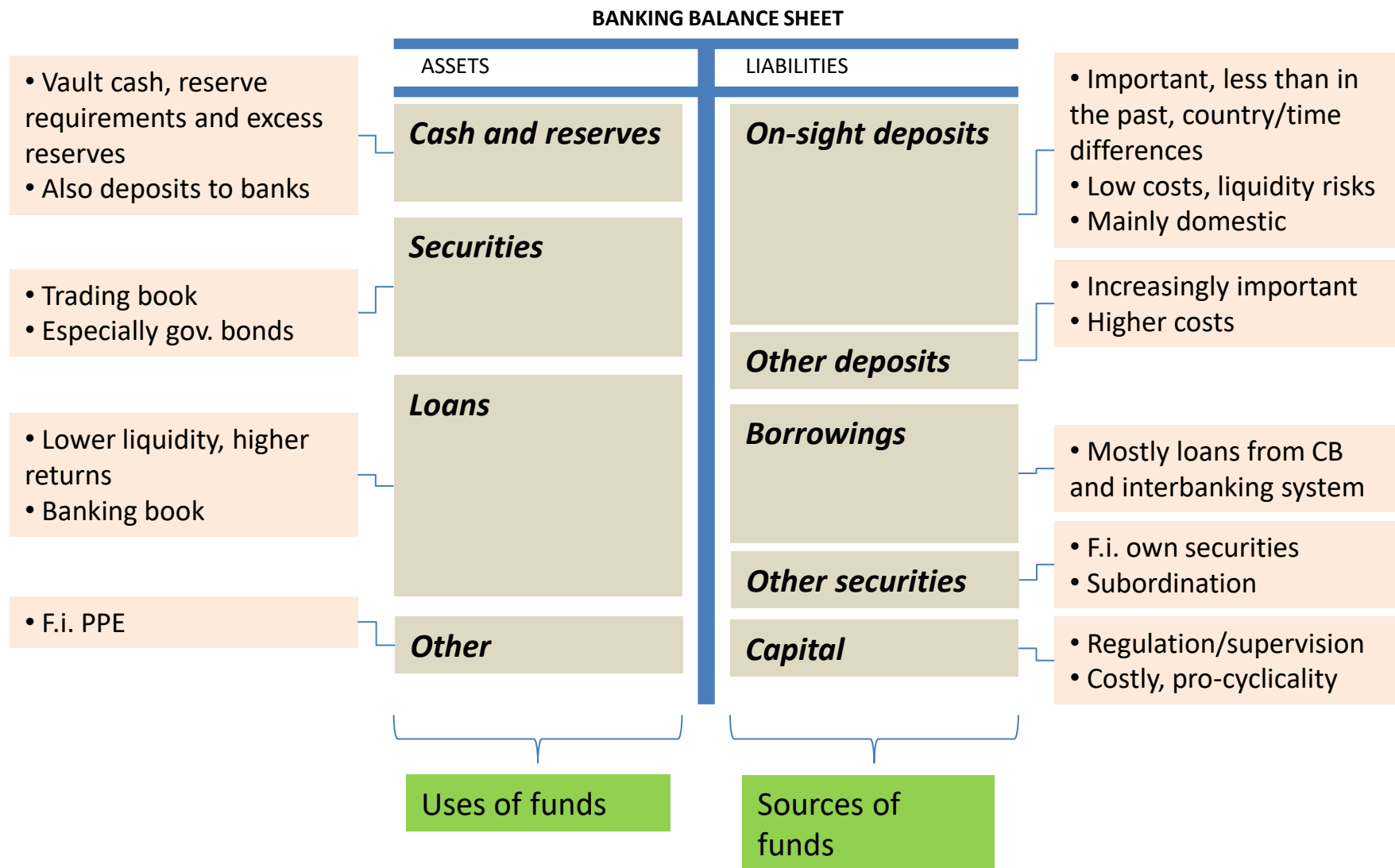
AGENDA



- Financial structure of banks
- Main banking management areas
- Banking performance
- Evolution and issues of banking

FINANCIAL STRUCTURE OF BANKS

- Typically, a bank has the following financial structure



FINANCIAL STRUCTURE OF BANKS

Banking operations move around **asset transformation**:

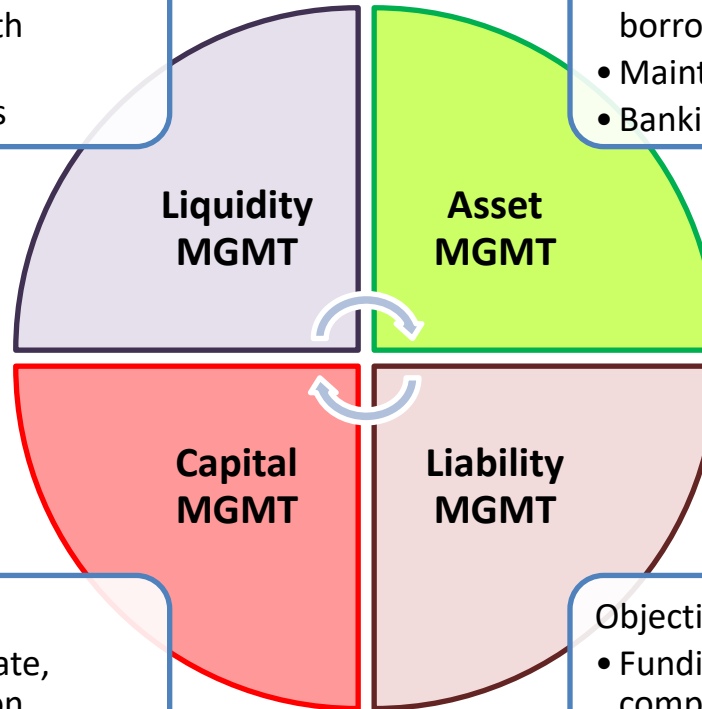
- **Selling liabilities** with features desirable to **lenders**
- **Buying assets** with features desirable to **borrowers**
- Profitable if liabilities are cheaper than assets, **considering also risks and costs**
- Risks if short-term liabilities question bank's solvency compared with less liquid, longer-termed assets (bank runs)
- Transforming mainly **liquidity/duration** and **credit** risks, but extending to **geography** and **size**



BANK MANAGEMENT

Objectives:

- Maintain desired cash levels while predicting/managing in/outflows
- Building portfolio of liquid assets or short-term funding channels to deal with unpredictability
- Control costs and risks of reserves



Objectives:

- Build profitability constrained by desired levels of safety and liquidity
- Achieving diversification while selecting borrowers and monitoring exposures
- Maintaining flexibility / planning long-term
- Banking/trading portfolios

