STRATEGIC ISSUES FACING INVESTMENT BANKS

FALL 2016

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Office Hours: Upon request. E-mail for an appointment. Preferred means of communication is via email. Students can expect a response within 12 to 24 hours. Students are welcome to email the professor at any time.

REQUIRED COURSE MATERIALS

1. Reading Packet
2. Recent and relevant articles (to be sent by Professor)

REQUIRED PREREQUISITES AND CONNECTION TO THE CORE

The learning in this course will utilize, build on, and extend concepts covered in the following core courses:

<table>
<thead>
<tr>
<th>Core Course</th>
<th>Connection with Core</th>
</tr>
</thead>
<tbody>
<tr>
<td>CORPORATE FINANCE</td>
<td>1. Risk</td>
</tr>
<tr>
<td></td>
<td>2. Firm Valuation Model</td>
</tr>
<tr>
<td>DECISION MODELS</td>
<td>1. Fundamental Concepts of Decision Making</td>
</tr>
<tr>
<td>FINANCIAL ACCOUNTING</td>
<td>1. Financial Statements of Banks</td>
</tr>
<tr>
<td>GLOBAL ECONOMIC ENVIRONMENT</td>
<td>1. Role of Financial Markets in the Economy</td>
</tr>
<tr>
<td>LEADERSHIP DEVELOPMENT</td>
<td>1. Ethics, Decision-Making, Persuasion, and Teams</td>
</tr>
<tr>
<td>STRATEGY FORMULATION</td>
<td>1. Trade-Offs, Value-Added, Competing Firms, Strategic Analysis, Diversification, and Cross-Selling</td>
</tr>
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</table>
COURSE DESCRIPTION

The course is designed to help those interested in evaluating the financial industry which is undergoing rapid change (e.g., a student interested in management consulting or professional services); working in financial services or investment banking (but wants a broader understanding of the various divisions and departments and how they interrelate); or learning generally more about the financial system.

Each class session focuses on one critical strategic issue facing a global investment bank. In general, case discussions will be led by the teacher or a guest speaker. The class topics/strategic issues often vary depending on the students’ interests and topical issues.

Topics

1st class is an overview of class and expectations. No work is necessary. It would be helpful to watch these videos. Assets / Liabilities. Banking 1 and 2. [https://www.khanacademy.org/economics-finance-domain/core-finance/money-and-banking/banking-and-money/v/banking-1](https://www.khanacademy.org/economics-finance-domain/core-finance/money-and-banking/banking-and-money/v/banking-1)

An Overview of Investment Banks. The first two classes typically go through the organization and structure of a universal and investment bank. Typically, we use the real life example of JP Morgan. Typically we cover why banks are organized the way they are. JP Morgan presentation from Investor Day: [https://www.jpmorganchase.com/corporate/investor-relations/document/firm_overview_investor_day_2016.pdf](https://www.jpmorganchase.com/corporate/investor-relations/document/firm_overview_investor_day_2016.pdf)

Different Banks’ Strategies, Leadership/Crisis and Cross-Selling.

Corporate Culture. What is it? Why is it important? What is organizational drift. What pressures an organization? We will read some parts of What Happened to Goldman Sachs. Talent Oriented or Process Oriented? See End of This Document for Class Discussion Questions.

The Financial Crisis. We typically read two cases about the financial crisis. Why did it happen? The importance of Confidence. Leverage and Risk. Interest Rate Risk. Credit Risk.

Income Statements and Balance Sheets. We will review Income Statements / Press releases of Various Banks. What is the biggest cost? What about legal costs? Costs to comply with regulations? Technology costs? DVA. VAR.

Valuation. How do you value banks. What does this mean for strategy?

Compensation and Promotion. We will read a case study about a banker up for promotion. We will review the Proxy statements of various banks. Research what you can for each bank as if you were HR. What would you advise for the bonus pool this year? ? See End of This Document for Class Discussion Questions.

Risk Management. See End of This Document for Class Discussion Questions.

Legal/Regulatory. Glass Steagall, Sarbanes Oxley, Gramm Leach Biley to Dodd Frank to Volker Rule. See End of This Document for Class Discussion Questions.

Strategy. Would you rather run a technology driven, process driven, talent driven, industry/product driven, or global bank? How would you differentiate?
The focus is on learning and learning practical information and tools to help a student’s career.

