

The Wharton School
University of Pennsylvania

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Fall Semester 2004

FNCE220-FNCE732: Issues in International Banking

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

The class format will include lectures and class discussions. Questions are encouraged. The reading list is divided into two parts. The first lists assignments topic by topic. The second lists supplementary readings for those who wish to pursue a particular topic in greater detail. *Financial Institutions Management*, Fourth Edition, by Anthony Saunders and Marcia Cornett (S&C) will be used for background reading and will be particularly useful for those who have not studied banking. Copies are available at the University of Pennsylvania Bookstore and at the library.

Several cases and problems will be assigned. The mid-term examination will be Wednesday evening, October 20 from 6:00 to 7:30 p.m. and the final examination will be a common exam on December 20 from 4:00 to 6:00 p.m. The mid-term examination will receive a 35% weight and the final examination a 45% weight in the computation of your final grade. In addition, three projects will be graded and will receive a weight of 20%. I will adjust borderline scores upward to reward effective participation in class discussions.

International banking is an especially dynamic sector of the financial services industry, so you are urged to follow current developments in the *Financial Times*, *Wall Street Journal*, or *New York Times*. In addition, you may find it helpful to browse through some of the many periodicals which focus on banking and/or international finance. Among the most useful are:

The American Banker

The Economist

Euromoney

The Financial Regulator

Global Finance

The International Economy

The Institutional Investor (International Edition)

Risk

See the course on Webcafé for hot links (located under "Links") to these publications as well as research institutes, public and private financial international financial institutions, and other sources of information relevant to international banking.

Course Outline

09/08/04	1. Introduction and Overview of Recent Trends
09/13/04	2. Regulatory Framework: The Financial Safety Net
09/15/04	3. The Financial Safety Net in Practice: Continental Illinois
09/20/04	4. Bank Restructuring
09/22/04	5. Hedge Funds and Financial Stability
09/27/04	6. Taxes and the Structure and Location of International Banking Activities
09/29/04	7. The Role of Capital
10/04/04	8. The Securities Market Perspective
10/06/04	9. Liquidity and Liquidity Risk Management
10/11/04	10. The Treasury Function
10/13/04	11. The Management of Credit Risk
10/18/04	12. International Capital Regulation: The Original Basel Accord
10/20/04	MID-TERM EXAM
10/25/04	ENJOY FALL BREAK (no class)
10/27/04	13. The Management of Market Risk
11/01/04	14. The Management of Market Risk and Extension of the Basel Accord to Encompass Market Risk
11/03/04	15. Proposed Revisions to the Basel Accord: Basel II
11/08/04	16. International Supervision: The Basel Concordat
11/10/04	17. The Structure of International Loan Agreements
11/15/04	18. Valuing a Syndicated Loan
11/17/04	19. Country Risk Analysis
11/22/04	20. Debt Crises and Their Resolution: From the Oil Crisis to Brady Bonds
11/24/04	21. Securitizing Troubled Country Debt: Aztec Bonds
11/29/04	22. Debt Crises and Their Resolution: From the Tequilla Hangover to Bahtulism and Calls for a New Financial Architecture
12/01/04	23. Financial Liberalization
12/06/04	24. Consolidation and Conglomeration
12/08/04	25. Forming a Financial Conglomerate: Case Study

1. Introduction and Overview of Recent Trends

Readings

International Banking Glossary

S&C pp. 3-21, 24-41 & 138-153.

Class notes: “Overview of Recent Trends: Convergence in Products & Distribution Channels”

2. Regulatory Framework: The Financial Safety Net

Readings

G. Caprio and P. Honohan, “Preventing and Minimizing Crises,” Ch. 2 in *Finance for Growth: Policy Choices in a Volatile World*, World Bank, 2001, pp. 75-121.

S&C pp. 475-510

Class notes: “Safety & Soundness of Financial Institutions: The Safety Net in Principle”

Assignment

The Safety Net

3. The Financial Safety Net in Practice: Continental Illinois

Readings

S&C pp. 424-442

Class notes: “The Safety Net in Practice: Continental Illinois”

Assignment

The Safety Net in Operation: Continental Illinois Bank and Trust Company

4. Bank Restructuring

Readings

David Scott, “A Practical Guide to Managing Systemic Financial Crises: A Review of Approaches Taken In Indonesia, The Republic of Korea, and Thailand,” May 2002, pp. 56-66.

Daniella Klingebiel, “The Use of Asset Management Companies in the Resolution of Banking Crises Cross-Country Experiences,” World Bank Policy Research Working Paper 2284, February, 2000, pp. 2-8.

Assignment

The Melon Bank Case

5. Hedge Funds and Financial Stability

Readings

S&C pp. 123-124

Franklin Edwards and Stav Gaon, "Hedge Funds: What Do We Know?," *Journal of Applied Corporate Finance*, Vol. 15, Number 4, Summer 2003, pp. 8-21.

Basel Committee on Banking Supervision, "Bank's Interactions with Highly Leveraged Institutions," <http://www.bis.org/publ/bcbs45.htm>

Class notes: "Hedge Funds and Financial Stability"

6. Taxes and the Structure and Location of International Banking Activities

Readings

Y.K. Henderson, "The Taxation of Banks: Particular Privileges or Objectionable Burdens?" *New England Economic Review*, May/June 1987, pp. 3-18

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

Class notes: "Taxation and the Structure of International Banking"

Assignment

Taxes and the Geographic Distribution of Banking Activity

7. The Role of Capital

Readings

S & C pp. 513-520

Koch, "The Effect of Capital Requirements on Bank Operating Policies," in *Bank Management*, pp. 405-409.