Objectives:

- Comply with shareholders' mandate, rating requirements and regulation
- Keep K_e under control considering strategy, risk, competition and markets

Objectives:

- Funding activities while complying with competition, demand preferences and evolution of markets
- Considering costs, flexibility, quickness and risks

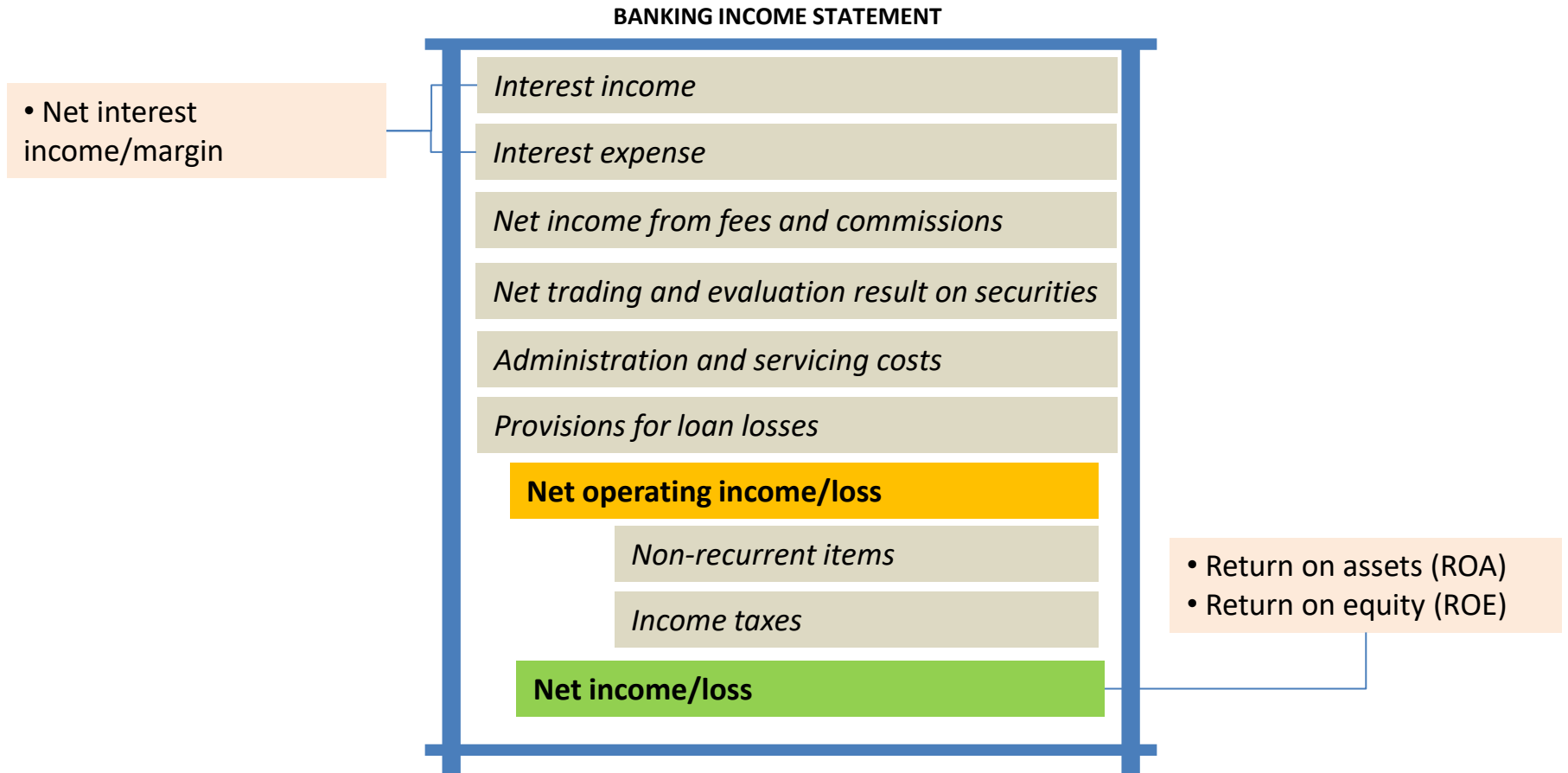
BANK MANAGEMENT

- Banks also provide products and services that do not influence balance sheets directly: **off-balance sheet** activities
- Main examples:
 - Servicing loan sales and securities' issues
 - Accessing markets on behalf of customers (Forex, stocks, ...)
 - Issuing guarantees on debt of customers or loan commitments
 - Trading in derivatives, commodities and currencies
- Off-balance sheet activities provide significant **profitability** but at the cost of material increases in **risk**-taking (leverage, pro-cyclicality, fair valuation, regulatory arbitrage, ...)

