CAPITAL MARKETS REGULATION

Harvard Kennedy School / Harvard Law School
Course Syllabus, Spring Semester 2016
Wednesdays, 5-7pm
Law School Campus, 1563 Massachusetts Avenue

Instructors

Professor Robert Glauber  
Office: Belfer 506, Harvard Kennedy School
Phone: (617) 495-4691
E-mail: robert_glauber@harvard.edu

Professor Hal Scott  
Office: Lewis 339, Harvard Law School
Phone: (617) 495-4590
E-mail: hscott@law.harvard.edu

Faculty Assistants

For Professor Robert Glauber:  
Assistant: Minoo Ghoreishi
Phone: (617) 384-7329
E-mail: minoo_ghoreishi@harvard.edu

For Professor Hal Scott:  
Assistant: Josi Chapman
Phone: (617) 495-3579
E-mail: jchapman@law.harvard.edu

Office Hours

Professor Robert Glauber  
Wednesdays, 2:00pm-4:00pm,  
Or preferably by appointment

For Professor Hal Scott:  
By Appointment

Course Assistant

James Howat (HKS, MPP2)

Class Schedule

<table>
<thead>
<tr>
<th>Class #</th>
<th>Date</th>
<th>Topic</th>
<th>Lead / Guest</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Wed Feb 3rd</td>
<td>Objectives of Financial Regulation</td>
<td>Glauber, Scott</td>
<td>5:00-7:00</td>
</tr>
<tr>
<td>2</td>
<td>Fri Feb 5th</td>
<td>Systemic Risk: Correlation, Connectedness and Contagion</td>
<td>Scott</td>
<td>3:15-5:15</td>
</tr>
<tr>
<td>3</td>
<td>Wed Feb 10th</td>
<td>Capital and Liquidity</td>
<td>Kuritzkes</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Wed Feb 17th</td>
<td>Resolution</td>
<td>Krimminger</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Wed Feb 24th</td>
<td>Lender of Last Resort</td>
<td>Kohn</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Wed Mar 2nd</td>
<td>Volcker Rule and Too Big to Fail</td>
<td>Glauber</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Wed Mar 9th</td>
<td>Derivatives and Clearing</td>
<td>Massad</td>
<td>5:00-7:00</td>
</tr>
<tr>
<td>8</td>
<td>Wed Mar 23rd</td>
<td>GSE Reform</td>
<td>Golding</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Wed Mar 30th</td>
<td>Money Market Funds &amp; Shadow Banking</td>
<td>Scharfstein</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Wed Apr 6th</td>
<td>Market Structure: Dark Pools, High Frequency Trading and Decimalization</td>
<td>Chan</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Wed Apr 13th</td>
<td>Cost Benefit Analysis</td>
<td>Scott</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Wed Apr 20th</td>
<td>Regulatory Structure</td>
<td>Glauber</td>
<td></td>
</tr>
</tbody>
</table>
**Mission Statement**

I. Analyze current U.S. government policy on issues relating to:
   a. Financial Institutions;
   b. Regulation; and
   c. Capital Markets

II. Debate the formulation, implementation, and impact of regulatory policy on the capital markets and the financial system, emphasizing current issues.

III. Enrich classroom discussion with guest speakers.

**Course Overview**

This course examines important current issues in the regulation of the U.S. capital markets, with emphasis on the recent financial crisis, reform efforts thus far, and potential future actions. The class will be primarily one of discussion rather than lecture. As noted in the syllabus, we will have regular guest speakers. This course does not have any prerequisites and there is not an expectation that students will have prior professional or academic work in this field. A useful resource for students with no exposure to any of these topics is the website of MIT Sloan Professor Simon Johnson (http://baselinescenario.com/financial-crisis-for-beginners/).

**Grading**

There will be a take-home open book final exam that will count for 75% of your grade; the balance of the remaining 25% will be based on participation in class discussions.

**Participation**

After the end of the add-drop period, panels of approximately 8-10 students will be designated for each class. Members of that panel will be expected to lead discussion in their assigned class and, as a group, to have full command of all readings for the class, including optional readings. For other class meetings, each panel should also coordinate among themselves to make sure that at least one member in each group has read each of the optional readings, in addition to the required readings. To the extent feasible, panel members should arrange to meet together before every class session to have a preliminary discussion of class readings. All students should feel free to participate in each class discussion.

