



## GLEF 4020 International Banking and Financial Regulation

2018-19 Term 2

### Course outline

Instructor: Professor NGUYEN Xuan Hai

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Office location/hours: Wednesdays, 10am – 12pm, Esther Lee Bldg 934 & by appointment

Class time: Tues 2:30pm - 5:15pm

Location: **Cheng Yu Tung 215**

TA: Xiaoyang Li

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#### I. Overview

Two central objectives of the course are: to provide a historical narrative of financial regulatory developments in the U.S. and to introduce theoretical frameworks that explain the importance and shortcomings of financial regulations. By the end of the course, students shall have both a birds'-eye view of the industry and a concrete knowledge of finance and banking theories.

History shows that financial crises and regulatory reforms are two synchronous developments, insofar as one foreshadows the other. In the face of the Great Recession and our response to overhaul the financial system under the Dodd-Frank Act, whose social and economic ramifications have not been fully understood by lawmakers, market-participants and academics alike, it is critical for economic students to take a step back and study the evolution of the regulatory landscape. In that spirit, the course will begin with the time of the great Framers and chronologically trace financial developments to the present time. Accordingly, students shall gain a broad understanding of past crises in the U.S., including the roots, the costs, the aftermath and especially the policy responses.

Furthermore, the course offers a range of simplified and intuitive theoretical frameworks that give students insights on the necessity of, as well as the problems with, an array of key regulations, including deposit insurance, bank capital and liquidity requirements, and supervisory rules. Via representative models and theories, students will be able to examine financial regulations through the analytical eyes of economists, and thus, understand the crucial relationships between policy-making and academic research that have transpired in America. Specifically, students will be exposed to scholarly works by Bagehot, Bernanke, Friedman and Schwartz, among others, so as to appreciate the existence, as well as the roles and limitations, of the Federal Reserve System and various other regulatory agencies.



## II. Prerequisites

Students are required to complete Basic Macro/ Microeconomics before taking the course. Intermediate Macro and Money and Banking are recommended.

## III. Course Organization

The course will consist of one lecture per week. The lectures will be presented using PowerPoint slides, which will be provided in advance. Students are expected to have the slides with them, as the instructor will fill in parts of the materials during class. Lecture slides are meant to be complementary to the lectures, NOT substitute.

Lecture notes and other course materials (extra readings, answers to problem sets and exams, etc.) will be posted on eLearning.

Two classes will be devoted to student debates. Students will be divided into groups of 2 to 3, and will discuss assigned topics. The debates will have the team-policy format, following by questions from the instructor and the audience. Credits are given based on preparations, clarity of speeches and ability to response to questions accurately and on topic.

Topics include: central elements of Dodd-Frank implementation, such as limits on proprietary trading, regulation of OTC derivative markets, and winding down large financial firms; rationales for regulations and supervision of banks; the need to shift from microprudential toward macroprudential regulations; and tradeoffs between consumer protections and market efficiency.

## IV. Exams and Grading

The final grade for the course will be determined by the following factors:

- One (01) in-class midterm exam, worth 35%. The exam will consist of long/short answers and exercises.
- One (01) student debate and (01) 500-word argument, worth 30% [can be substituted by class presentations, TBD].
- One (01) final exam, worth 35%. The exam will have a similar format as the in-class midterm.

The final exam is cumulative. All students are required to take the final exam.



There will be no make-up exam for the midterm. The percentage weight of the missed midterm will be shifted to the final.

If you miss the final, the availability of a make-up exam will be determined on a case-by-case basis.

Students can only miss an exam with an appropriate excuse, such as experiencing health-related issues or observing religious holidays. A notification must be made in advance. All excuses are subject to verifications by proper documents, to be submitted to me within one week of the exam.

Students must present their University Photo ID in order to take part in exams.

## **V. Attendance and Classroom Etiquette**

Though attendance is not recorded, students are expected to be on time for every meeting and prepared to learn. Students will be held responsible for all material covered in class. It includes, but is not limited to, problem sets, exam date announcements, and/or any adjustment in the materials being covered.

Furthermore, students are expected to be considerate of the instructor and classmates; to come to class on time and stay the entire period. Cell phones and beepers should be off during class time. Students are also advised to refrain from personal activities, such as private conversations, eating or drinking.

## **VI. Academic Honesty and Related Procedures**

Attention is drawn to University policy and regulations on honesty in academic work, and to the disciplinary guidelines and procedures applicable to breaches of such policy and regulations. Details may be found at <http://www.cuhk.edu.hk/policy/academichonesty/>.

With each assignment, students will be required to submit a signed declaration that they are aware of these policies, regulations, guidelines and procedures.

- In the case of group projects, all students of the same group should be asked to sign the declaration, each of whom is responsible and liable to disciplinary actions should there be any plagiarized contents in the group project, irrespective of whether he/she has signed the declaration and whether he/she has contributed directly or indirectly to the plagiarized contents.



