Second Edition

Introduction to Banking

Barbara Casu

Cass Business School, City University London

Claudia Girardone

Essex Business School, University of Essex

Philip Molyneux

Bangor Business School, Bangor University

List of figures

List of tables

List of boxes

Preface

Acknowledgements List of abbreviations and acronyms		xviii xxxv
F	Part 1 Introduction to banking	
1	What is special about banks?	3
	1.1 Introduction	3
	1.2 The nature of financial intermediation	3
	1.3 The role of banks	7
	1.4 Information economies	8
	Why do banks exist? Theories of financial intermediation The benefits of financial intermediation	14 16
	1.7 Conclusion	17
	Key terms	18
	Key reading	18
	Revision questions and problems	19
2	Bank activities and services	20
	2.1 Introduction	20
	2.2 What do banks do?	20
	2.3 Banks and other financial institutions	21
	2.4 Banking services2.5 Sustainable and ethical banking: a brief overview	25 42
	2.5 Sustainable and ethical banking: a brief overview2.6 Conclusion	45
	Key terms	46
	Key reading	46
	Revision questions and problems	
3	3 Types of banking	
	3.1 Introduction	47
	3.2 Traditional versus modern banking	48
	3.3 Retail or personal banking	53
	3.4 Private banking 3.5 Corporate banking	59 61
	3.6 Investment banking	72
	3.7 Islamic banking	78
		vii

xiii

xvii

XX

xxiii

	3.8 Conclusion	81
	Key terms	81
	Key reading	82
	Revision questions and problems	82
4	International banking	83
	4.1 Introduction	83
	4.2 What is international banking?	83
	4.3 Brief history of international banking	86
	4.4 Why do banks go overseas?	87
	4.5 Types of bank entry into foreign markets	94
	4.6 International banking services	99
	4.7 Conclusion	112
	Key terms	113 114
	Key reading Revision questions and problems	114
	Appendix 4.1 Syndicated lending: a selected glossary	115
	, a colocida gioccary	110
F	Part 2 Central banking and bank regulation	
5	Theory of central banking	121
	5.1 Introduction	121
	5.2 What are the main functions of a central bank?	122
	5.3 How does monetary policy work?	123
	5.4 Monetary policy functions of a central bank	127
	5.5 Why do banks need a central bank?	145
	5.6 Should central banks be independent?5.7 Conclusion	149 151
		151
	Key terms	
	Key reading Revision questions and problems	152 153
6		
O	Central banks in practice	154
	6.1 Introduction	154
	6.2 The Bank of England 6.3 The European Central Bank (ECB)	154 168
	6.4 The Federal Reserve System	178
	6.5 Conclusion	186
	Key terms	187
	Key reading	
	Revision questions and problems	188
7	Bank regulation and supervision	
	7.1 Introduction	189
	7.2 The rationale for regulation	190
	7.3 Types of regulation	191
	7.4 The financial safety net	192

	7.6 7.7 7.8 Key tei Key rea		202 205 206 225 225 225 225
8	8.1 8.2 8.3 8.4 8.5 8.6 Key tel		227 227 228 233 239 246 255 255 256
P	art 3	Issues in bank management	
9	9.1 9.2 9.3 9.4 9.5 Key tel		259 259 260 274 279 294 294 294
10	Bank 10.1 10.2 10.3 10.4 10.5 10.6 10.7 10.8 Key ter Key rea	financial management Introduction Asset-liability management (ALM) Liquidity management and the importance of reserves Capital adequacy management Off-balance-sheet (OBS) business in banking Loan sales and the process of securitisation Derivative business in banking Conclusion	296 297 302 303 307 310 327 328 328
11	Bank 11.1 11.2	ing risks Introduction Credit risk	329 329 329

