

International Financial Regulation

Fall 2011

LW.11214.001

Tuesday 2:00-3:15pm and Thursday 12:00-1:15pm

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Office Hours: 3:30-5:30pm Tuesdays (or by appointment)

Objectives of the Class

The financial crisis which started in 2007 has spurred a great deal of analysis and a global effort to redesign international financial regulation. Over the past three years, finance and law practitioners, regulators and academics have all had to work together, due to the numerous complex interlinked issues at hand. One thing is clear: that the industry landscape has changed drastically and that an understanding of the nature and state of financial regulation will be important for anyone participating in the financial sector.

The objective of this course is to provide a solid introduction to the basics of international financial regulation (namely, the Basel Capital Accord, the Dodd-Frank Act and EU Directives), with an in-depth view of how regulatory concerns drive participants in the financial system as well as regulators. A key focus of the course is on capital adequacy requirements, regulatory arbitrage cases and how the regulatory framework deals with key risks as observed in the financial crisis. The course will also emphasize issues relating to current events in the international financial sphere, as financial institutions work to comply with recent, ongoing financial reforms.

The course is mainly designed for students interested in joining multi-national financial institutions, their various advisors such as law firms and consulting firms, and domestic or international financial supervisory organizations (e.g., the Bank for International Settlements or the Financial Stability Board). As a course which not only touches on the conceptual design of the regulatory framework but also the implementation and practice issues, guest speakers will be invited to speak for part of certain classes. Guest speakers from the last semester include a senior vice president from Capital One Bank speaking on the Basel II framework, a Credit Suisse risk manager discussing the indirect regulation of hedge funds through counterparty risk management, and a managing director from Moody's presenting on the alternatives to credit ratings.

Topics in this course can be divided into six segments:

- Key risks underlying the design of the financial regulatory framework
- Causes of the recent financial crisis and the resolution of bank failures (including those from prior recessions)
- Capital adequacy regulation under the Basel Capital Accords, as implemented in the United States and Europe
- Different regulatory techniques used in the financial regulatory framework (e.g., disclosure requirements, activity limits, accounting rules, liquidity standards, etc)
- Regulatory structures and the role of regulators in different jurisdictions
- Specialized topics in international financial regulation (e.g., securitization, derivatives, stress-testing, credit rating agencies, hedge funds, etc)

Recommended Books

There is no single textbook which covers all the relevant material in this area, given the ongoing reforms in financial regulatory frameworks globally. Handouts, exercises, case studies, or material will be put on the Blackboard. Recommended books include:

Hal S. Scott, *International Finance: Transactions, Policy and Regulation* (2010, 17th Ed)

Viral V. Acharya, Thomas F. Cooley, Matthew P. Richardson, Ingo Walter, et al, *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (2010)

Grading

The final grade will be made up as follows:

Project (Written Paper – Individual Work): 40%

Project (In-Class Presentations – Team Work): 20%

Take-Home Final: 40%

Class Performance is taken into account for grading purposes and it can result in a grade being raised or lowered one step.

Course Policies

Attendance

Regular classroom attendance is required and part of a student's grade, as taken into account under Class Participation. Students are advised that excessive absenteeism can result without warning in: 1) grade lowering or 2) denial of permission to complete course work and/or sit for the exam, or receipt of a grade of WD (withdrawn) or FAB (failed for absence). Missing more than one-fifth of classes is presumptively excessive.

Project Papers & Presentations

The main assignment for this course, which constitutes a major part of the grade, is the Project where each team will work on a project in an area relating to ongoing reforms in international financial regulation and proposed regulatory initiatives from a suggested list of topics. The project will entail the application of concepts and principles learnt in class, some research on the arguments for and against the reforms as well as recommendations for improving the design of the regulatory framework. More details will be provided on the project during the first two classes.