- For assignments in the form of a computer-generated document that is principally text-based and submitted via VeriGuide, the statement, in the form of a receipt, will be issued by the system upon students' uploading of the soft copy of the assignment.

Assignments without the properly signed declaration will not be graded by teachers.

Only the final version of the assignment should be submitted via VeriGuide.

The submission of a piece of work, or a part of a piece of work, for more than one purpose (e.g. to satisfy the requirements in two different courses) without declaration to this effect, shall be regarded as having committed undeclared multiple submission. It is common and acceptable to reuse a turn of phrase or a sentence or two from one's own work; but wholesale reuse is problematic. In any case, agreement from the course teacher(s) concerned should be obtained prior to the submission of the piece of work.

## VII. References

Note: The required readings are indicated under "Reading" in Section VIII: Course Calendar. Interested students who would like to advance further in the field will find the rest of the list helpful.

### a. Books

- Acharya, V., and Cooley, T., and Richardson, M., and Walter, I., *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance*. NYU, 2011.
- [1] Bagehot, W. *Lombard Street: A Description of The Money Market*. London: Paul, 1878.
- [2] Benston, G.J. *Regulating Financial Markets: A Critique and Some Proposals*. Washington DC: The AEI Pr, 1999.
- [3] Dewatripont, M. and Tirole, J. *The Prudential Regulation of Banks*. Cambridge, MA and London: MIT Pr, 1996.
- [4] Friedman, M. and Schwartz, A.J. *A Monetary History of The United States, 1867 - 1960*. Princeton: Princeton Univ. Pr, 1971. Vol 12.
- [5] Galbraith, K.J. *The Great Crash 1929*. Houghton Mifflin Harcourt, 2009.
- [6] Johnson, S. and Kwak, J. *13 Bankers: The Wall Street Takeover And The Next Financial Meltdown*. New York: Phanttheon Books, 2010.



- [7] Mishkin, F. *The Economics of Money, Banking, and Financial Markets*. 8th ed. Boston: Pearson/Addison Wesley, 2007.
- [8] Reinhart, C, and Rogoff, K. *This Time Is Different: Eight Centuries of Financial Folly*. Princeton: Princeton Univ Pr, 2009. Part IV and V.
- [9] Shin, H.S. *Risk and Liquidity*. OUP Oxford, 2010.

#### **b. Articles**

- [10] Basel Committee on Banking Supervision. "The Basel Committee's Response to the Financial Crisis: Report to the G20." Bank for International Settlements, 2010.
- [11] Benston, G.J., and Kaufman, G. "The Appropriate Role of Bank Regulation." *Economic Journal* (106), 1996. Page 688-697.
- [12] Berger, A.N. and Herring, R.J. and Szegö, G.P. "The Role of Capital in Financial Institutions." *Journal of Banking and Finance* (19:3), 1995. Page 393-430.
- [13] Bernanke, B. "Non-monetary effects of the financial crisis in the Propagation of the Great Depression." *American Economic Review* (1983).
- [14] ----- "Reducing Systemic Risk." Speech at the Federal Reserve Bank of Kansas City's Annual Economic Symposium, Jackson Hole, Wyoming, 2008.
- [15] Bordo, M. "The Classical Gold Standard: Some Lessons for Today." *Federal Reserve Bank of St. Louis Review* (63), 1981.
- [16] Brunnermeier, M.K. and Goodhart, C.A.E. and Persaud, A. and Crockett, A. and Shin, H. "The fundamental principles of financial regulation." *International Center for Monetary and Banking Studies* (2009).
- [17] Bryant, J. "A Model of Reserves, Bank Runs, and Deposit Insurance." *Journal of Banking and Finance* (4:4), 1980. Page 335-344.
- [18] DeLong, J.B. "America's Peacetime Inflation: 1970s," in Christina Romer and David Romer, *Reducing Inflation: Motivation and Strategy*. Chicago: Uni. Of Chicago Pr., 1997. Page 247-276.