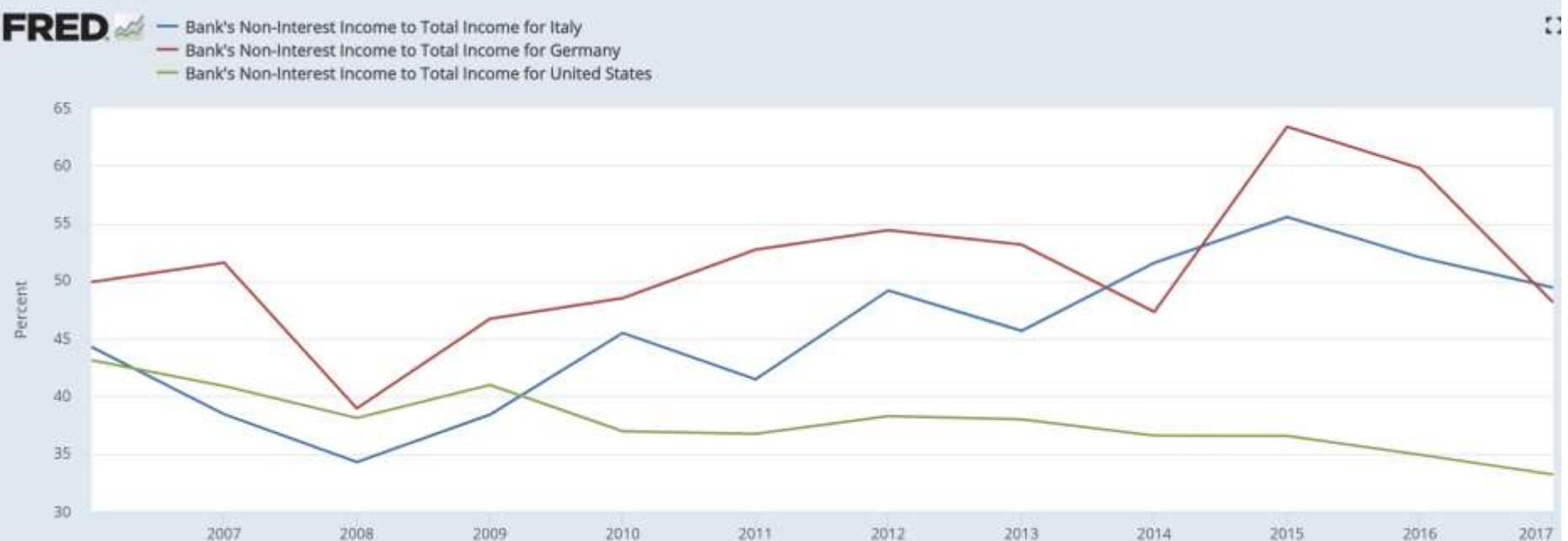
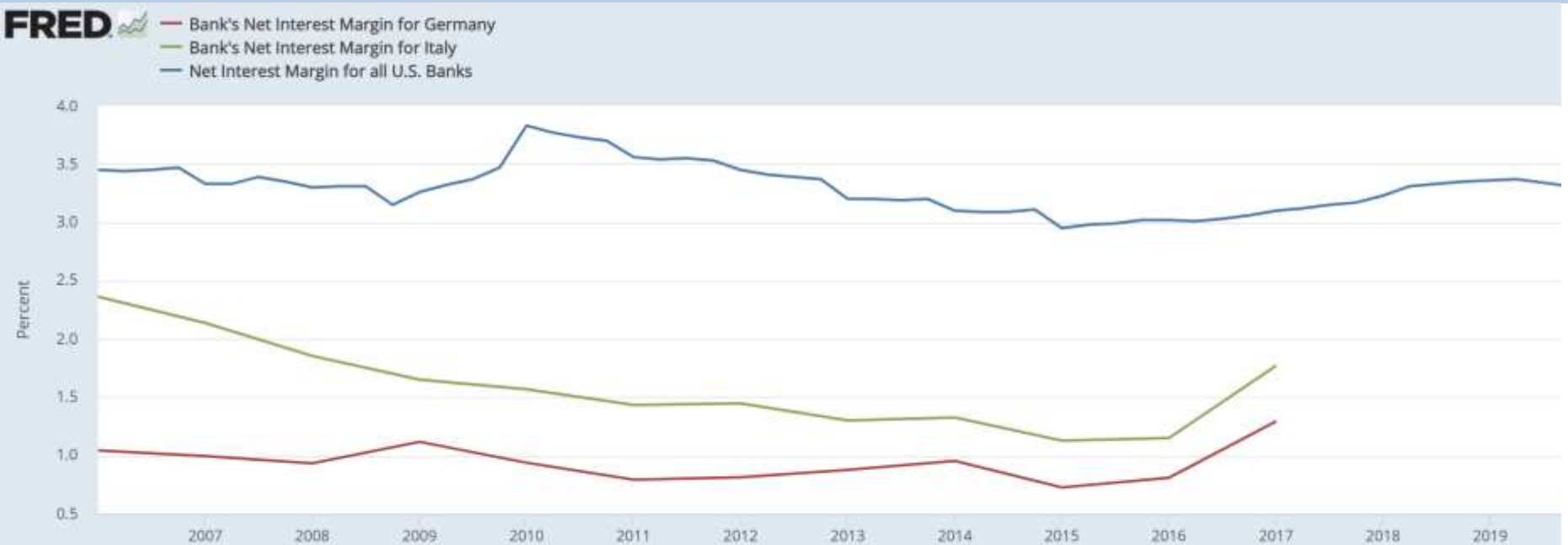