**Reading Material**

Readings will be available on the course website in digital format only. It will not be available in hard copy.

**On the syllabus, all required readings are marked with an asterisk (*). All other readings are optional.**

Harvard students can log on to the course website with their Harvard University ID and PIN at: canvas.harvard.edu. Students that are not yet enrolled will have to email Josi Chapman directly at jchapman@law.harvard.edu to gain access to the reading materials.

Non-Harvard students should contact Josi Chapman: jchapman@law.harvard.edu to find out how to gain access to the course website (access protocol varies according to originating school).
Class 1 - Objectives of Financial Market Regulation  
Wednesday, February 3

Economic literature suggests a number of possible rationales for financial regulation, including: externalities (such as systemic risk), information asymmetries, consumer protection (e.g. deposit insurance), principal-agent problems, maintenance of competition, and limitation of moral hazard due to government supports. But financial regulation needs to be both justified by such rationales and also effective. Some dimensions of effectiveness might include efficiency and economy; a role for management in assuring regulatory compliance; proportionality to require that restrictions on firms and market behavior be in proportion to expected benefits to consumers and industry; international harmonization of regulation; and the avoidance of unnecessary distortions or impediments to competition.

The Dodd-Frank Act of 2010 is the most recent and in many dimensions an extraordinarily sweeping regulatory intervention into the financial markets. The course will focus in many sessions on various dimensions of this Act’s interventions and seek to evaluate the effectiveness of this legislation. The first class will provide an introduction in the concepts underlying financial regulation and an introduction to the Dodd-Frank Act and an overview of recent. It will also discuss the implications of financial regulation for the competitiveness of U.S. capital markets.

Introduction to Capital Markets Regulation in the U.S.


Principles of Regulation


Overview of the Dodd-Frank Act


*Frank, B., “Assessing the Impact of the Dodd-Frank Act Four Years Later”, Testimony before the House Committee on Financial Services, July 2013 (pp.3-8).


*Wallison, P, “The Dodd-Frank Act Five Years Later: Are we more prosperous?,” American Enterprise Institute, Congressional Testimony before the House Committee on Financial Services, July 2015 (pp.2-13).

Davis Polk, “Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act,” July 21, 2010, (pp.1-130). [This summary will be a useful reference, particularly for the first half of the course.]

**Competitiveness of U.S. Capital Markets**


*Committee on Capital Markets Regulation, “U.S. capital market competitiveness showed historic and alarming signs of weakness in the third quarter of 2015,” Press Release, November 12, 2015 (pp.1).


*Staff, “Reinventing the Company,” The Economist, October 2015 (pp.1-3).


Clinton, H., “Wall Street Should Work For Main Street,” Briefing Paper, October, 2015 (pp.6-9) (The section titled “Hold both individuals and corporations accountable when they break the law”).
One of the central features of the recent financial crisis was the fear of systemic risk. Following the failure of Lehman Brothers, many believed that the subsequent failure of any large, interconnected financial institution would have devastating impacts on the financial system. An alternative view is that the primary danger comes from contagion runs rather than the interconnectedness of firms causing cascading bankruptcies. The Dodd-Frank Act sought to reduce systemic risk through, among other actions, the identification of systemically important institutions and the creation of the Financial Stability Oversight Council (FSOC). This class will focus on an overview of systemic risk as a concept, how it manifested itself in the 2008 financial crisis, and current regulation of systemic risk in the U.S.

**Overview of Systemic Risk**


Committee on Capital Markets Regulation, Memorandum to Chairman Dodd and Ranking Member Shelby: Systemically Important Institutions, May 4, 2010 (pp. 1-3).

**Correlation, Connectedness, and Contagion**

*Scott, H., “The Concept of Connectedness,” Chapter 1, Connectedness and Contagion, 2015 (pp.3-4).

*Scott, H., “The Concept and History of Contagion,” Chapter 2, Connectedness and Contagion, 2015 (pp. 5-6, 9-13).


**Current Regulation of Systemic Risk**


*Committee on Capital Markets Regulation, Comment Letter to FSOC on Systemically Important Institutions, November 5, 2010 (pp. 1-5).


*Financial Stability Board, “2015 update of lists of global systemically important banks” (G-SIBs),” November 3, 2015 (pp. 1-3).