	11.3 Interest rate risk 11.4 Liquidity (or funding) risk	332 336
	11.5 Foreign exchange risk	339
	11.6 Market (or trading) risk	342
	11.7 Country and sovereign risk	344
	11.8 Operational risk	346
	11.9 Off-balance-sheet risk	346
1	1.10 Other risks	347
	1.11 Capital risk and solvency	348
-	1.12 Interrelation of risks	349
1	1.13 Conclusion	350
k	ey terms	351
k	ey reading	351
F	evision questions and problems	351
12 E	Bank risk management	352
	12.1 Introduction	352
	12.2 General risk management	353
	12.3 Credit risk management	359
	12.4 Managing the lending function	362
	12.5 Managing interest rate risk	369
	12.6 Managing liquidity risk	376
	12.7 Managing market risk	378
	12.8 Managing operational risk	384
	12.9 International risk assessment	388
	2.10 Conclusion	395
	ey terms	395
	ey reading	396
F	evision questions and problems	396
Pa	rt 4 Comparative banking markets	
13 E	Sanking in the UK 13.1 Introduction	399
	13.1 Introduction 13.2 The crisis in UK banking	399 400
	13.3 Regulatory reforms and the changing face of UK banking	409
	13.4 The structure of the UK banking sector	417
	13.5 Financial structure of the UK banking sector	422
	13.6 Balance sheet features and the performance of UK banks	427
	13.7 The UK payment system	431
	13.8 Competition in UK banking	433
	13.9 Conclusion	438
k	ey terms	438
	ey reading	439
	evision questions and problems	439
	ppendix 13.1 Demutualisation of the UK building society sector	440

			Contents
14	Banking in Europe		
	14.1	Introduction	441
		The European Union	442
	14.3	The Single European Market for financial services	446
		Building a new EU financial architecture	454
		Structural features and the consolidation trend	474
		Balance sheet structure and performance in European banking	484
	14.7	Conclusion	489
	Key te		489
	Key re	S .	490
	Revision	on questions and problems	490
15	Banking in the US		491
	15.1	Introduction	491
	15.2	The financial crisis in the US	492
	15.3	Structure of the US banking and financial systems	499
	15.4	US payments systems	507
	15.5	Balance sheet features of US commercial banks	510
		Performance of US commercial banks	510
		Regulation of the US banking system	515
	15.8	Conclusion	524
	Key terms		525
	Key reading		525
	Revision	on questions and problems	526
16	Banking in Japan		527
	16.1	Introduction	527
		Structure of the banking system	528
		Payment systems	538
		Banking crises in Japan	542
	16.5	Changing structure of the financial system	545
	16.6	Conclusion	552
	Key terms		553
	Key reading		553
	Revision	on questions and problems	553
17	Banking in emerging markets		554
	17.1	Introduction	554
	17.2	Benchmarking financial development	555
	17.3	Finance and growth	560
	17.4	The macroeconomic outlook	564
	17.5	Structural features and trends	570
	17.6	Conclusion	585
	Key terms		586
	Key reading		586
	Revision	on questions and problems	586

Part 5 Advanced topics in banking

18	Bank	s and markets	589
	18.2 18.3 18.4 18.5 18.6 18.7 18.8 18.9 Key te Key re	Types of securitisation Securitisation, credit-rating agencies and monoline insurers The future of securitisation Conclusion rms	589 590 593 598 604 606 607 611 614 615
19	Mera	ers and acquisitions	616
	19.1 19.2 19.3	Introduction Mergers and acquisitions: definitions and types Recent trends in bank M&As M&A and bank performance Managerial motives for M&As The impact of M&As on bank customers	616 617 621 629 632 633 634 637
	Key te Key re Revision		642 642 643
20	20.1 20.2 20.3 20.4 20.5 20.6 20.7 Key te Key re	Structure-conduct-performance (SCP) Non-structural measures of banking sector competition Comparing competition measures – are they consistent? Competition and risk in banking Bank competition and stability Conclusion rms	644 645 653 660 662 664 667 668 668
App Glos	endix A endix A ssary erences	A1 Interest rates, bonds and yields A2 Introduction to portfolio theory and further reading	669 679 689 725 749