BANK PERFORMANCE

- Structure of income statements

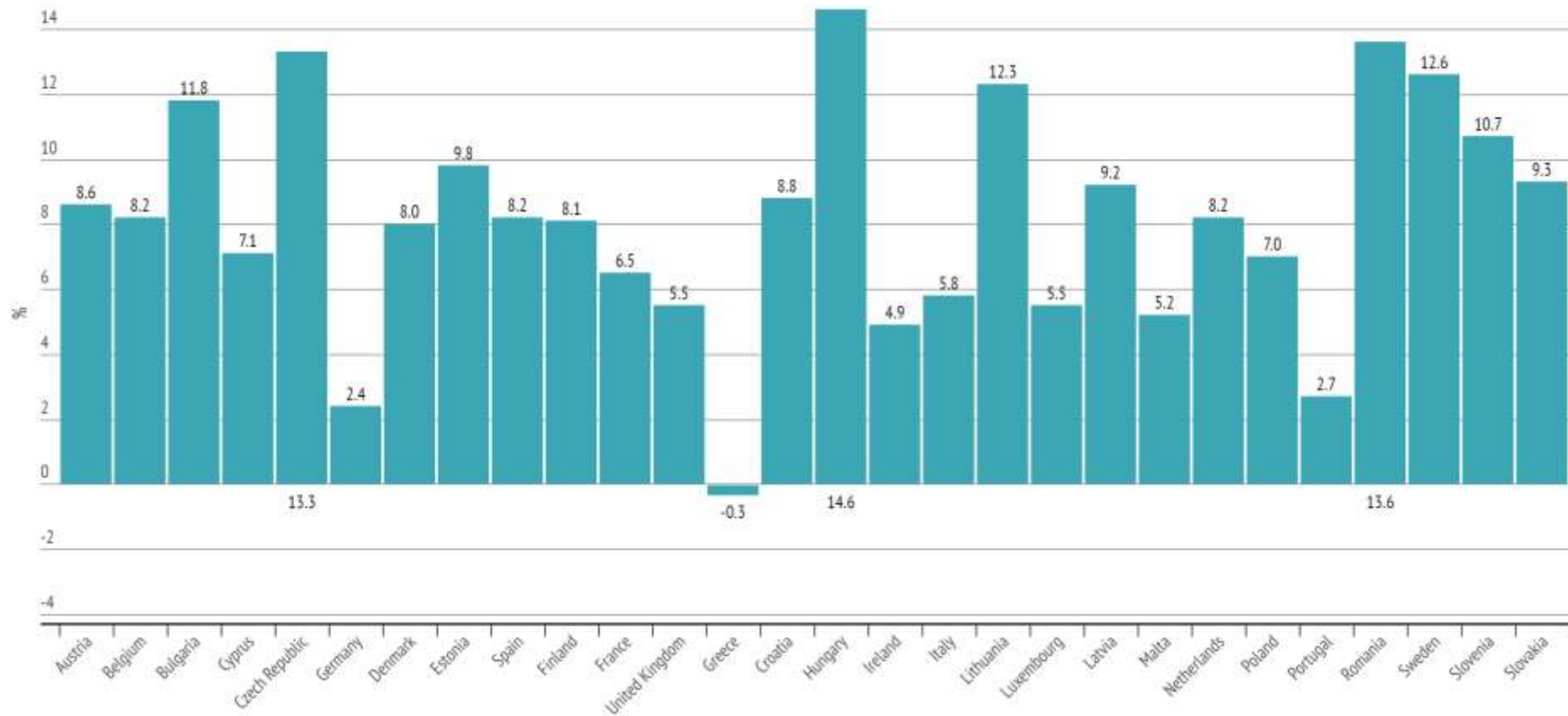


BANK PERFORMANCE



BANK PERFORMANCE

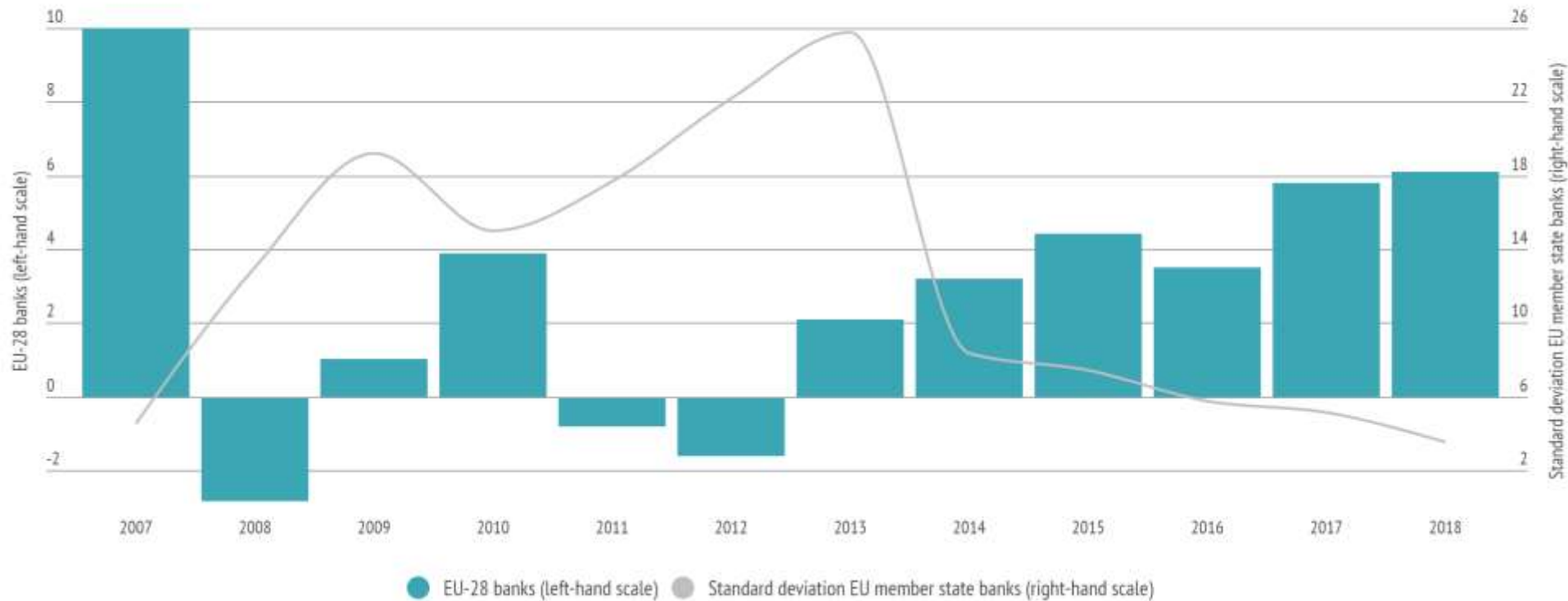
Return on equity by country



Source: EBF, 2018:2

BANK PERFORMANCE

Return on equity of European banks



Source: EBF, 2018:2

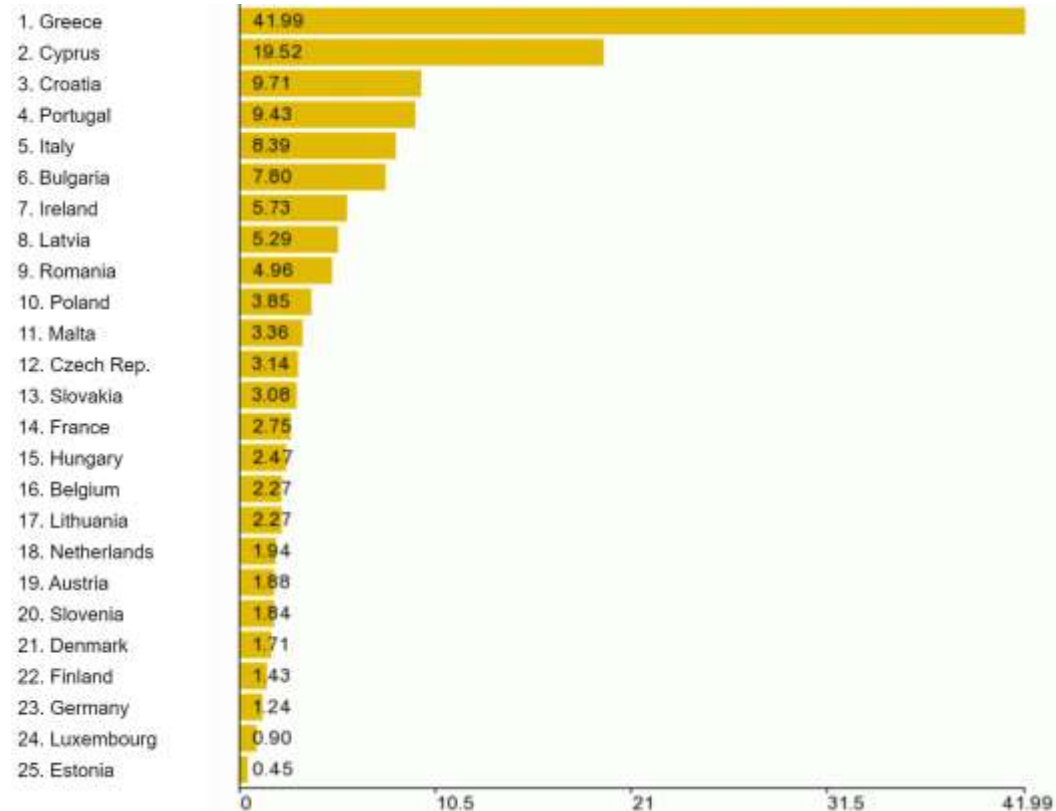
BANKS AND NPLs

Non-performing loans:

- Past due over 90 days, OR
- Unlikely to be repaid

Response:

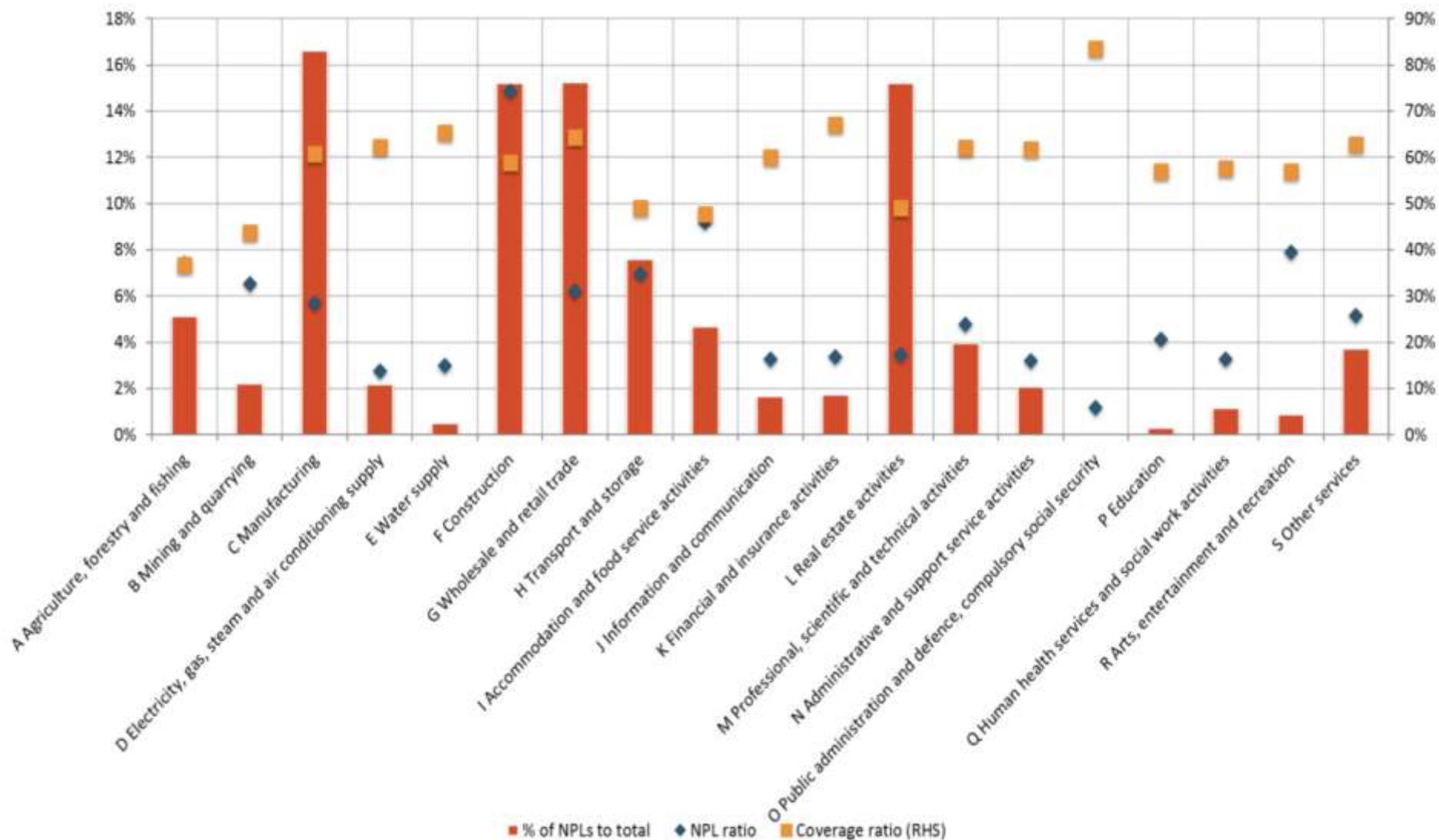
- Scrutiny and monitoring to reduce likelihood or early warning / forbearance
- Collateral and conditions to improve recoverability
- Pricing, provisioning, write-offs
- Legal, sale, securitization