- [19] Demirguc-Kunt, A., and Laeven, L. and Levine, E. "Regulations, market structure, institutions, and the cost of financial intermediation." NBER Paper (2003).
- [20] Diamond, D.W., and Dybvig, P.H. "Bank runs, deposit insurance, and liquidity." *The Journal of Political Economy* (1983). Page: 401-419.
- [21] Dowd, K. "The Case for Financial Laissez-Faire." *Economic Journal* (106:436), 1996. Page 679-687.
- [22] Grubb, F. "Benjamin Franklin and the Birth of a Paper Money Economy." Federal Reserve Bank of Philadelphia, 2007.
- [23] Jacklin, C.J. "Demand Deposits, Trading Restrictions, and Risk Sharing," in Edward D. Prescott and Neil Wallace, *Contractual arrangements for intertemporal trade*. Minneapolis: U. of Minnesota Press, 1987. Page 26-47.
- [24] Jeanne, O. *Lectures notes for Global Financial Crisis*. 2012.
- [25] Komai, A, and Richardson, G. "A Brief History of Regulations Regarding Financial Markets in the United States: 1789 to 2009." NBER Working Paper (2011).
- [26] Moen, J. and Tallman, E. "The Bank Panic of 1907: The Role of the Trust Companies." *Journal of Economic History* (52:2), 1992. Page: 611-630.
- [27] Rahman, K. "Democracy and Productivity: The Glass-Steagall Act and the Shifting Discourse of Financial Regulation." *Journal of Policy History* (24:4), 2012.
- [28] Rajan, R.G., and Zingales, L. "The great reversals: the politics of financial development in the twentieth century." *Journal of Financial Economics* (2003). Page: 5-50.
- [29] Rochet, J.C. and Vives, X. "Coordination failures and the lender of last resort: was Bagehot right after all?" *Journal of the European Economic Association* (2:6), 2004. Page: 1116-1147.
- [30] Rockoff, H. "Money, Prices and Banks in the Jacksonian Era," in Stanley Engerman. *A Reinterpretation of American Economic History*. New York: Harper & Row, 1972.
- [31] Rolnick, A.J. and Weber, W.E. "New Evidence on the Free Banking Era." *American Economic Review* (73:5), 1983. Page: 1080-1091.



- [32] Schwartz, A.J. "The Beginning of Competitive Banking in Philadelphia, 1792 – 1809." *Journal of Political Economy* (55:5), 1947. Page: 417-431.
  
- [33] Sylla, R. and Wright, R.E., and Cowen, D.J. "Alexander Hamilton, Central Banker: Crisis Management during the U.S. Financial Panic of 1792." *Business History Review* (83), 2009. Page: 61-86.
  
- [34] Wheelock, D. "Monetary Policy in the Great Depression: What the Fed Did and Why." *Federal Reserve Bank of St. Louis Review*, 1992. Page 3-28.
  
- [35] ----- . "Lessons Learned? Comparing the Federal Reserve's Responses to the Crises of 1929-1933 and 2007-2009." *Federal Reserve Bank of St. Louis Review* (92:2), 2010. Page 89-107.
  
- [36] White, E.N. "The Political Economy of Banking Regulation, 1864-1933." *Journal of Economic History*, 1982.
  
- [37] ----- . "The Stock Market Boom and Crash of 1929 Revisited." *Journal of Economic Perspectives*, 1990. Page 76-83.



### VIII. Course Calendar

Note: The numbers in bracket under “Reading” refer to the items in the list above. Bolded items are absolutely essential, while the rest are highly recommended.

| Meeting | Topic   | Reading  |
|---------|---|--|
| 8 Jan   | Introduction to the course, overview of materials and course organization; the importance of banking and finance  | <b>[4]</b> , <b>[25]</b>   |
| 15 Jan  | Theory of banking: Nature of banking and rationale for regulation   | <b>[3]</b> , <b>[24]</b>   |
| 22 Jan  | Theory of banking: Diamond-Dybvig model   |  |
| 29 Jan  | Theory of banking: Rationale for supervision  |  |
|         |   |  |
| 12 Feb  | Early formations of banking industry; constitutional foundations of the financial system and the early form of crisis, Regulatory reforms in the late 19 <sup>th</sup> and early 20 <sup>th</sup> centuries, the creation and initial roles of the Federal Reserve System | <b>[4]</b> , <b>[5]</b> , <b>[13]</b> , <b>[25]</b> , <b>[27]</b> , <b>[34]</b> , <b>[36]</b> , <b>[37]</b>                            |
| 19 Feb  | Midterm exam  |  |
| 26 Feb  | Great Depression and Policy responses: the Glass-Steagall Act and the new roles of the Federal Reserve’s Board of Governors, The period of “Boring Banking” 1940s – 1970s,  | <b>[1]</b> , <b>[24]</b> , <b>[29]</b> , <b>[4]</b> , <b>[6]</b> , <b>[18]</b> , <b>[21]</b> , <b>[25]</b> , <b>[28]</b> , <b>[31]</b> |
| 5 Mar   | Systemic Risk, Regulations in the early 21 <sup>st</sup> centuries, the recent financial crisis and its costs, the aftermath of the crisis and financial reform: Dodd-Frank and related issues  |  |
| 12 Mar  | Guest Lecture   | TBA  |
| 19 Mar  | Financial Deregulations and the Savings and Loan crisis, Too big to fail and the modern financial contagion and bank runs   |  |
| 26 Mar  | Measuring, Taxing, and Preventing Systemic Risk   |  |
| 9 Apr   | Shadow banking  |  |
| 16 Apr  | Student Debates / Cryptocurrency Regulation / Final Review  |  |
|         | Final Exam: Centralized   |  |