Heltman, J., “Macroprudential’: A Real World Cure or Just a Buzzword?,” *American Banker*, January 22, 2015 (pp.1-3).
Capital requirements have become an integral feature of the safety and soundness regulatory regime for financial institutions. While capital requirements are designed to decrease the probability of failure for institutions, the financial crisis led many to conclude that existing requirements were insufficient. The international Basel III reforms that are currently being implemented have not only significantly increased minimum capital requirements, but have also placed greater emphasis on the types of capital that qualify for regulatory purposes, imposed new liquidity requirements and layered on additional requirements for systemically important institutions. Evaluating these changes, some have argued that the new capital requirements are overly burdensome and complex; others maintain that the increased capital levels will come at a significant cost, increasing borrowing costs, and also potentially harming future GDP growth. This class will examine the role of capital requirements in financial regulation, the Basel III reforms, and the costs and benefits of higher capital levels and new liquidity requirements.

**Guest Speaker**

Mr. Andrew Kuritzkes, Executive Vice President and Chief Risk Officer, State Street Corporation

Mr. Kuritzkes is responsible for leading State Street Corporation’s risk management function globally. He is also a member of State Street’s Management Committee, the company’s most senior strategy and policy-making team. Prior to joining State Street in 2010, Mr. Kuritzkes was a partner of Oliver Wyman and led the firm’s public policy practice in North America. He was a managing director in the firm’s London office from 1993 to 1997, and served as vice chairman of Oliver, Wyman & Company globally from 2000 until the firm’s acquisition by MMC in 2003. From 1986 to 1988, he worked as an economist and lawyer for the Federal Reserve Bank of New York. Mr. Kuritzkes serves as a member of the Financial Research Advisory Committee of the US Treasury’s Office of Financial Research. He is also a member of the Financial Advisory Roundtable of the Federal Reserve Bank of New York, and is a member of the US Committee on Capital Markets Regulation.

Mr. Kuritzkes holds a Juris Doctor degree from Harvard Law School, a Master of Philosophy degree in economics from Cambridge University and a Bachelor of Arts degree from Yale College.

**Capital and Liquidity Requirements in General**


**Basel III**


*Scott, H., “Liquidity Requirements,” Chapter 15, Connectedness and Contagion, 2015 (pp.3-9).


While the Federal Deposit Insurance Corporation (FDIC) has traditionally been in charge of “resolving” failing depository banks, other financial institutions have been subject to the normal bankruptcy process. During the financial crisis many argued that these existing procedures were inadequate for resolving large, interconnected bank holding companies and non-bank financial institutions, and thus led to the requirement of injecting public funds, most prominently through TARP. This class will examine the operation by the FDIC, pursuant to Dodd-Frank, of new resolution procedures for systemically important institutions (most recently the “single-point of entry” procedure) and whether these procedures have solved the “too big to fail” problem.

Guest Speaker

Mr. Michael H. Krimminger, Partner, Cleary Gottlieb

Mr. Krimminger's practice focuses on domestic and international banking and financial institutions. In particular, he advises on the challenges and opportunities stemming from statutory and regulatory reforms, as well as a variety of restructuring and insolvency-related matters. Mr. Krimminger joined Cleary Gottlieb in 2012 after serving for more than two decades in numerous leadership positions with the Federal Deposit Insurance Corporation (FDIC), including most recently as its General Counsel. Mr. Krimminger's international experience includes serving as the co-chair of the Basel Committee’s Cross Border Resolutions Group and representing the FDIC on the Financial Stability Board’s Resolution Steering Group and other bodies. He earned his undergraduate degree from the University of North Carolina and his J.D. from Duke University.
*Simmons, R., “Single Point of Entry Strategy,” Banking Perspective, Quarter 1 2014, Clearing House (pp.36-43).


*Scott, H., “Bank Resolution Procedures, Contingent Capital (CoCos), and Bail-Ins,” Chapter 16, *Connectedness and Contagion*, 2015 (pp.1-5, 9-19).

*Scott, H., “Dodd-Frank Orderly Liquidation for Non-Bank SIFIs (including Bank Holding Companies),” Chapter 17, *Connectedness and Contagion*, 2015 (pp.6-17).


*Pellerin S. & Walter, J., “Orderly Liquidation Authority as an Alternative to Bankruptcy,” Economic Quarterly, Volume 98, Number 1, 2012 (pp. 1-5, 1019).