Course Content

Introduction & Why International Financial Regulation

Risk Management Concepts underlying the Design of Financial Regulations [Handout on Blackboard]

Glossary: Vocabulary Frequently Used in Financial Regulations and Risk Management [Handout on Blackboard]

Warwick Commission, Why Regulate?, pp 9-11

http://www2.warwick.ac.uk/research/warwickcommission/report/chapter_1.pdf

Warwick Commission, Macro-Prudential and Micro-Prudential Regulation, pp 12-16

http://www2.warwick.ac.uk/research/warwickcommission/report/chapter_2.pdf

Congressional Oversight Panel Report: The Global Context and International Effects of the TARP (August 2010), pp 7-18, 74-91

<http://cop.senate.gov/reports/library/report-081210-cop.cfm>

The Financial Crisis in Iceland and the Fault Lines in Cross-Border Banking (2010)

<http://www.bis.org/review/r100129a.pdf>

Causes of the Financial Crisis and Bank Failures

The Financial Crisis Inquiry Commission, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, pp xvii-xxvii, 27-80, 292-308 (skim)

<http://www.fcic.gov/>

Federal Deposit Insurance Corporation, An Examination of the Banking Crises of the 1980s and Early 1990s – see chapter on 'Commercial Real Estate and the Banking Crises of the 1980s and Early 1990s'

http://www.fdic.gov/bank/historical/history/137_165.pdf

Extracts from Material Loss Reviews (2008-10) [Handouts on Blackboard]

Regulating Wall Street, Chapter 8 (Resolution Authority), pp 220-31

DG Internal Market and Services, Technical Details of a Possible EU Framework for Bank Recovery And Resolution (2011)

http://ec.europa.eu/internal_market/consultations/docs/2011/crisis_management/consultation_paper_en.pdf

Northern Rock Shareholders' Appeal to the Court of Appeal [2009] EWCA Civ 788, pp 9-12 (start from para 25) & pp 20-22 (start from para 73) [Handout on Blackboard]

Bankruptcy Examiner's Report on Washington Mutual (2010), pp 304-10, 313-14 [Handout on Blackboard]

Shareholder Report on UBS's Write-Downs (2008), pp 28-42 [Optional]

<http://www.ubs.com/1/ShowMedia/investors/agn?contentId=140333&name=080418ShareholderReport.pdf>

Capital Adequacy Regulation: Understanding "Capital"

Financial Services Authority, Definition of Capital, pp 12-16

http://www.fsa.gov.uk/pubs/discussion/dp07_06.pdf

12 CFR 208.43 - Capital measures and capital category definitions

http://edocket.access.gpo.gov/cfr_2009/janqtr/pdf/12cfr325.102.pdf

Brookings Institute, Bank Capital and the Stress Tests, pp 6-18

http://www.brookings.edu/~media/Files/rc/papers/2009/0303_bank_capital_elliott/0303_bank_capital_elliott.pdf

FDIC, Economic Capital and the Assessment of Capital Adequacy

http://www.fdic.gov/regulations/examinations/supervisory/insights/siwin04/economic_capital.html

Challenges in Economic Capital Modeling (June 2010) [Optional]

<http://www.frbsf.org/publications/economics/letter/2010/el2010-19.html>

Admati et al, Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive, Stanford Graduate School of Business Research Paper No. 2065 (2011)
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669704

Capital Adequacy Regulation: Computing Regulatory Capital

Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems, pp12-27, 60-61
<http://www.bis.org/publ/bcbs189.htm>

Dodd-Frank provisions (Collins Amendment)
[Available on Lexis/Westlaw – section 171 of the Dodd-Frank Wall Street Reform And Consumer Protection Act]

Commentary: 'The Dodd-Frank Act implementation of the Collins Amendment'
http://www.nixonpeabody.com/services_pubdetail.asp?ID=3472&SID=25

FDIC Law, Regulations, Appendix A to Part 325—Statement of Policy on Risk-Based Capital
<http://www.fdic.gov/regulations/laws/rules/2000-4600.html>. See pages on Procedures For Computing Risk-Weighted Assets and Minimum Risk-Based Capital Ratio

