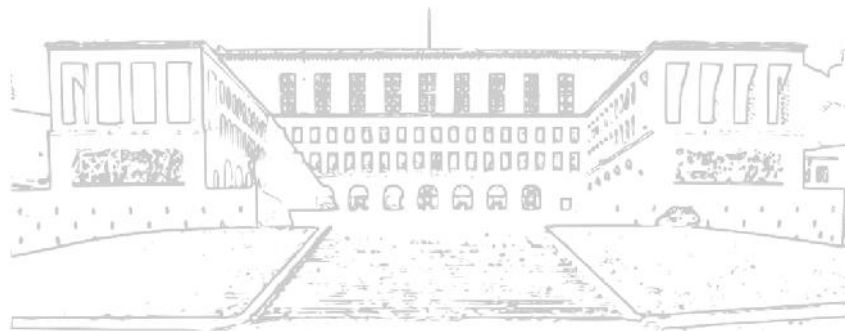


FINANCIAL MARKETS AND INSTITUTIONS

BANKS

A.Y. 2016/2017
Prof. Alberto Dreassi – adreassi@units.it

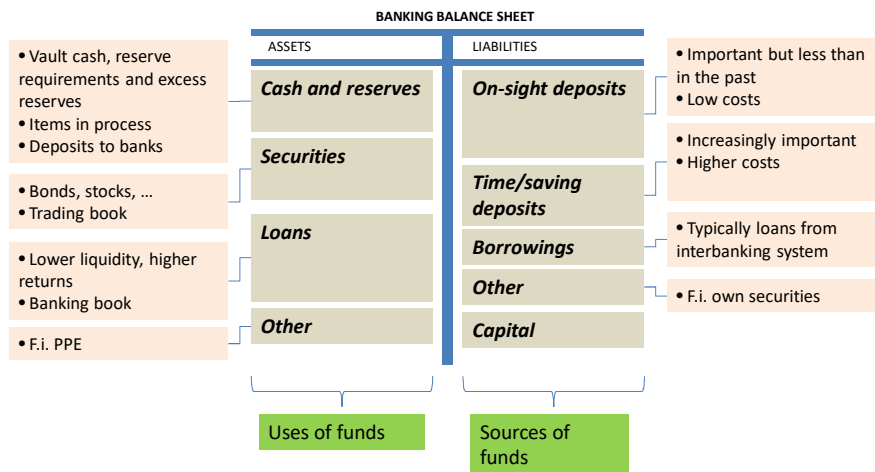


AGENDA

- Financial structure of banks
- Main banking management areas
- Banking performance
- Structure of the banking industry

FINANCIAL STRUCTURE OF BANKS

- Typically, a bank has the following financial structure



FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

3

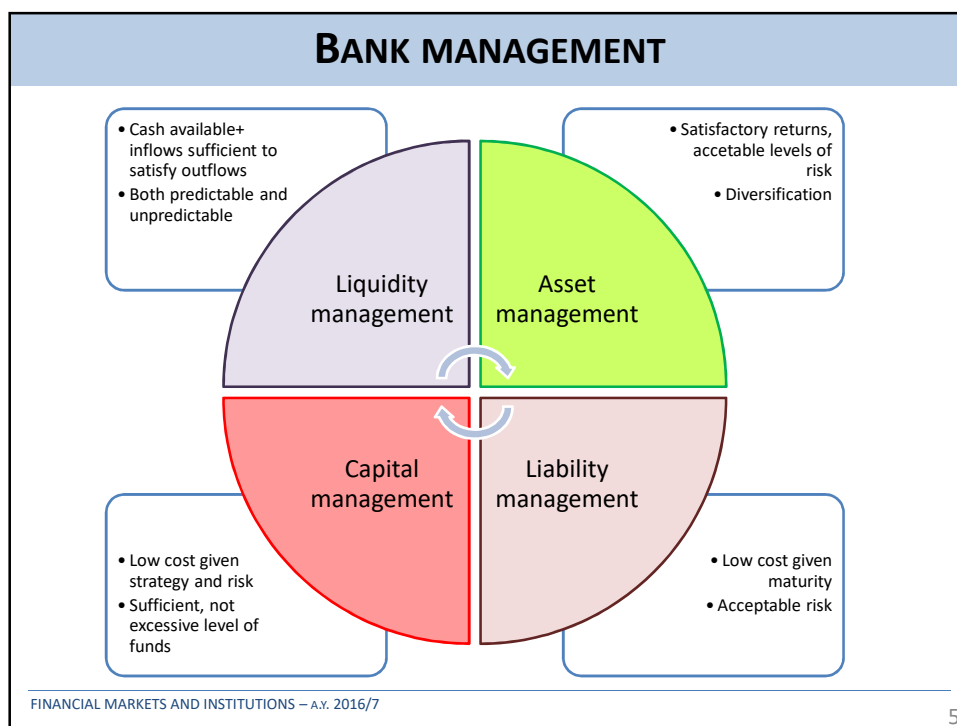
FINANCIAL STRUCTURE OF BANKS

Banking operations move around **asset transformation**:

- Selling liabilities with features desirable by lenders
- Buying assets with features desirable by borrowers
- Profitable if liabilities are cheap compared to returns on assets (rationale of intermediation)
- But risky if short-term liabilities question bank's soundness compared with less liquid, longer-termed assets (bank runs)
- Transforming both **liquidity** and **credit** risks

FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

4



BANK MANAGEMENT

Liquidity management

- Excess reserves reduce liquidity risks stemming from deposits, but reduce banks' profitability
- Lack of reserves is costly, since it requires more borrowing, selling of assets, discount lending, not renewing due loans

Asset management

- At the same time provide profitability, safety and liquidity
- Managerial options: asset selection, borrowers' scrutiny, diversification, planning

FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7 6

BANK MANAGEMENT

Liability management

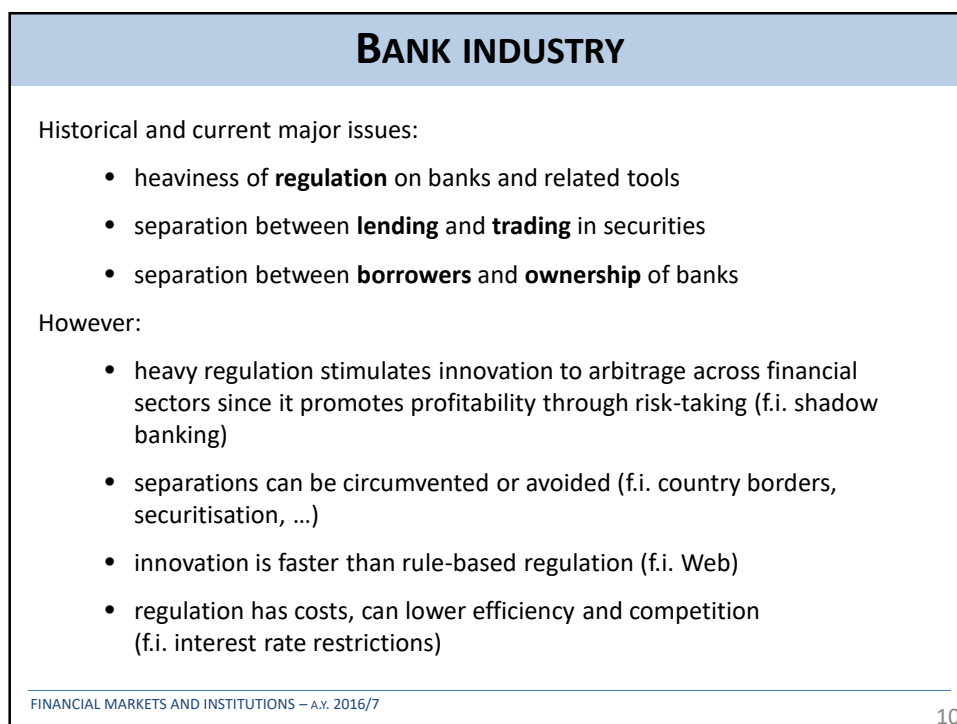
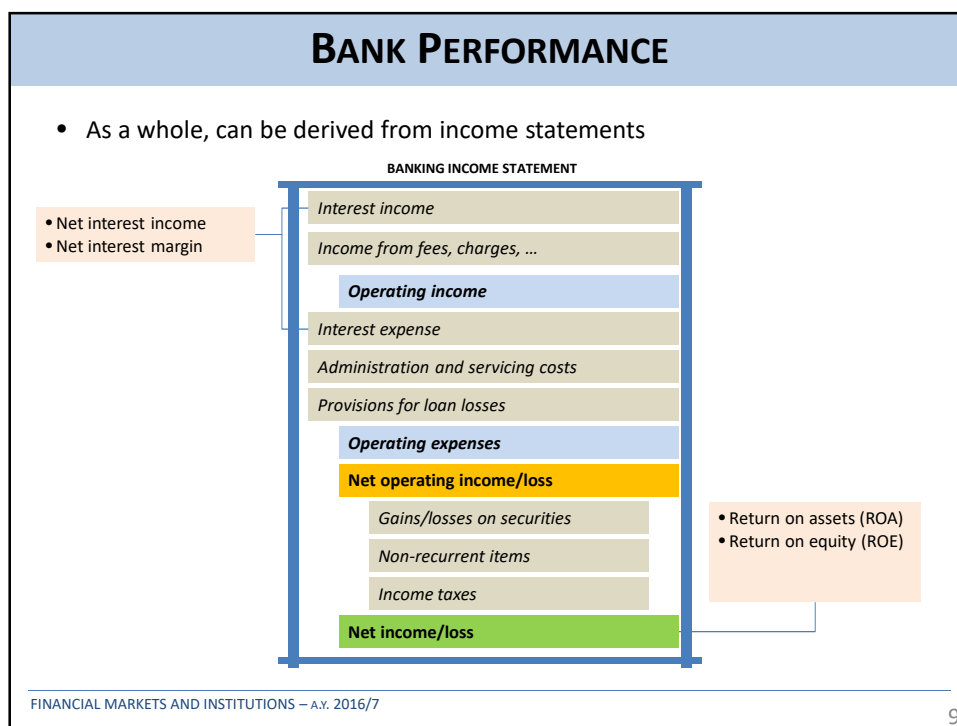
- Historically the starting point of bank's operations
- Now activities are more asset-driven
- Management focuses on assets and liabilities together (ALM)