Source: theglobaleconomy.com, 2018

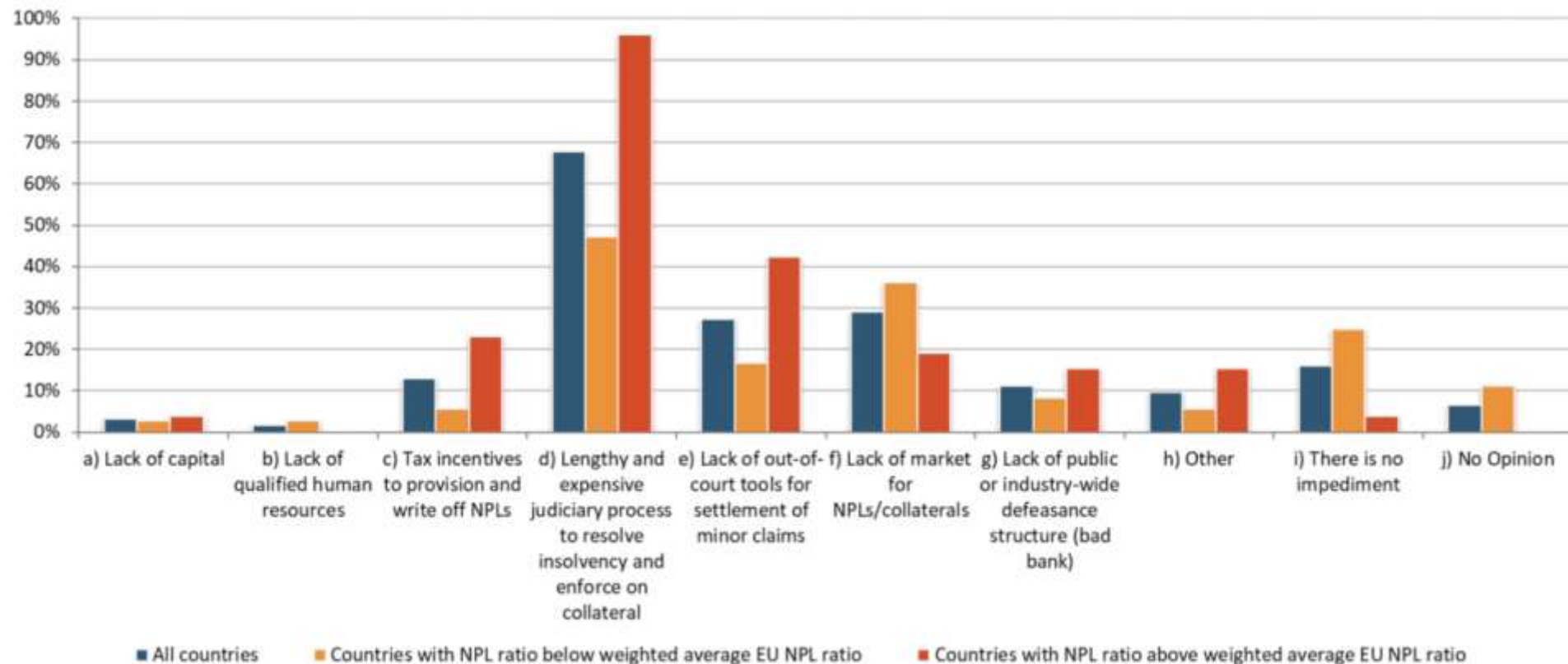


BANKS AND NPLs



BANKS AND NPLs

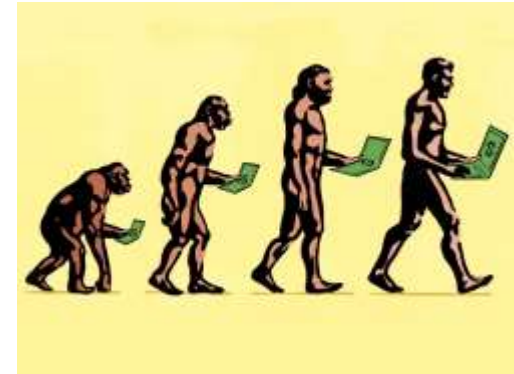
Issues in dealing with NPLs



EVOLUTION AND ISSUES

Historical major issues:

- heavy **regulation**, increasing **sophistication**
- separation between **lending** and **trading**
- separation between **borrowers** and **owners**



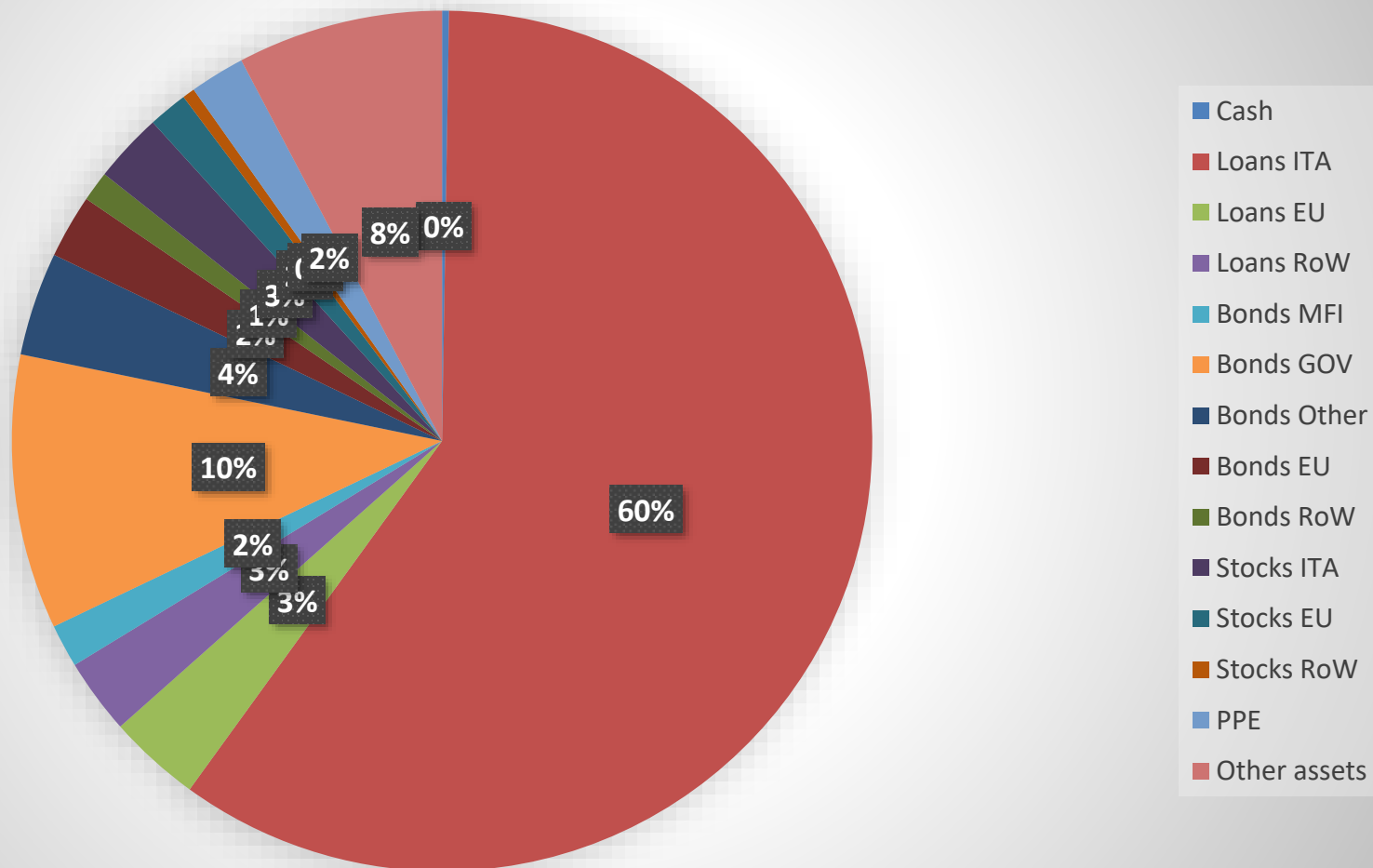
However:

- regulation stimulates innovation to **arbitrage** (f.i. shadow banking)
- separation can be **circumvented** (f.i. country borders, securitisation, ...)
- **innovation is faster** than rule-based regulation (f.i. FinTech)
- regulation has **costs** lowering efficiency and competition (f.i. interest rate restrictions)

