

Provisional Reading List & Course Outline

The Wharton School
University of Pennsylvania
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FNCE 220/732: Issues in International Banking

This course focuses on international financial institutions. We will examine how historical and current events reshape the industry as well as the basic analytics of managing an institution's exposure to liquidity, market, operational, credit and country risk. In addition, we will consider how to evaluate and compare risk exposures and performance among individual banks. Throughout the semester we will discuss public policy issues such as financial crises, bailouts, proposed regulatory changes and sovereign debt crises.

The class format includes lectures and class discussions. I welcome your questions and, indeed, your constructive classroom participation will help boost your grade if you conclude the semester at the breakpoint between two different grades. More importantly, the more actively you participate in class, the better your mastery of the material.

The course calendar in webCafé integrates the reading list and other class material. Some readings and assignments will undoubtedly change over the semester as events warrant. You can find the *provisional reading list* on the web should you wish to refer back to it for logistical details, but please note that it will **not** be updated during the semester. You should regard the syllabus embedded in the calendar as definitive with regard to assignments and readings. It contains links to all readings and assignments as well as due dates for cases and information about review sessions and examinations.

We will use excerpts from *Financial Institutions Management, A Risk Management Approach*, by Anthony Saunders and Marcia Cornett (S&C) as a basic reference, largely for the last part of the course. The relevant excerpts will be available in a book especially prepared for this course, *International Banking, FNCE-220/732* (Text) that is available at the bookstore, but if you have had no prior experience with the financial services industry or if you plan to build your career in the sector, you may want to acquire the complete seventh edition of the textbook. It has become the industry standard.

I have assigned several problem sets to help you think more deeply about the course material and gauge your progress. Please try to do them before the relevant class. They will not be

graded, but answers will be posted on the calendar the following class. Since many of the questions derive from former exams, you will find it valuable to work through them carefully.

You will also be required to complete three projects that will be graded. (You may use webCafé to form teams as large as **five** to work on these projects as well as to submit projects and other assignments.) The first project will involve using accounting and market data to compare and contrast the performance of three internationally active banks. The second project will require you to compute value at risk (VaR) for a relatively simple bank under a number of different assumptions. The third and final project, an integrative case, will be distributed (electronically) just after the second mid-term and due (electronically) on the last day of the reading period.

International banking is an especially dynamic sector of the financial services industry, so I urge you to follow current developments in the *Financial Times*, *Wall Street Journal*, or *The New York Times*. In addition, you may find it helpful to browse through some of the many periodicals that focus on banking or international finance such as *The American Banker*, *The Economist*, *Euromoney*, *The Financial Regulator*, *Global Finance*, *The International Economy*, *The Institutional Investor* (International Edition), and *Risk*. And you will undoubtedly want to sample some of the ever-growing number of blogs, some of which are linked on webCafé. I regard this list as a collaborative project, so if you have found something useful that is not on the list (or a web link that is broken), please let me know.

To provide you with an incentive to keep up with 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. This exercise must be undertaken individually (not in teams) and must be turned in electronically on the date specified for credit. Some of the most interesting articles will be posted in the Current Events folder of webCafé. I have designed this exercise to sharpen your writing skills as well. The folder “Current Events Assignment” explains the rules I want you to follow to improve the clarity of your writing as well as a sample submission.

Because this course has an unusually large number of students who were born outside the United States, I prefer to give mid-term examinations outside of regularly scheduled class periods so that time constraints can be as flexible as possible. (This does not mean that I intend to give you longer exams, only that I want you to have enough time to do your best.) It also permits me to get a much larger statistical sample to assign grades consistently across the three sections of the class (although under Graduate Division rules, MBAs must be graded on a different scale than undergraduates). The first mid-term examination takes place on **Tuesday evening, October 18th, 6:00-8:00**. The second mid-term takes place on **Thursday evening, December 1st, 6:00-8:00**. Please consult these dates on the course calendar to see the room to which you are assigned. There will be no final exam. In compensation for your willingness to take these exams outside the regularly scheduled class time, we will **not** hold class on November 2nd and the day before Thanksgiving.