**COURSE OBJECTIVES**

Students will learn how to design and implement a coherent strategy to address a critical strategic issue facing an investment bank through lectures, discussions, and case analyses.

Students will learn how to more effectively contribute to their firms and understand complex challenges facing senior management.

**ASSIGNMENTS**

Students are expected to read the cases and materials and be prepared to present or discuss key themes. Typically, this is one or two cases per class and one or two short articles. Students are grouped together in teams to represent “their bank” which could be Goldman Sachs, Morgan Stanley, Citigroup, JP Morgan, Wells Fargo, B of A, Lazard, Evercore, PIT, etc.

**MIDTERM MEMO (25%)**: Students are expected to turn in a [two-to-three page memo to a fictional CEO about a strategic topic](#). A successful memo typically answers the following questions: What is the issue/challenge and background (what are the regulatory, organizational, competitive, or technological issues causing the problem/issue?); why should the CEO care/why is the topic important?; what is your recommended course of action?; costs?; resources required?; timing? (and potential consequences?); how will you judge success?/what metrics? The paper should provide ideas from readings and discussions as well as data/evidence to support one’s answer/opinion. If you can’t find data, figure out how you could ball park the data, and then use it. Since most executives prefer memos to be short and to the point, the short memo forces the student to focus on the question, the answer and the reasons why the student has the answer/opinion. This is Type B Assignment. You can discuss the memos and receive outside help, but you must submit your own work and conclusions and the grade is individual.

**MIDTERM QUESTIONS / MID TERM EXAM (25%)**: Students will be required to generate a total of 10 questions and answers about the course content covered up to a certain point in the course, based on their readings and notes. A good balance would be at least two questions per each class’ materials. These questions are questions the student feels could/would be appropriate for a midterm exam. The question itself should highlight the understanding of a key concept of the class and should be essentially leading to a very obvious answer. The answers should be very obvious and short, one or two words. For example, the questions should not be “Define XYZ?” A very thoughtful definition that includes the context of why the concept/word is important and was raised or discussed in class should be in the question, and then the answer should be the word/two-three word concept. There should not be any true or false or multiple-choice questions. Questions (and their answers) will be submitted to the professor in a MS Word document with a header of the student’s name and the page number. These questions will be used as part of the Midterm Group Exam described below. This is an individual assignment.

The questions require the student to think of the 10 things he/she found interesting/most important in the class from readings and discussion. In order to succeed, the student must draw out what is important and balance them from the various learning methods including readings and discussion. This allows the professor to see what is resonating with students and is it matching the learning objectives. True/False or multiple-choice questions are NOT acceptable.

Some sample questions and how I evaluate them:

1. Q. What is the foundation of the entire financial system?
A. Confidence.

My evaluation: This is fine/great. We discussed this in class. It is an important concept. One word answer that is obvious. B+/A-

Another way:

Q. What is the foundation of the entire financial system that GS also tried to address when it took money from Buffet and also when Paulson tried to address the crisis with his Bazooka?
A. Confidence

This is very good/excellent. Brought in some other concepts/ideas raised in class and readings. A-/A

2. Q. What kind of trading was the prime target of the Volker Rule?
A. Proprietary trading.

My evaluation: This is fine/great. We discuss this in class. It is an important concept. One word answer that is obvious, B+/A-

Another way:

Q. it was believed that a functioning commercial banking system is essential to the stability of the financial system and it was unsafe for banks to engage in high-risk speculation which created unacceptable levels of systemic risk. Therefore This Rule, which is a part of Dodd Frank, specifically prohibits a bank or institution that owns a bank from engaging in proprietary trading (except treasuries and municipal bonds), and from owning or investing in a hedge fund or private equity fund above 3% of Tier One Capital. This rule which has been compared and contrasted to Glass Steagall is also a difficult Rule to interpret because what is proprietary or not is subject to some level of subjectivity and some have argued is a reason why some top proprietary traders from large banks left?
A. Volker Rule

My evaluation: This is excellent. It shows an excellent understanding of the Volker Rule, why it was created and consequences. Grade: A

