Bank Valuation & Value-Based Management: Deposit & Loan Pricing, Performance Evaluation & Risk Management

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2nd Edition

Professor Dermine’s book covers the full range of critical topics in banking today—valuation, pricing, and risk management. Analytical, complete, and relevant, this book is a gem! At a time of increased scrutiny of the banking industry, this volume uses an analytic approach that will serve the reader well for years to come. A must-read for anyone in the profession."Anthony M. Santomero, Director, Citigroup; Former President, Federal Reserve Bank of Philadelphia; Senior Advisor, McKinsey & Company; and Richard K. Mellon Professor Emeritus of Finance, the Wharton School

Unlike banking textbooks that emphasise institutional arrangements in the banking world, the primary purpose of this book is to propose a sound valuation model for banks. Surprisingly, very few publications on the subject are available. Anchored in the fields of economics and finance, this book provides not only useful tools for valuing banks, but also an integrated value-based management framework for discussing managerial issues such as fund transfer pricing, risk-adjusted performance evaluation, deposit pricing, capital management, loan pricing and provisioning, securitization, and the measurement of interest-rate risk. To create value in banking, it is necessary to first understand the drivers of value. A sound and explicit bank valuation model is, as shown in this book, a very powerful tool for evaluating decisions that enhance shareholder value. In short, the book provides rigorous foundations for discussing asset and liability management, the control of long-term value creation and risks in banks. The second edition incorporates a discussion of the significant impact of the Basel III regulations on capital and liquidity.

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Valuing banks, insurance companies and investment banks has always been difficult, but the market crisis of 2008 has elevated the concern to the top of the list of valuation issues. The problems with valuing financial service firms stem from two key characteristics. A conservative bank will set aside more for loan losses, given a loan portfolio, than a more aggressive bank, and this will lead to the latter reporting higher profits during good times. Debt and Equity In the financial balance sheet that we used to describe firms, there are only two ways to raise funds to finance a business — debt and equity. Regulation and Risk When investing in financial service firms, we accept the fact that we know far less about their assets than we would like to know, because they are regulated.