WebCafé contains mid-term exams (along with answers) for the past two years the course has been offered. These exams can help you judge quickly whether this course fits your needs and interests. They also indicate the *kind* of questions I am likely to pose. Please be aware, however, that the course does change from year to year both with regard to concepts covered and the emphasis placed on particular topics so the content of the exam you take is likely to be different.

Your grade will depend on your final score weighted as follows:

- 20% for the combined three projects – 5% for the first two and 10% on the last
- 10% for your analyses of current articles
- 35% for your grade on the first mid-term exam
- 35% for your grade on the second mid-term exam

If your weighted final score falls on a borderline, it will be adjusted upward if you have participated actively and effectively in class discussions.

Topical Outline of the Course

I. Introduction and Overview of the Course

- A. The Evolving Institutional Infrastructure of the International Banking System
- B. Taxes and the Corporate Structure and Geographical Location of International Banking Activity
- C. The Role of Capital in Banks
 - 1. Viewing Banks from the Perspective of a Security Analyst
 - 2. Accounting Differences: Pitfalls in Drawing Comparisons Across Banks in Different Countries

II. Financial Crises

- A. Real Estate Bubbles and Financial Crises
- B. The Safety Net for Financial Institutions
 - 1. The Safety Net in Principle
 - 2. The Safety Net in Practice (Banks)
 - a. Continental Illinois National Bank
 - b. Northern Rock
 - c. Fortis
 - d. Dexia
 - e. The Icelandic Banking Crisis
 - 3. Capital Market Crises
 - a. LTCM
 - b. Bear Stearns
 - c. Lehman Brothers
 - d. AIG
- C. Private Sector Initiatives: Restructurings
- D. Sovereign Debt Crises and their Relation to Financial Crises
 - 1. The Simple Dynamics of Debt Problems
 - 2. Country Risk Analysis

III. Regulatory Reforms in Response to the Crisis

A. The Dodd-Frank Bill

1. What Has Been Done?
2. What Remains to Be Done?

B. Parallel Issues in Europe

C. Basel III

1. Basel I and Its Perceived Defects
2. Basel II and Its Revealed Defects
3. The Evolving Scope of Basel III
4. The Likely Impacts on the Banking System
 - a. Impacts on profitability
 - b. Consolidation and conglomeration
5. The Unfinished Agenda

IV. Risk Management and the International Regulatory Supervision of Risk

A. Liquidity and Liquidity Risk Management

1. Proposals to Regulate Liquidity

B. The Treasury Function

C. The Management of Credit Risk

D. The Management of Market Risk and VaR

E. The Governance of Risk Management

F. International Supervision of Risk

1. The Basel Concordat
2. Proposed Revisions to the Concordat

I. Introduction and Overview

1. The Evolving Structure of Official International Institutions

Readings

International Banking Glossary

“What is the Group of 20?” <http://www.g20.org>

“Leader’s Statement: The Pittsburgh Summit” 24-25 September 2009

A. Walter, 2011, “Global Governance after the Crisis: The G2, the G20, and global imbalances,” pp.1-24 only

“While You Were Away: An Update on Financial Regulation Developments,” *ICFR*, 1 September 2010

Andrew G. Haldane Speech, Risk Off, 18 August 2011

Class notes: The Evolution of International Financial Institutions

2. Taxes and the Corporate Structure and Location of International Banking Activities

Readings

“International Taxation,” Wikipedia.org

L. Vaughan, “Tax Shadow of €90 bn hangs over Europe’s Banks,” *Financial News*, 13 July 2010

Excerpt from Bankers Trust presentation to security analysts on the use of foreign tax credits

R. Reid, “A Taxing Time for Financial Transactions,” *ICFR*, 17 August 2011

C. Comstock, “Here’s What Mike Mayo Thinks Citi Is Doing to Cook Its Books,” *Business Insider*, 27 August 2010

Class notes: Taxation and the Corporate Structure and Geographic Location of International Banking