*Baxter, T., “Resolving the Unresolvable: The Alternative Pathways to Ending Too Big to Fail,” Remarks at the International Insolvency Institute 13th Annual Conference, Columbia University Law School, New York City, June 17, 2013 (pp. 1-6).


*House Financial Services Committee, “The Dodd-Frank Act and the Persistence of “Too Big To Fail,” 2014 (pp.1-9).


Class 5 – Lender of Last Resort

Wednesday, February 24

The Federal Reserve has traditionally been the lender of last resort for the financial system, primarily through the discount window. During the financial crisis, the Fed created new lending programs, for both banks and non-banks, and greatly expanded its balance sheet to inject additional liquidity into the financial market. Dodd-Frank significantly expanded the Fed’s reach as a regulator (to all Significantly Important Financial Institutions) but at the same time significantly pared back its powers to act as lender of last resort. This class will discuss the Fed’s role as lender of last resort.

Guest Speaker

Mr. Donald L. Kohn, Former Vice Chairman of the Board of Governors, Federal Reserve System.

Donald Kohn is a 40-year veteran of the Federal Reserve System and served as vice chairman of the Board of Governors of the Federal Reserve from 2006 to 2010. He was named to serve on the advisory committee to the U.S. Treasury’s new Office of Financial Research. He was also appointed by the government of the United Kingdom and the Bank of England to serve on its interim Financial Policy Committee. Kohn focuses on issues of monetary policy, financial regulation and macroeconomics.

U.S. Government: Liquidity Supplier and Lender of Last Resort


*Scott, H., “Dodd-Frank Restrictions on the Lender of Last Resort,” Chapter 9, Connectedness and Contagion, 2015 (pp.2-20).


**Central Bank Independence**


*Kohn, D., “Federal Reserve Independence in the Aftermath of the Crisis: Should We Be Worried?,” Hutchings Center on Fiscal & Monetary Policy, January 16, 2014 (pp.1-8).


Class 6 — Volcker Rule and Too Big To Fail

*Wednesday, March 2*

Former Federal Reserve Chairman Paul Volcker has argued over the course of the past several years that commercial banks, with access to the “safety net” of deposit insurance and the Fed discount window, should be restricted from engaging in proprietary and speculative activities. This proposal, which was dubbed the “Volcker Rule”, was included in Dodd-Frank and has been implemented by a new joint-agency rule-making. However, many observers claim that distinguishing propriety trading from permissible market making, underwriting, and hedging will be complex and onerous. The U.K. has also proposed structural reforms, but instead would require retail deposit-taking institutions to be in a separate subsidiary, or ring-fenced, from investment banks with higher standalone capital requirements. This class will examine these efforts to restrict activities and their impact on the financial system. The class will also evaluate whether large, systemically important financial institutions were “too big to fail” (TBTF) during the recent financial crisis, whether they still are, and analyze the implications of TBTF for future regulatory policies.

**Volcker Rule**


*Volcker, P., “Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies,” Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., February 2, 2010 (pp. 1-5).*

*Scott, H., “Implications of the Volcker Rules for Financial Stability,” Testimony before the Committee on Financial Services, U.S. House of Representatives, June 16, 2011 (pp. 3-7).*

*“Universal Banking — Together, Forever?,” The Economist, August 18, 2012 (pp. 1-2).*


*Schacht, K., “Volcker vs. Vickers – Which Plan Is Best for Banks?,” CFA Institute, May 1, 2013 (pp. 1-3).*

*Oliver Wyman, “The Volcker Rule Restrictions on Proprietary Trading – Implications for Market Liquidity,” February, 2012 (pp. 2-6).


**Too Big To Fail (TBTF)**

*Bair, S. C., “We Must Resolve to End Too Big To Fail,” FDIC Quarterly, 2011, Volume 5, No. 2 (pp. 25-29).

*Barth, J. & Prabha, A., “Too-Big-to-Fail: A Little Perspective on a Large Problem,” from the Fifteenth Annual International Banking Conference, Federal Reserve Bank of Chicago, Chicago, IL, November 15-16, 2012 (pp. 5-17).


*Mayo, M., “JP Morgan Chase — Break It Up?,” CLSA Asia Pacific Markets and Credit Agricole Securities USA, September 4, 2012 (pp. 1-6).