EXAMPLES

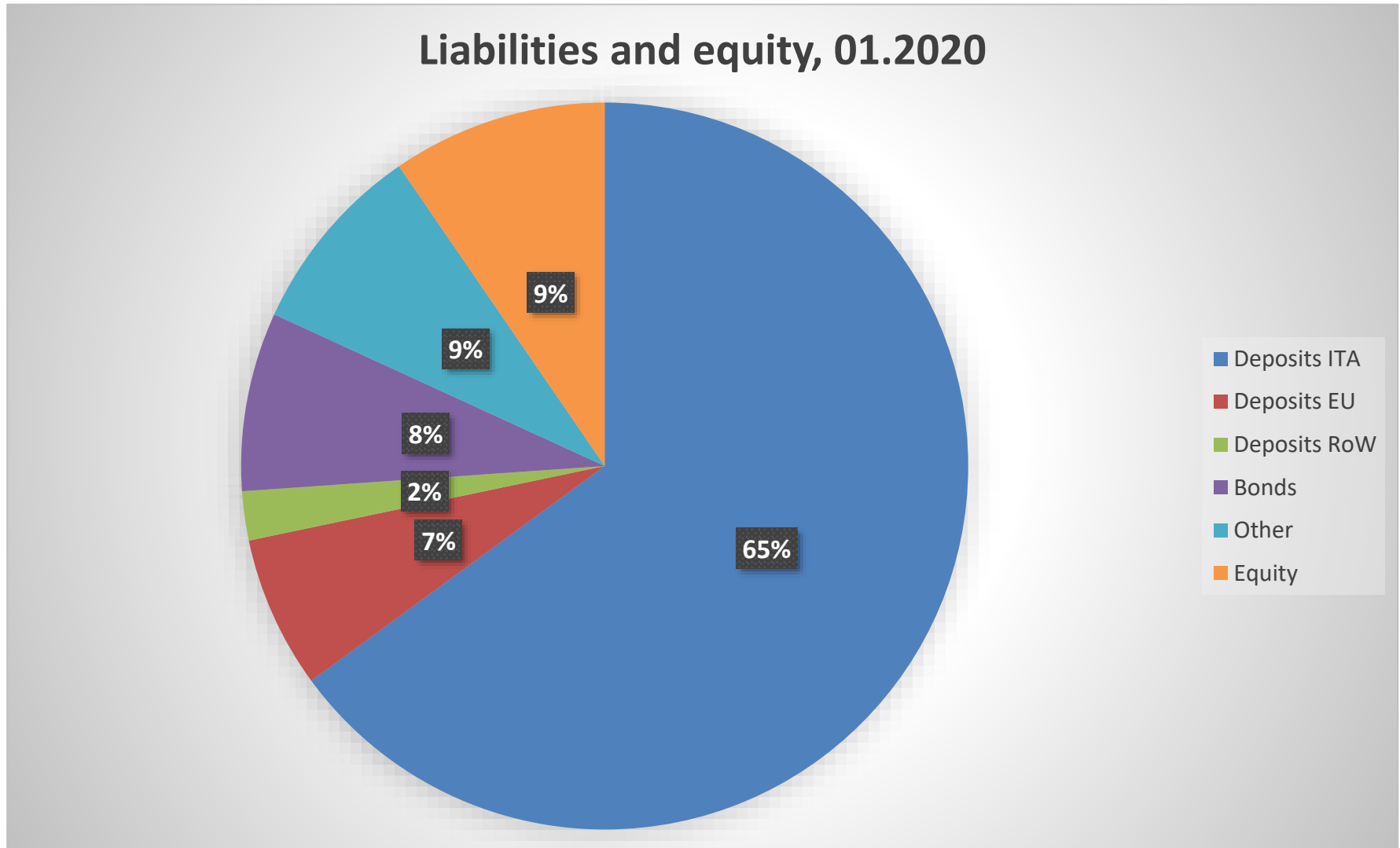
1. The following is the balance sheet of Italian banks as of 01.2020. Comments?

Assets, 01.2020 (tot 3,75 TRN EUR)