Assignment

Taxes and the Geographic Distribution of Banking Activity

3. The Role of Capital in Financial Institutions

Readings

A. Berger, R. Herring and G. Szegő, 1995, “The Role of Capital in Financial Institutions,” Reprinted in *The Regulation and Supervision of Banks*, edited by Maximilian J.B. Hall, The International Library of Critical Writings in Economics, Edward Elgar Publishing Limited

P. Pfleiderer, 2011, “On the Relevancy of Modigliani and Miller to Banking: A Parable and Some Observations”

C. Calomiris and Richard J. Herring, 2011, “Why and How to Design a Contingent Convertible Debt Requirement”

Class notes: The Role of Capital in Financial Institutions

4. How Security Analysts Evaluate International Banks

Readings

Financial Statement Analysis Using a Return on Equity (ROE) Framework

The following articles will help you compare a private sector with a public sector perspective to analyzing banks:

FitchRatings, Global Special Report: “A Universal Spreadsheet for Bank Analysis,” 14 April 2009

Federal Financial Institutions Examination Council, “A User’s Guide for the Uniform Bank Performance Report,” December 2008

“Definitions of UBPR Items,” *UBPR’s User Guide*, December 2008

FitchRatings, Criteria Report: “Bank Rating Methodology”

Accounting issues:

R. Herring, 2011, “Fair Value Accounting and Financial Instability: Does How We Keep Score Influence How the Game is Played?” Reprinted in *Encyclopedia of Financial Globalization*

A. Jones and J. Thompson, “IASB criticises Greek debt writedowns,” *Financial Times*, 30 August 2011

FitchRatings Corporates U.S. Special Reports: “Demystifying Recent Accounting Pronouncements: An Analytical Guide for Reviewing 10-Ks and 10-Qs,” 1 April 2010 (*Optional, for those with particular expertise in accounting*)

Class notes: Notes on Bank Accounting and Ratio Analysis

Assignment

Financial Analysis of Banks

II. Financial Crises and Sovereign Debt Crises

5. Real Estate Bubbles and Financial Crises

Readings

R. Herring and S. Wachter, “Real Estate Booms and Banking Busts: An International Perspective”

Class notes: Real Estate Booms and Banking Busts

6. Real Estate Bubbles and Financial Crises

Readings

C. Reinhart and K. Rogoff, 2008, “Is the 2007 Sub-Prime Crisis So Different? An International Historical Comparison,” *American Economic Review* 98(2), pp.339-344

Assignment

Why Real Estate Prices Especially Prone to Form Bubbles?

7. Restructuring Financial Institutions

Readings

D. Scott, 2002, “A Practical Guide to Managing Systemic Financial Crises: A Review of Approaches Taken in Indonesia, The Republic of Korea and Thailand”

W. Buiter, “Don’t touch the unsecured creditors! Clobber the tax payer instead: Good Bank vs. Bad Bank” ft.com/maverecon, 13 March 2009

W. Buiter, “Fixing the banking system: How to set up a new ‘good bank,’” VOX, 22 February 2009

J. Bulow and P. Klemperer, “Reorganising the banks: Focus on the liabilities, not the assets,” VOX, 21 March 2009

W. Buiter, “Slaughtering sacred cows: it’s the turn of the unsecured creditors now,” ft.com/mavrecon, 18 March 2009

Class notes: Bank Restructuring: Opportunities and Pitfalls

Group Project Assignment Distributed

Compare and contrast the strengths and weaknesses of three different internationally active banks (Questions and case material to be distributed)

Assignment

Restructuring Financial Institutions

8. The Safety Net in Principle: An International Comparative Perspective

Readings

G. Caprio and P. Honohan, 2001, “Preventing & Minimizing Crises,” Ch. 2 in *Finance for Growth: Policy Choices in a Volatile World*, World

Bank, pp. 75-121

G. Morgenson, "The Rescue That Missed Main Street," *New York Times*, 27 August 2011

B. Keoun and P. Kuntz, "Wall Street Aristocracy Got \$1.2 Trillion from Fed," Bloomberg.com, 22 August 2011

Class notes: The Safety Net in Principle: An International Comparative Perspective