*Haldane, A., “The $100 Billion Question,” Comments delivered at the Institute of Regulation & Risk, Hong Kong, March 30, 2010 (pp. 4-6).

*Brainard, L., “Dodd-Frank at Five: Assessing Progress on Too Big to Fail,” Speech, July 9, 2015 (pp.2-8,11-13).

*Bipartisan Policy Center, “The Big Bank Theory: Breaking Down the Breakup Arguments,” October 2014 (pp.5-7, 19-26).

*Evans, L., “Large Bank Holding Companies: Expectations of Government Support,” Testimony Before the Subcommittee on Financial Institutions and Consumer Protection, Committee on Banking, Housing and Urban Affairs, July 31, 2014 (pp.5-10).

Derivatives are financial instruments whose value is derived from some other underlying security or commodity. While some derivatives (futures and options) trade on exchanges, most trade in the largely unregulated over-the-counter (OTC) market. Since the passage of the Commodities Futures Modernization Act (CMFA) in 2000, this market has grown from a total notional value of $88 trillion in 1999 to nearly $700 trillion in 2014. Reforming the derivatives market became a significant area of focus after the financial crisis, both because of the role derivatives (credit default swaps specifically) played in the failure of AIG, and the perception that derivatives exposures at many large financial institutions increased their interconnectedness and systemic risk. This class will examine the role of derivatives in the financial system; what, if any, regulatory oversight they should be subject to; and the regulatory reforms that are underway in the U.S. and Europe.

**Guest Speaker**

Mr. Timothy G. Massad, Chairman, Commodity Futures Trading Commission

Mr. Massad was sworn-in as Chairman of the CFTC on June 5, 2014. Previously, Mr. Massad was the Assistant Secretary for Financial Stability at the U.S. Department of the Treasury. In that capacity, Mr. Massad oversaw the Troubled Asset Relief Program (TARP). Prior to joining Treasury, Mr. Massad served as a legal advisor to the Congressional Oversight Panel for TARP, under the leadership of (now Sen.) Elizabeth Warren. Prior to his government service, Mr.  

---

Class 7 – Derivatives and Clearing

*Wednesday, March 9*


Financial Crisis Inquiry Commission, “Governmental Rescues of ‘Too Big to Fail’ Financial Institutions,” Preliminary Staff Report, August 31, 2010 (pp. 3-4).


*Lex, “US Banks: Apocalypse Maybe,” Financial Times, December 4, 2015 (pp.1).*

Massad was a partner in the law firm of Cravath, Swaine & Moore, LLP. Mr. Massad had a broad corporate practice with a focus on corporate finance and financial markets. He helped to draft the original standardized agreements for swaps and helped many businesses negotiate and execute transactions to hedge exposures in the derivatives markets. Mr. Massad earned his bachelor’s and law degrees at Harvard.

**OTC Derivatives Market Overview**


*U.S. Commodity Futures Trading Commission, Selected Financial Data for Futures Commission Merchants (FCMs) and Retail Foreign Exchange Dealers (RFEDs), October 31, 2014 (p.1).

**Derivatives Regulation**


*Heltman, J., “Regulators Cut Big Banks a Break in Final Swaps Rule,” American Banker, October 22, 2015 (pp.1-3).

Ernst & Young, “Dodd-Frank’s Title VII: OTC Derivatives Reform,” 2013 (pp. 1-6).


**Clearing Houses**

16
Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that were created by Congress to increase liquidity in primary and secondary mortgage markets as well as to supply capital for residential housing loans. Over time, the marketplace inferred an implicit government guarantee on GSE securities, providing these agencies with a lower cost of capital relative to other financial institutions. Because of this funding advantage, the GSEs grew dramatically in size to become some of the largest financial institutions in the world.

The market expectation of a government guarantee proved mostly correct when the institutions were placed into conservatorship in early September 2008; their debt was in effect guaranteed by the government, although both the preferred and common equity were not. The issue is now what to do with these two giant mortgage institutions under direct government control,
including how to use them to help ameliorate the foreclosure crisis, how to recoup taxpayer assistance, and since the Dodd-Frank Act did not touch on these institutions, how to reform them as part of a greater goal of redesigning the U.S. system of housing finance.