Midterm Group Exam: Students will be broken into small groups. Each group will elect a captain to take their collective 10 questions each and synthesize the group question bank into a group list of the top 10 questions. The list should include the best questions the group has posed in the aggregate and remove any duplicates. The group list should have a header with every team members’ name and the group name/number on the top of every page. The group questions should list the name of the person contributing the question, as well as the question and the answer. For the Midterm Group Exam, the groups will ask each other the questions in a game show style, where teams will earn points for the correct answers. The team is graded based on the quality of their group questions selected and if the questions covered the essential concepts and their correct answers discussed in class in the live, oral, and open-book exam as a group. Make sure each question for the group really highlights a key important concept and shows an understanding of the concept / idea beyond something basic and has an easily identifiable one word answer.

The purpose of the class is to learn. Learning collectively and in a fun, engaging, competitive, and collaborative way ensures that all students are exposed to key questions and answers within the content area that match the course’s learning objectives. The purpose of this assignment is to ensure everyone is learning the most important material before moving on to the second half of the class.

Final Questions and Exam (25%): Similar to the Midterm Questions assignment, students will be required to generate a total of 15 questions and answers about the entire course content, based on their readings and notes. Five (5) will be from the first half of the class. You can use five from your previous ten or use new ones based on the midterm. These questions are questions the student feels could/would be appropriate for a final exam. The questions will be submitted to the professor in a MS Word document with a header of the student’s name and the page number. This is an individual assignment. Students have the option of participating in the Final Exam on the last day of class, or submitting the Final Paper/Presentation. The format of the Final Exam is similar to the Midterm Group Exam in that groups will ask each other the questions in a game show style, and teams will earn points for the correct answers. The team is graded based on their performance in the live exam as a group.
If a student will miss the final or prefers to write a paper versus participate in the Q&A and exam, then the student can re-write or write a new strategic issue paper OR write a review of a chapter in *What Happened to Goldman Sachs*.

**Participation (25%)**: Students will be required to attend class, contribute to class discussion, participate in the group activities and share relevant resources with each other pertaining to sports management. Contributing to class discussions means enhancing the quality of the class experience for yourself and others. It involves making relevant, useful comments, or posing pertinent questions, in clear and succinct language. To make sure we have interesting class discussion, often students will be required to answer questions and send them to the professor in advance of class. Some sample questions are at the end of the document. The responses can be bullet points and are graded as one of three grades: good, ok or not good/did not turn in.

You can miss one class and it will not impact your grade – as long as you email the professor in advance. If you miss a second class, and you do not get approval in advance (which in not normally unreasonably withheld), then it will impact your grade.

In order to avoid ambiguity that may lead to unintentional violations of the Honor Code, the description types for assignments have been standardized. They are specified in the table below.

<table>
<thead>
<tr>
<th>Type</th>
<th>Designation</th>
<th>Discussion of concepts</th>
<th>Preparation of submission</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Group/group</td>
<td>Permitted with designated group*</td>
<td>By the group</td>
<td>Same grade for each member of the group</td>
</tr>
<tr>
<td>B</td>
<td>Group/individual</td>
<td>Permitted</td>
<td>Individual (No sharing of any portion of the submission)</td>
<td>Individual</td>
</tr>
<tr>
<td>C</td>
<td>Individual/individual</td>
<td>None of any kind</td>
<td>Individual</td>
<td>Individual</td>
</tr>
<tr>
<td>D</td>
<td>(An optional category to be defined in detail by the individual faculty member)</td>
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*The designated group can either be an assigned study group or a self-selected one.

**METHOD OF EVALUATION**

The focus is on learning and learning practical information and tools to help a student’s career.

**There is no curve.**

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Participation</td>
<td></td>
</tr>
<tr>
<td>Questions/Mid-Term</td>
<td>25%</td>
</tr>
<tr>
<td>Memo</td>
<td>25%</td>
</tr>
<tr>
<td>Questions/Final Exam</td>
<td>25%</td>
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CLASSROOM NORMS AND EXPECTATIONS

Class attendance is a part of participation. If you can’t make class or will be late or need to leave early, just email me. I typically give a student one free pass on a class and one free pass on being late or leaving early. I am particularly sensitive to promptness and attendance when we have guest speakers.

You can eat and drink in class, as long as it is discrete and does not disrupt the class or your neighbors. *So please be polite, thoughtful, and respectful.* Ask the people around you if you are disturbing them or not.