Assignment

The Safety Net

9. The Safety Net in Practice, Part I, Banking Crises: The First Modern Bank Run, Continental Illinois National Bank

Readings

Continental Illinois and "Too Big to Fail," Ch. 7 in *An Examination of the Banking Crises of the 1980s and Early 1990s*, FDIC, 1997, pp. 235-257

Class notes: The Safety Net in Practice: Continental Illinois National Bank

Assignment

1. The Safety Net in Operation: Continental Illinois National Bank & Trust
2. Continental Illinois Before the First Run

10. The Safety Net in Practice, Part I, More Recent Banking Crises: Northern Rock, Fortis, Dexia, and the Icelandic Banks

Readings

D. Llewellyn, 2008, "The Northern Rock Crisis: A Multi-Dimensional Problem Waiting to Happen," *Journal of Financial Regulation and Compliance* 16(1), pp. 35-58

"Rock carving: Splitting Northern Rock is just the beginning," *The Economist*, 29 October 2009

S. Claessens, R. Herring, and D. Schoenmaker, *A Safer World Financial System: Improving the Resolution of Systemic Institutions*, Geneva Studies on the World Economy 12, pp. 49-55

Class notes: Systemic Risk: The Safety Net in Practice British Style:
Northern Rock et al

11. The Safety Net in Practice, Part II, Capital Market Crises: Hedge Funds

Readings

Text, pp.143-150

C. Geczy, 2010, “Thoughts on the Future of the Hedge Fund Industry”

Sidley Austin LLP, “Title IV – Regulation of Advisers to Hedge Funds and Others,” 30 June 2010

“Hedge funds: Bigger, safer but duller,” *The Economist*, 26 August 2010

“Hedge funds: Many unhappy returns,” *The Economist*, 20 August 2011

Class notes: Systemic Risk: Hedge Funds & Financial Stability

Assignment

How Do Hedge Funds Differ from Other Financial Institutions?

12. The Darker Side of Securitization

Readings

Text, pp.814-821, 833-847

A. Ashcraft and T. Schuermann, 2007, “Understanding the Securitization of Subprime Mortgage Credit”

You Tube Video, “ABCs of CDO (CLO, CBO, CDO of ABS)” (a fairly painless way to learn the basics)

You Tube Video, “The Long Johns” (just for fun!)

Class notes: The Darker Side of Securitization

Assignment

How Securitization Became Too Clever by Half: Analyzing a CDO

13. The Role of the Ratings Agencies

Readings

R. Herring and E. Kane, “How to Reform the Credit-Rating Process to Support a Revival of Private-Label Securitization”

IMF Global Financial Stability Review, “Policy Initiatives Aimed at Restarting Sustainable Securitization,” 9 September 2009, pp.17- 34

Class notes: The Role of Ratings Agencies

14. The Demise of the Big Five Investment Banks

Readings

D. Duffie, 2010, “How Big Banks Fail and What to Do about It”

S. Claessens, R. Herring, and D. Schoenmaker, *A Safer World Financial System: Improving the Resolution of Systemic Institutions*, Geneva Studies on the World Economy 12, pp. 41-50

“Lehman, two years on: Mission unaccomplished,” *The Economist*, 9 September 2010

R. Drew, “Goldman Sachs Group Inc.,” *New York Times*, 19 October 2010

House Banking Committee Release of Confidential Bear Stearns Memo

Class notes: The Demise of the Big Five Investment Banks

15. Financial Crises and Sovereign Debt Crises

Readings

Text, pp. 228

A. Mares, “Ask Not Whether Governments Will Default, but How,” Morgan Stanley, 26 August 2010

A. Beattie and C. Giles, “IMF and eurozone clash over estimates,” *Financial Times*, 31 August 2011

Class notes: Country Risk Analysis

16. The Dynamics of Debt Crises & How they are Resolved

Readings

...to be supplied reflecting current developments

“Sovereign-debt theories: Domino theory,” *The Economist*, 18 February 2010

M. Wolf, “Is there the will to save the eurozone?” *Financial Times*, 7 December 2010

Class notes: The Dynamics of Debt Crises and How They Are Resolved

III. Risk Measurement and Management

17. VaR and the Revolution in Risk Management

Readings

Text, pp.81-110

G. Guill, 2007, “Bankers Trust and the Birth of Modern Risk Management”

Class notes: Managing Market Risk

Group Project Assignment Distributed

Value-at-risk (Questions and case material to be distributed)