Capital management

- Financial strength reduces likelihood of failures
- But more capital is costly and can produce lower profitability results
- Restraints come from supervisors, rating agencies and markets
- "Capital crunch" anticipated today's credit crunch

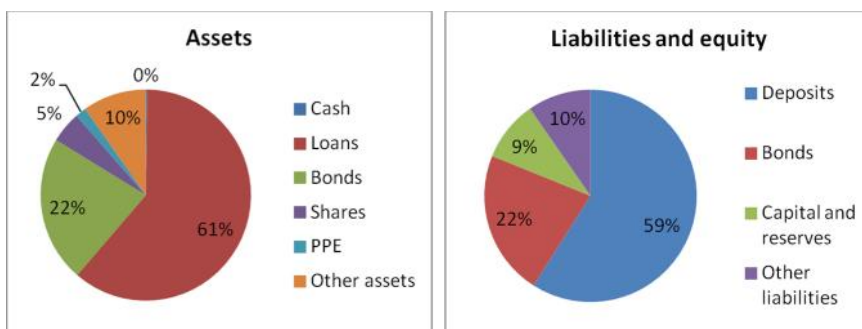
BANK MANAGEMENT

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



EXAMPLES

1. The following is the balance sheet of Italian banks as of 31 March 2013, totaling 4,213 billion €. Comments?

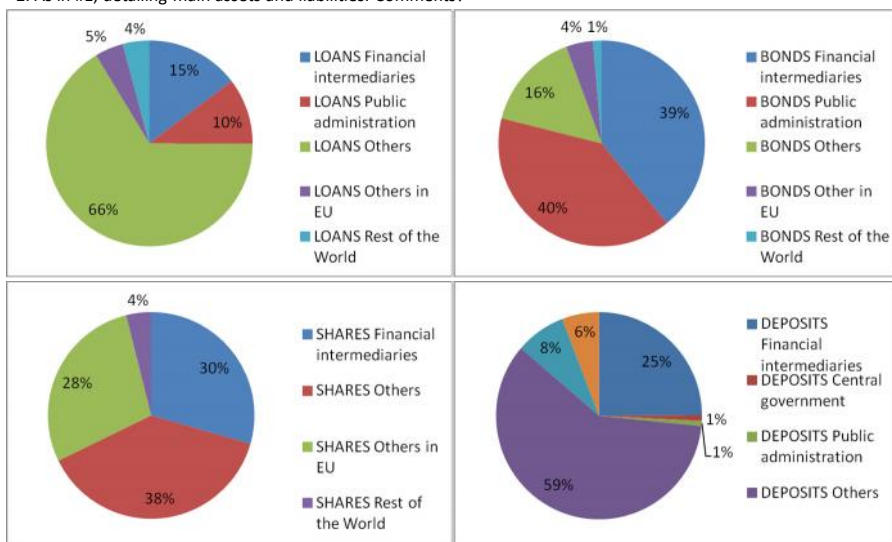


FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

11

EXAMPLES

2. As in #1, detailing main assets and liabilities. Comments?



FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

12

EXAMPLES

3. As before, detailing loans totaling 2,650 bln €. Comments?

Banks	ITA	347,293	13.09%
	EURO	80,867	3.05%
	ROW	90,129	3.40%
Monetary institutions	ITA	30,382	1.15%
	EURO	80,762	3.04%
Financial intermediaries	ITA	237,384	8.95%
	EURO	23,734	0.89%
Insurers and pension funds	ITA	4,819	0.18%
	EURO	161	0.01%
Government	ITA	184,846	6.97%
	EURO	605	0.02%
Public administrations	ITA	82,833	3.12%
Non financial companies	ITA	855,244	32.24%
	EURO	9,455	0.36%
Consumer families	ITA	499,635	18.83%
Production families	ITA	96,667	3.64%
No profit organisations	ITA	10,220	0.39%
	EURO	436	0.02%
Other	EURO	17,681	0.67%

FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

13

EXAMPLES

4. The following is the Italian banking income statement as of Dec. 2012 (mln €). Comments?

Interest income		82,141
	-CB	135
	-Banks	5,048
	-Loans	58,736
	-Bonds	13,789
	-Other	4,433
Interest expense		-47,002
	-CB	-1,931
	-Banks	-5,882
	-Loans	-10,848
	-Bonds	-24,106
	-Other	-4,235
Hedging derivatives		1,953
Interest margin		37,092
Revenues from trading		5,498
Revenues from servicing		22,084
Other revenues		9,890
Intermediation margin		74,564
Salaries		-24,459
Other operational costs		-22,450
Operating result		27,655
Impairment on loans		-24,195
Other impairments		-6,057
Other income and expense		-2,233
EBT		-4,830
Income taxes		2,349
Net income		-2,480

FINANCIAL MARKETS AND INSTITUTIONS – A.Y. 2016/7

14