Laptops and checking devices for messages are permitted as long as it is discrete and does not disrupt the class or your neighbors. *So please be polite, thoughtful, and respectful.* If I have to speak to you about abusing this privilege, then it will hurt your participation grade.

Please respect the contributions and time of others in the class.

Please bring your name card and place it front of you.
JP Morgan 4Q Presentation

First, map out what are the business units (what do they do) and what are the revenues of each. What is the biggest business? You may need to refer to this https://www.jpmorganchase.com/content/dam/jpmorganchase/en/investor/includes/document/4Q2015_Earnings_Presentation.pdf

Which group has highest ROE? Highest overhead ratio?

JP Morgan Investor Day Presentation


Page 8 – what are the businesses?

On page 1 JPM highlights 4 key ratios. What are they? What do they mean? Why are they important?

On page 3. JPM gives EPS YoY growth. What was YOY revenue growth? What caused earnings growth? Which bank has the highest ROE (Surprise!)?

Page 5 – what is being highlighted and why?

Page 15 – NCOs – what is it? Why important?

Page 19 – What is CCAR stress? GSIB surcharge? How does JPM get to the minimum level?

Page 20 IS JPM capital going up or down over time?

Page 21 – What is ROE? Which area has the highest ROE?

Page 24 – Why talk about rising rates?

Page 27 – How is income growing? What is driving it?

Page 33 – How does JPM finance itself? What is largest funding source?
Questions on Corporate Culture/ What Happened to Goldman Sachs?

What was the academic question posed in the book? Chapter 1

What was the hypothesis? Chapter 1

What was the conclusion? Chapter 1

What would GS’ response be? Chapter 1

What evidence was there that there was a higher than legal line? pg 50

What were the characteristics of the people GS hired? pg 51

What is the problem of nostalgia?

What were the advantages of partnership structure pg 70, 71

What was the power of the partnership prize? pg 75

What is a social network of trust? 81

What is productive dissonance 83

What is financial interdependence? 89

What is drift? - pg 93-116

What are the signs - skim chapter 5 and pick 2 or 3 that interest you

What were the consequences of going public - skim chapter 6 and pick 2 or 3
173-180, which example do you like and why?

From 267-269, which 2 or 3 changes do you think were most interesting

Give one piece of data / evidence the culture changed? Eg Management Committee numbers at IPO and now?
Compensation and Promotion

1. Would you promote him? Yes or No and why?
2. If you are not going to promote him, what would/could you do?
3. If he was your friend, what would be your career advice after the various possibilities?
4. Do you / did you have a boss like his boss?
5. Was he doomed to fail?

What are the salaries and bonuses of the CEO, CFO, #2/President and a 4th person?
Are they similar?
Do they indicate anything about culture / priorities?
What makes up compensation? What went into the decision?
How much is cash versus stick versus other? What is the vesting of the stock?

What is the average comp per person at your assigned firm?

http://www.ibankinginsider.com/on-the-job/investment-banking-salary-total-pay/
http://www.forbes.com/sites/kenrapoza/2013/03/13/how-much-do-wall-streeters-really-earn/#d5d59117f08a
http://www.mergersandinquisitions.com/boutiques-vs-bulge-brackets/
http://www.ft.com/cms/s/0/d99d271c-5545-11e5-8642-453585f2cfcd.html#axzz4Dm0088GA
Sarbanes Oxley

JUL 29, 2012 @ 01:56 PM 3

Sarbanes-Oxley 10 Years Later: Boards Are Still the Problem

What is Sarbanes Oxley?
Why was it implemented?
What are the specific changes?
What is the author suggesting as changes? Do you agree?

Repeal of Glass Steagall

November 11, 2015 3:52 pm

We were wrong about universal banking

John Reed

http://www.ft.com/cms/s/0/255fafee-8872-11e5-90de-f44762bf9896.html#axzz3rHpSOGws

A Big Banker’s Belated Change of Heart

By JEFF MADRICK
JULY 29, 2012

http://www.nytimes.com/2012/07/30/opinion/a-big-bankers-belated-apology.html?_r=0

What is G-S?

What 2 things were wrong according to Reed?