Assignment

Text, pp.107-110, #4, 5, 6, 14, & 16

18. The Management of Credit Risk Management

Readings

Text, pp.112-154, 167-181

R. Herring and T. Schuermann, “Capital Regulation for Position Risk in Banks, Securities Firms, and Insurance Companies”

Class notes: Credit Risk

Assignment

Text, pp.155-159, #18, 22, 23, 24, & 32

19. The Treasury Function: Managing Interest Rate Risk

Readings

Text, pp.1-80

Class notes: The Treasury Function: Funding the Bank Subject to Liquidity and Interest Rate Risk Constraints

Assignment

Text, pp.63-68, #3, 4, 14, & 21

20. The Treasury Function: Managing Liquidity Risk

Readings

Text, pp. 230-252

J. Tirole, 2011, “Illiquidity and All Its Friends,” *Journal of Economic Literature* 49(2): pp.287-325 (for those with advanced training in

economics or a special interest in liquidity)

Class notes: Liquidity & Liquidity Risk Management

IV. International Financial Regulatory and Supervisory Policies

21. The Inadequacy of the Initial Policy Responses to the Crisis

Readings

R. Herring, “How Financial Oversight Failed and What it May Portend About the Future of Regulation”

Class notes: The Inadequacy of the Initial Policy Response

22. International Regulatory Reform: Introduction to Basel I, II, & III

Readings

You Tube Video, “Basel II Overview”

R. Herring, “Implementing Basel II: Is the Game Worth the Candle?”

R. Herring, “The Rocky Road to Implementation of Basel II in the United States”

R. Herring, “Basel III: A Non-Official American View”

Basel Committee on Banking Supervision, 2011, “Basel III Framework for Liquidity – Frequently Asked Questions”

Basel Committee on Banking Regulation, 2011, “Basel III Definition of Capital – Frequently Asked Questions”

Y. Onaran, 2011, “Global Bank Capital Regime at Risk as Regulators Spar over Rules,” Bloomberg.com, 20 August 2011

Class notes: Basel I, II & III (A Reader’s Digest)

23. International Supervisory Reform: The Evolving Basel Concordat

Readings

R. Herring and R. Litan, Chapter 5 (“Prospects for International Cooperation in the Regulation and Supervision of Financial Services”) of *Financial Regulation in the Global Economy*

R. Herring and J. Carmassi, “The Structure of Cross-Border Financial Supervision”

Basel Committee on Banking Supervision, 2010, “Good Practice Principles on Supervisory Colleges”

Senior Supervisors Group, 2009, “Risk Management Lessons from the Global Banking Crisis of 2008”

Class notes: International Trends in Supervision

24. Dodd-Frank & National Reform Efforts in the EU

Readings

Davis Polk, 2010, “Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010”

Davis Polk, 2011, “Dodd-Frank Rulemaking Progress Report”

Cleary Gottlieb, “Alert Memo: Financial Regulatory Reform in the European Union: State of Play and Prospects,” 28 July 2011

S. Claessens, R. Herring, and D. Schoenmaker, *A Safer World Financial System: Improving the Resolution of Systemic Institutions*, Geneva Studies on the World Economy 12, pp. 57-82

G. Parker, P. Jenkins and N. Cohen, “Banks to avoid big shake-up until 2015,” *Financial Times*, 31 August 2011

Class notes: Dodd-Frank, Basel III & 2 Key Remedies: CoCos & Rapid Resolution