Classroom Example for Capital Calculations [Handout on Blackboard]

Capital Adequacy Regulation: The Basel II Framework and Regulatory Arbitrage Case Studies

Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (2006), pp 2-11, 15-22 (skim), 48-69
<http://www.bis.org/publ/bcbs107.htm>

Hal Scott, International Finance, pp 428-446

Basel Committee on Banking Supervision, The Internal Ratings-Based Approach, pp 1-8
<http://www.bis.org/publ/bcbsca05.pdf>

Introduction to the internal ratings based approach under Basel II [Optional]
<http://www.allenoverly.com/AOWeb/binaries/49832.PDF>

Government Accountability Office, Risk-Based Capital - Appendix II: Three Pillars of the Advanced Approaches (2008), pp 58-63
<http://www.gao.gov/products/GAO-08-953>

Hal Scott, International Finance, pp 460-469

Office of the Comptroller of the Currency et al, Risk-Based Capital Guidelines: Market Risk (2010), pp 6-13
<http://www.occ.treas.gov/news-issuances/news-releases/2010/nr-ia-2010-142a.pdf>

Financial Services Authority, The Prudential Regime For Trading Activities: A Fundamental Review (2010) [Optional]
http://www.fsa.gov.uk/pubs/discussion/dp10_04.pdf

Thinking Beyond Basel III: Necessary Solutions For Capital And Liquidity, pp 2-21 [Optional]

<http://www.oecd.org/dataoecd/42/58/45314422.pdf>

Barclays-Black Diamond Case Study [Handout on Blackboard]

AIG Credit Default Swaps and Capital Relief Case Study [Handout on Blackboard]

Market Risk-Credit Risk Transformation Case Study [Handout on Blackboard]

Troubled Assets and the Regulation of Systemic Risk

Hal Scott, International Finance, pp 31-43

Congressional Oversight Panel Report: The Continued Risk of Troubled Assets (August 2009), pp 6-26, 37-62
<http://cop.senate.gov/documents/cop-081109-report.pdf>

Advance Notice Of Proposed Rulemaking issued by the Financial Stability Oversight Council
<http://edocket.access.gpo.gov/2010/pdf/2010-32005.pdf> (skim)

European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (2010), pp 1-11 (skim)
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0001:0011:EN:PDF>

Regulators and Regulatory Structures for Bank Supervision

Warwick Commission, Regulatory Capture, pp 27-32
http://www2.warwick.ac.uk/research/warwickcommission/report/chapter_5.pdf

UK Government Consultation Paper, A New Approach to Financial Regulation: Judgment, Focus and Stability, pp 3-6
http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf

Dodd-Frank provisions (Lincoln Amendment)
[Available on Lexis/Westlaw – section 716 of the Dodd-Frank Wall Street Reform And Consumer Protection Act]

Hal Scott, International Finance, pp 217-229

Statement of Scott M. Polakoff, Office of Thrift Supervision regarding American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation, before the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate (2009), pp 3-16
<http://www.ots.treas.gov/files/87171.pdf>

Bankruptcy Examiner's Report on Lehman Brothers Holdings (2010), pp 732-49 (Repo 105 and Regulatory Scrutiny) and selected appendices of supervisory oversight of Lehman under the CSE Regime [Handouts on Blackboard]
<http://lehmanreport.jenner.com/>

Office of Inspector General, Follow-up Audit of the FDIC's Use of Special Examination Authority and DOS's Efforts to Monitor Large Bank Insurance Risks (2002) [Optional]
http://www.fdicoinig.gov/reports02/02-004_w_03-004.pdf

Basel III Proposed Reforms: Leverage Ratio & Countercyclical Buffer

Basel Committee on Banking Supervision, A Global Regulatory Framework for More Resilient Banks and Banking Systems (2010), pp 61-63 (esp. paras 160-4)
<http://www.bis.org/publ/bcbs189.htm>