The issue of reform of the GSEs is the most polarizing and unresolved problem from the financial crisis and will be a fiercely fought political battle in the coming years. We will discuss Fannie and Freddie before the crisis, how the financial crisis affected them and the decision to place them into conservatorship, what has occurred while they are under conservatorship and their current regulation, and finally, some of the proposals for GSE reform and the future of housing finance in the U.S.

**Guest Speakers**

Mr. E. L. Golding, Principal Deputy Assistant Secretary, Office of Housing, HUD and former Senior Vice President, Freddie Mac, and

**Bio:**

Edward L. Golding joined Freddie Mac in 1989 and held a number of senior research and policy positions, including Senior Vice President of Economics and Policy, and Program Executive of Making Home Affordable. At Freddie Mac, Mr. Golding has been responsible for overseeing regulatory capital compliance, analysis of the mortgage market, capital management and economic and policy analysis of issues affecting Freddie Mac. He also helped implement the risk-based capital rules under which Freddie Mac operates. Mr. Golding has significant experience in government and academia, including experience as a special assistant to the Board member at the Federal Home Loan Bank Board, an economist with the Federal Trade Commission and as an assistant professor at the University of Florida and the Wharton School of the University of Pennsylvania.

**Fannie and Freddie Pre-Crisis**


**Financial Crisis, Insolvency and Conservatorship**


Future of GSEs and GSE Regulation

*Millstein, J., “A Blueprint for Housing Finance Reform in America,” Remarks at the Woodrow Wilson International Center for Scholars, Program on America and the Global Economy: Are We Becoming a Nation of Renters?, May 22, 2012 (pp. 1-14).


*Bipartisan Policy Center, “Housing America’s Future: New Directions for National Policy,” Economic Policy Program (Housing Commission), February, 2013 (pp. 5-13).


*Levitin, A., “Housing Finance Reform: Should There Be a Government Guarantee?,” Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 13, 2011 (pp. 1-9).


Class 9 – Money Market Funds and Shadow Banking

Wednesday, March 30

The Shadow Banking System, which includes non-bank financial institutions that provide many of the services of banks but are not directly regulated as banks, is viewed by many as contributing importantly to the 2007-08 financial crisis. Prominent Shadow Banking institutions include investment banks, special investment vehicles (generally affiliates subsidiaries of banks) insurance companies, hedge funds and money market funds. Dodd-Frank empowers the Financial Stability Oversight Council (FSOC) to extend bank regulatory oversight to selected Shadow Bank institutions that are “systemically important” to financial market stability (SIFIs). Three insurance companies have been designated as SIFIs and FSOC has considered designation of certain asset management companies as SIFIs. The SEC has recently adopted new rules to address risks of investor runs in money market funds. The class will focus on the threats to financial stability posed by the Shadow Banking System and regulatory policies to deal with these threats.

Guest Speaker

Mr. David S. Scharfstein, Edmund Cogswell Converse Professor of Finance and Banking, Harvard Business School.

David S. Scharfstein is the Edmund Cogswell Converse Professor of Finance and Banking at Harvard Business School. His research focuses on banking, financial distress, risk management, housing finance, venture capital and corporate investment. He teaches the introductory finance course in the MBA program and the Ph.D. corporate finance course. Previously, he has taught courses on private equity and venture capital.

Regulation of Money Market Funds


Burne, K., “BlackRock to Shift Funds to Comply With New Rules,” The Wall Street Journal, April 7, 2015 (pp.1-3)


*Scharfstein, D., “Perspectives on Money Market Mutual Fund Reforms,” Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., June 21, 2012 (pp. 1-12).

**Shadow Banking System**


Class 10 – Market Structure: Dark Pools, High Frequency Trading, Decimalization
Wednesday, April 6

In 2005 the SEC put in place Regulation NMS (National Market System) with the major focus on enhancing competition among market makers and exchanges through lowering barriers to entry. The regulation succeeded in spawning a host of new institutions (electronic exchanges, trading platforms, dark pools) and trading practices, such as computerized high speed trading. The consequence of these changes has been increased competition, with the attendant benefits of reduced transaction costs, but this has been accompanied by dramatic fragmentation of market trading among competing execution venues. Further, the lowered transaction costs have encouraged the development of computerized trading systems, including “high frequency trading systems,” that have greatly expanded transaction volume. Some believe that the consequences of these changes have been reduced transparency of transactions and periods of dramatic price instability (the “Flash Crash” of May 2010). This class will focus on the evolution of market trading structure and practices, the implications for market stability, and the need for reforms of the rules that shape trading market structure.