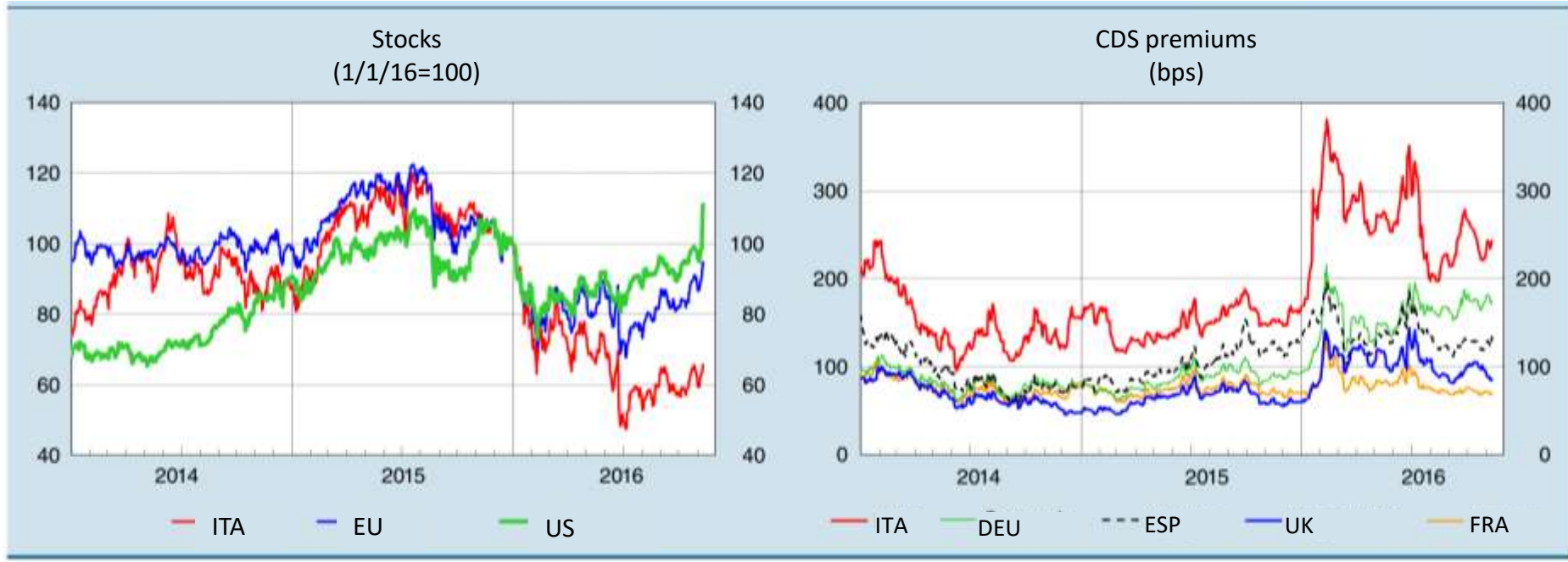
EXAMPLES

1. The following is the balance sheet of Italian banks as of 01.2020. Comments?



EXAMPLES

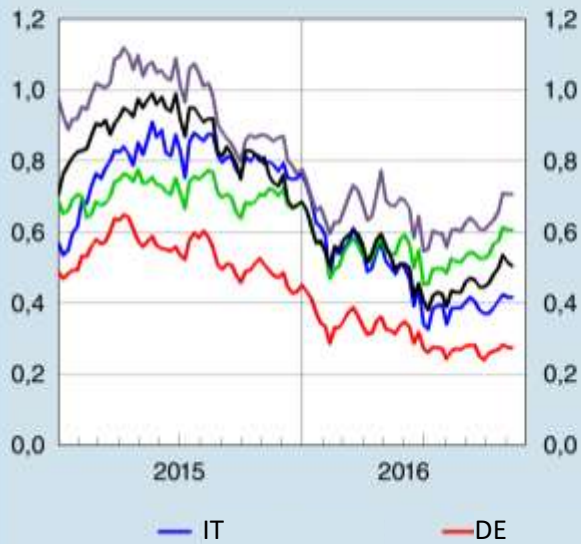
2. Banking stocks and CDS



EXAMPLES

3. Listed EU banks fundamentals

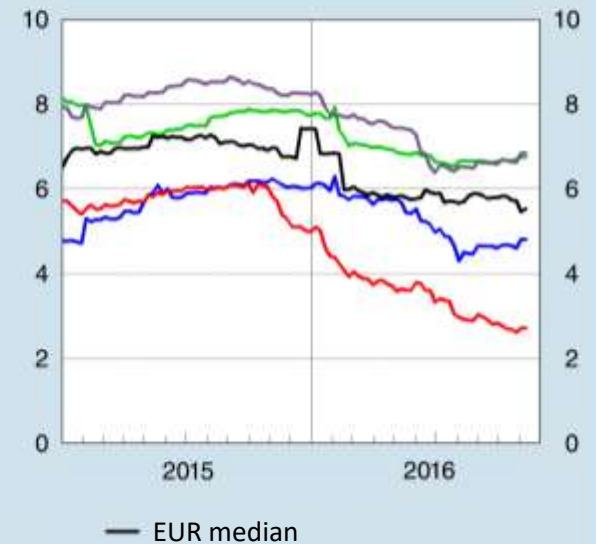
P/BV



P/E



E/BV

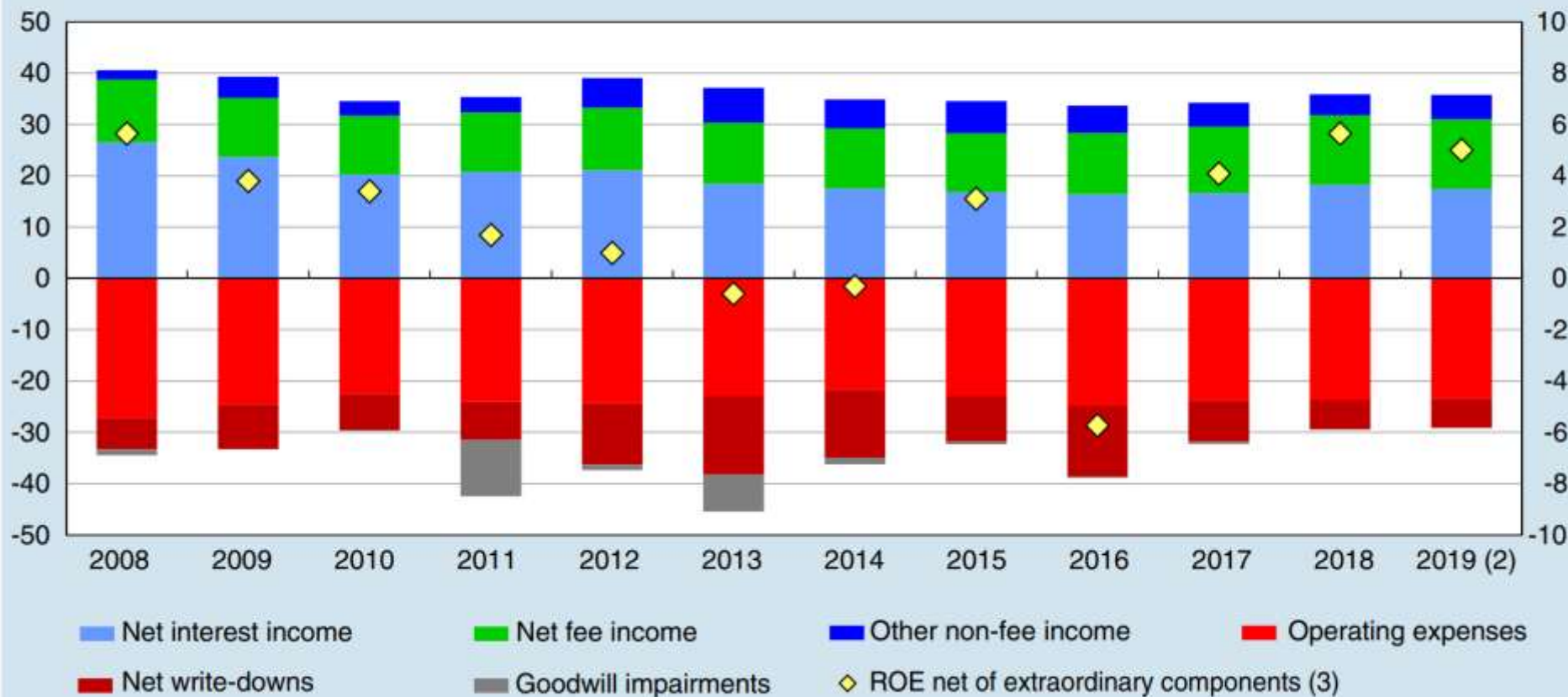


EXAMPLES

4. Economic flows across time. Comments?

Figure 13.6

Main profit and loss items of Italian banks and banking groups (1)
(per cent)



Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for stand-alone banks.
(1) As a ratio to average equity in the year. – (2) Provisional data. – (3) Right-hand scale.

EXAMPLES

5. Commercial bank branches per 100,000 adults