Comment Letter from Deutsche Bank to the Basel Committee (Apr. 16, 2010), focus on comments regarding the Leverage Ratio, pp 17-18

Comment Letter from BB&T Corporation to the Basel Committee (Apr. 15, 2010), focus on comments regarding the Leverage Ratio, pp 6-7

Basel Committee on Banking Supervision, Guidance for National Authorities Operating the Countercyclical Capital Buffer (2010), pp 3-5
<http://www.bis.org/publ/bcbs187.htm>

Comment Letter from Barclays Capital to the Basel Committee on the Countercyclical Capital Buffer Proposal (Sep. 10, 2010), pp 1-3 of Appendix 1

Comment Letter from Reserve Bank of New Zealand to the Basel Committee on the Countercyclical Capital Buffer Proposal (Aug. 26, 2010), pp 1-3

Basel III Proposed Reforms: Securitization

Regulating Wall Street, Chapter 16 (Securitization Reform), pp 472-84

Committee of European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive (2010), pp 14-20
<http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf>

FDIC Notice of Proposed Rulemaking, Credit Risk Retention (2011), pp13-23
<http://www.fdic.gov/news/board/29Marchno2.pdf>

Securitization Case Study [Handouts on Blackboard]

Basel III Proposed Reforms: Derivatives

Hal Scott, International Finance, pp 834-6, 842-6

Basel Committee on Banking Supervision, A Global Regulatory Framework for More Resilient Banks and Banking Systems (2010), pp 28-48 (Counterparty credit risk reforms)
<http://www.bis.org/publ/bcbs189.htm>

Basel Committee on Banking Supervision, Capitalisation of Bank Exposures to Central Counterparties (2010), pp 1-6
<http://www.bis.org/publ/bcbs190.htm>

European Central Bank, Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties & Trade Repositories (2011), pp 1-4 [Handouts on Blackboard]

Financial Stability Board, Implementing OTC Derivatives Market Reforms (2010) [Optional]
http://www.financialstabilityboard.org/publications/r_101025.pdf

Stress-Testing

Government Accountability Office, Troubled Asset Relief Program: Bank Stress Test Offers Lessons as Regulators Take Further Actions to Strengthen Supervisory Oversight (2010)
See Highlights front page & pp 13-18 (skim for background), pp 41-53
<http://www.gao.gov/new.items/d10861.pdf>

Federal Reserve, Comprehensive Capital Analysis and Review (2011), pp 1-6, 15-18
<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20110318a1.pdf>

European Banking Authority, Overview of the EBA 2011 Banking EU-Wide Stress Test (2011), pp 1-8
<http://www.eba.europa.eu/cebs/media/Publications/Other%20Publications/2011%20EU-wide%20stress%20test/EBA-ST-2011-003--%28Overview-of-2011-EBA-EU-wide-stress-test%29.pdf>

Regulation of Credit Rating Agencies

Regulating Wall Street, Chapter 15 (Regulation of Rating Agencies), pp 443-460

SEC, Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (2008), pp 10-37
<http://www.sec.gov/news/studies/2008/craexamination070808.pdf>

European Commission, Public Consultation on Credit Rating Agencies (2010), pp 5-28
http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf

Regulation of Hedge Funds

Regulating Wall Street, Chapter 12 (Hedge Funds, Mutual Funds and ETFs), pp 358-64

Congressional Research Service, Hedge Funds: Legal History and the Dodd-Frank Act (2010), pp 1-7 [Handout on Blackboard]

Federal Reserve Bank of New York, Hedge Funds, Financial Intermediation, and Systemic Risk (2007). pp1-15
<http://www.newyorkfed.org/research/epr/07v13n3/0712kamb.html>

European Central Bank, Hedge Funds and the Implications for Financial Stability (2005), pp25 – 55
<http://www.ecb.int/pub/pdf/scpops/ecbocp34.pdf>