Guest Speaker

Derrick Chan, SVP, Fidelity Centralized Electronic Trading

Derrick joined Fidelity in 2003 and has served in a variety of roles within Fidelity Capital Markets (FCM) Equities Division, including institutional agency trading, market making, market structure, and electronic trading where he led the product development and financial engineering efforts for Fidelity’s CrossStream ATS (Dark pool), smart order routing, algorithmic trading suite, co-location infrastructure and transaction cost analytics. He currently leads the Fidelity Centralized Electronic Trading (FCET) group responsible for FCM’s multi-asset electronic trading product suite and trading research, including algorithmic trading, liquidity management, risk management, decision support, and quantitative analytics. Derrick graduated from the Massachusetts Institute of Technology with degrees in Electrical Engineering & Computer Science, Management Science, and received an MBA from the Sloan School of
Management. He holds Series 7, 24, 55 & 63 registrations and is a member of the SIFMA Equity Markets & Trading Committee.

Overview – Market Structure


Dark Pools


*Securities and Exchange Commission, “Strengthening the Regulation of Dark Pools,” Fact Sheet from the SEC Open Meeting, October 21, 2009 (pp. 1-3).


High Frequency Trading

* Committee on Capital Markets Regulation, “What is High Frequency Trading?,” December 29, 2014 (pp. 1-9).


*O’Hara, M., “High Frequency Market Microstructure,” April 2015, (pp.17-31)


*Scott, H., Testimony before the Subcommittee on Securities, Insurance, and Investment Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 18, 2014 (pp.3-17).


**Decimalization**

*Securities and Exchange Commission, “Report to Congress on Decimalization,” July 2012 (pp. 1-23).


*Equity Capital Formation Task Force, “From the On-Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small Cap Companies,” Report issued November 11, 2013 (pp. 1-3).

**Class 11 – Cost Benefit Analysis**

*Wednesday, April 13*

Cost-Benefit analysis is generally included in a list of characteristics of effective regulation – whether the benefits of regulatory intervention outweigh the costs. Such analysis has been enshrined by Executive Order since the 1980s in the analysis of regulations proposed by agencies of the Executive Branch in the U.S. For many years, the independent agencies, not covered by the Executive Order, paid manly lip-service to Cost-Benefit analysis. But in the late 1990s, Congressional legislation required the SEC to perform such analysis, although the requirement attracted little attention at the time. In the last several years, federal court decisions have mandated that the CFTC and SEC conduct a serious Cost-Benefit analysis of newly proposed rules. The class will discuss the challenges to execute Cost-Benefit analysis.

*Committee on Capital Markets Regulation, “CCMR Warns that Inadequate Cost-Benefit Analysis Opens Dodd-Frank Regulation to Challenge and Delay,” March 7, 2012 (pp. 1-6).


*Sloan, S., “Cost-Benefit Analysis Puts the Brakes on Dodd-Frank,” Bloomberg, May 7, 2012 (pp. 1-4).


Class 12 – Regulatory Structure

Wednesday, April 20

This class focuses on the structure of the U.S. financial regulatory system, which is the most fragmented and complex of all developed economies. There are competing regulators at the federal, state and private (“self-regulatory organizations”) levels, as well as competition among regulators at the various levels. The 2010 Dodd-Frank Act did very little to reduce this regulatory fragmentation, eliminating only one regulator and adding several additional new regulatory bodies, such as FSOC, to an already complicated system. We will start from the Treasury Blueprint issued in 2008, compare it with other alternatives also not adopted, compare it with what was incorporated into the Dodd-Frank legislation and ask why Congress made the choices it did. We will then move on to discuss what improvements could be made and public policy that might move us there.

Review Readings


Regulatory Structure


*Norris, F., Independent Agencies, Sometimes in Name Only, New York Times, August 8, 2013 (pp. 1-3).


Bipartisan Policy Center, “Dodd-Frank’s Missed Opportunity: A Road Map for a More Effective Regulatory Architecture,” April 2014 (pp.5-10).

Pinschmidt, P., “Testimony before the House Financial Services Subcommittee on Oversight and Investigations,” 17 September 2014 (pp.1-5).