Do you think G-S should be repealed? Why?

Dodd-Frank

The Dodd-Frank act

Too big not to fail

Flaws in the confused, bloated law passed in the aftermath of America’s financial crisis become ever more apparent

Feb 18th 2012 | NEW YORK
House Votes to Repeal Dodd-Frank Provision

By ERIC LIPTON date published OCTOBER 30, 2013 7:03 PM http://dealbook.nytimes.com/2013/10/30/house-passes-bill-on-derivatives/

How many pages was the Banking Act? Dodd-Frank?

What are the problems with it?

What are the costs?

How involved was Citigroup in drafting a House bill to repeal a D-F provision?

VOLKER RULE

Q & A: The Volcker Rule

By SCOTT PATTERSON

June 13, 2012 2:40 p.m. ET

http://www.wsj.com/articles/SB100014240527023038222204577464661833507038

Volcker Rule Costs Tallied as U.S. Regulators Press Deadline

Jesse Hamilton and Cheyenne Hopkins

September 30, 2013 —


Volcker Rule Will Cost Banks Up to $4.3 Billion, OCC Says

Jesse Hamilton

March 21, 2014


What is the Volker Rule?

Why is it controversial?

What is the cost?

BASEL

Basel III Q&A
What are BASEL 1, 2 and 3 norms? What are the basic differences between these norms?

https://www.quora.com/What-are-BASEL-1-2-and-3-norms-What-are-the-basic-differences-between-these-norms

Basel III and European banking - McKinsey & Company

https://www.mckinsey.com/.../26_Basel_III_and...

McKinsey & Company

Nov 1, 2010 - Basel III will have significant impact on the European banking sector. .... paper, we review the challenges of implementation, especially the ...

What is Basel? What is its role?

What are problems with t?

What did 3 try to overcome?

What is the impact?

What are banks’ response?

SURCHARGE

Twenty-Eight Banks Qualify for Basel’s Too-Big-to-Fail Surcharge

Jim Brunsden

July 19, 2011 — 11:29 AM EDT

Updated on July 19, 2011 — 7:00 PM


How Do The Largest U.S. Banks Fare In Terms Of Basel III Compliance?


What’s the surcharge? On what and why?

What are CoCos? Are they allowed to be included?

TOO BIG TO FAIL
Andrew G Haldane 17 January 2013

http://www.voxeu.org/article/have-we-solved-too-big-fail

Fed Approves 'Too Big To Fail' Surcharges
By Dunstan Prial Published July 20, 201


Brainard: Fed Should Consider Including Capital Surcharge in Stress Tests
Officials are weighing stricter capital standard for biggest U.S. banks
By VICTORIA MCGRANE And RYAN TRACY

Have we solved too big to fail?
What does Haldine think? What’s the problem?
Will surcharges be in stress tests? Should they be?

STRESS TESTS
Stress tests: Banks need $75 billion

Results of long-awaited bank stress tests reveal that 10 out of 19 banks tested need to raise new capital. Bank of America must raise $33.9 billion.

By David Ellis, CNNMoney.com staff writer
Last Updated: May 8, 2009:


U.S. Banks Pass Stress Tests, Some With an Asterisk
By PETER EAVIS MARCH 11, 2015


What are stress tests?
Why have stress tests?
How did the stress tests go in 2009?
How about 2015?
CULTURE

SPEECH

Ending Too Big to Fail

11/07/2013

November 7, 2013

William C. Dudley, President and Chief Executive Officer

http://www.newyorkfed.org/newsevents/speeches/2013/dud131107.html

What It Will Take to Change the Culture of Wall Street

Steven G. Mandis

OCTOBER 24, 2014

https://hbr.org/2014/10/what-it-will-take-to-change-the-culture-of-wall-street

Culture, Not Leverage, Made Wall Street Riskier

Steven G. Mandis

OCTOBER 11, 2013

https://hbr.org/2013/10/culture-not-leverage-made-wall-street-riskier

How important is Culture?
Risk Management

There is a HBS Value at Risk case study in the Case Book. Read pages 201-204 of the GS Book.

and these articles:
GS VaR Reaches Record
MS FICC traders

The questions are:
What is VaR?
What is the typical reporting of VaR?
What is the problem with just relying on it?
How big of decline in VaR?