Class notes: "The Capital Decision"

Assignment

Financial Analysis of Banks, Part I

8. The Securities Market Perspective

Readings

S&C pp. 58-59 & 511-513

Federal Reserve Board, "Glossary," pp. 1-9.

Assignment

Bankscope project

9. Liquidity and Liquidity Risk Management

Readings

S & C pp. 449-469

R. J. Herring and J. Guttentag, "Strategic planning by international banks to cope with uncertainty," in *Strategic Planning and International Banking*, Macmillan, 1985.

Class Notes: "Liquidity and Liquidity Risk Management"

Assignment

Financial Engineering to Enhance Liquidity

10. The Treasury Function

Readings

S&C pp. 161-213

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

Assignment

S & C pp. 213-216, problems 2, 3, 14, 15, & 20

11. The Management of Credit Risk

Readings

S&C pp. 259-297 & 303-309,

Assignment

S&C pp. 297-303 problems 18, 22, 23,24 & 32

12. International Capital Regulation: The Original Basel Accord

Readings

S&C pp. 520-528 & 530-537

Class notes: "International Capital Regulation: The Original Basel Accord"

Assignment

Exercise on the Basel Accord

MIDTERM EXAM

FALL BREAK (No Classes)

13. The Management of Market Risk

Readings

S&C pp. 232-247

Class notes: “Managing Market Risk”

Assignment

S & C pp. 255-257, problems, 4, 5, 6, 14 & 16

14. The Management of Market Risk and Extension of the Basel Accord to Encompass Market Risk

Readings

S&C pp. 253-255

Class notes: “Extension of the Accord to Encompass Market Risk”

Assignment

Value at Risk

15. Proposed Revisions to the Basel Accord: Basel II

Readings

S&C pp. 528-530 & 538-542

Basel Committee on Banking Supervision, “International Convergence of Capital Measurement and Capital Standards, A Revised Framework,” June 2004 pp. 1-6.

Class notes: Proposed Revisions to the Basel Accord: Basel II

Assignment

Benjamin Esty & Aldo Sesia, Jr., “Basel II: Assessing the Default and Loss Characteristics of Project Finance Loans,” HBS9-203-035, January 2004.

16. International Supervision: The Basel Concordat

Readings

R. Herring and R. Litan, *Financial Regulation in the Global Economy*, Chapters 4 & 5, pp. 86-152.

S&C pp. 362-368

Settlement Risk in Foreign Exchange Transactions, Bank for International Settlements, Basel, March 1996, pp. 1-17 <http://www.bis.org/publ> -- No. 17 under Committee on Payment and Settlement Risk

CLS Overview, <http://www.cls-group.com>

Class notes: "International Trends in Supervision"

Class notes: "The Plumbing of the International Financial System: Clearing & Settlement Risk"

Assignment

Trends in International Supervision

17. The Structure of International Loan Agreements

Readings

P.R. Stansbury, "Legal Aspects of Syndicated Euro lending"

Anonymous, "Eurodollar Loan Agreement Parody"

Class notes: "The Structure of an International Loan Agreements: Syndicated Loans"

Assignment

G. Hoguet, *Republic of Zaire*

18. Valuing a Syndicated Loan

Readings

First Chicago Ltd., "Loan Syndication Memorandum"

Assignment

Syndications Arithmetic

19. Country Risk Analysis

Readings

S&C pp.395-423

"*Country Risk, Results and Methodology* " *Euromoney*, March 2004, pp. 106-111 (<http://www.euromoney.com>)

N. Ul Haque, D. Mathieson, and N.Mark, "Rating the Raters of Country Creditworthiness," *Finance and Development*, March 1997

Federal Financial Institutions Examination Council, Country Exposure Lending Survey: July 2002 release of March 2002 data (<http://www.ffiec.gov/E16/default.htm>) four sample tables.

Class notes: "Country Risk Analysis"

Assignment

Exercise on Country Risk Analysis

20. Debt Crises and Their Resolution: From the Oil Crisis to Brady Bonds

Readings

W.M. Corden and M.P. Dooley, "Issues in Debt Strategy: An Overview," in *Analytical Issues in Debt*, edited by J.A. Frenkel, M.P. Dooley and P. Wichkam, International Monetary Fund, 1989, pp. 10-37.

"Mr. Laffer meets third-world debt," *Economist*, October 12, 1991, pp. 24, 29 & 30.

Class notes: "Debt Crises and their Resolution"

Assignment

Exercise on Rating Countries

21. Securitizing Troubled Country Debt: Aztec Bonds

Assignment

H. Thomas, I. Walter and R. Smith. "United Mexican States, Collateralized Floating Rate Bonds Due 2008" with questions

22. Debt Crises and Their Resolution: From the Tequila Hangover to Bahtulism and Calls for a New Financial Architecture

Readings

IMF Staff, "The Asian Crisis: Causes and Cures," *Finance and Development*, June 1998, pp. 18-21

The 1994-95 Mexican Peso Crisis, Harvard Business School, N9-296-056

Class notes: "Debt Crises and Their Resolution: From the Tequila Hangover to Bahtulism & The New Financial Architecture."

23. Financial Liberalization

Readings

S & C pp. 606-619

Neil B. Murphy, "European Union Financial Developments: the Single Market, the Single Currency, and Banking," *FDIC Banking Review*, Vol. 13, No. 1, 2000, pp. 1-13

Economist Intelligence Unit, "Country Finance, Japan," April 2003, pp. 7-27

Class notes: "Financial Liberalization"

Assignment

Financial Liberalization

24. Consolidation and Conglomeration

Readings

S&C pp. 353-362

Class notes: "Consolidation & Conglomeration"

Assignment

Financial Conglomerates

25. Forming a Financial Conglomerate: Case Study

Case: Allianz