

## INTERNATIONAL FINANCIAL REGULATION (LL207)

**Course duration:** 54 hours lecture and class time (Over three weeks)

**LSE Teaching Department:** Department of Law

**Lead Faculty:** Dr Philipp Paech

**Pre-requisites:** Introduction to legal methods or equivalent.

### Course description and learning outcome:

The course uses the 2007-2010 financial crisis as a starting point to analysis the fundamental challenges that the regulation of financial markets poses to legislators, regulators and the society as a whole.

To this end, in a first part, the course explores the basics of policy making in the area of financial regulation, the 'why, how & who'. Accordingly, the course will first look at why policy choices are taken and which are the underlying rationales, notably systemic stability, market integrity, and the limitation of the consequences of the principal-agent problem. The course will go on to identify and scrutinise the tools that regulators use to achieve these policy goals, in particular building resilience into the system, typically on the basis of risk models, impose disclosure to investors and counterparties and require more risk-conscious internal management of financial institutions. Lastly, this course looks at financial regulators and supervisors. They operate within a multi-level governance regime, and the course also maps the regulatory structures at global, EU and national level, focusing on their dynamics and accountability.

In its second, main part, this course will turn to concrete areas of regulation. It will bring students in contact with the 'hottest' regulatory topics of the post-crisis years, i.e. regulation that will shape financial activity for many years to come: banking and financial stability; the Basel bank capital accords; the EU Banking Union; shadow banking; structural reforms of financial institutions; rating agencies; and, derivatives regulation and CCPs. These seven policy areas have all been substantially reinforced after the financial crisis – however, critics note that the overhauled rules might substitute new problems for old ones and that the issues surrounding moral hazard, systemic stability and the special treatment afforded to banks by societies are still not solved in a satisfactory manner. The course will conclude with a lecture on the lessons learned from the 2007-2010 financial crisis, ethics in finance and market pressures.

The course is internationally oriented and draws most of the examples from the standards set by the global committees (FSB, Basel, etc.) and from the post-crisis rules adopted in the EU, with a few digressions and comparisons with the regulatory debate in the USA, without focusing in details on any specific jurisdiction.

The course shall enable participants from the EU as well as from outside the EU to understand, put into context and use the main techniques of financial regulation. The further development of the current 'hot topics' is an on-going international exercise, and this course enables participants to participate in the relevant debates. The combination of general and specialised knowledge will enable participants to navigate through

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the panoply of financial regulation *without* the necessity to cut through the thicket of very technical provisions. The 3 key aims of this course are:

- Introducing participants to the rationales and main elements of financial regulation, so that they understand the 'why', 'how' and 'who', regardless of what concrete regulatory issue they will be looking at in the future.
- Exploring seven of the most important policy areas in the field of financial regulation, all of which underwent fundamental overhaul following the 2007-2010 financial crisis, and which are still subject of a continued regulatory debate.
- Enable participants to follow and shape the debate around financial markets regulation, be it their your current or future role in the financial sector, as legal practitioner, central banker, policy maker, researcher or NGO-representative.

### Course structure and target students:

There will be 12 three hour lectures spread over three weeks. Back-up classes (tutorials of max 18 students) of 90min each will accompany each of them to deepen the subject covered in the lecture and to answer problem questions. Participants are expected to prepare for the lectures by doing some of the reading before coming to the session. Course delivery is very interactive, i.e. participants are encouraged to engage and discuss with peers and with the teaching team.

This course is designed to be of both high academic and direct practical value. It appeals to students preparing for a career in financial markets as well as to practitioners wishing to broaden their horizon. It will be of particular interest for the –

- Private financial sector (strategy, management, compliance, legal, governmental and international affairs, etc.);
- Legal practice specialising in the above;
- Government and governmental agencies (policy makers from treasuries, ministries of economy/finance/justice, foreign office, etc.)
- Central banks (management, legal, regulation and oversight, international affairs, etc.);
- International organisation and EU organs and agencies (policy makers, strategy, legal, international affairs, etc.);
- Non-governmental organisations and advocacy groups active in the field of international financial markets;
- Current Bachelor or Master Students interested in any of the above, or pursuing a programme related to financial markets.

The course is centred on international standards and partly EU regulation. EU and UK regulation just serves as an example, alongside US regulation and regulation in other jurisdictions. Therefore, the course is suitable for EU and non-EU students alike.

## Assessment and formative work

Assessment for the course involves an essay (1500 words) which is worth 30% of the final mark and a 2 hour examination worth 70% of the final mark.

Students can also obtain a certificate of successful participation if they choose not to take the exam, provided they have regularly attended the back-up classes.

## Reading and core texts:

The reading lists identify 3-4 readings per lecture, plus some regulatory or policy documents. All readings are available electronically and can be accessed through the LSE library server. Regulatory and policy documents are all available online.

There are two excellent background books on the financial markets (not specifically on regulation). They provide all necessary knowledge for those intending to take the course without having any prior knowledge of financial markets:

- P. Coggan, *Inside the City – How the Money Machine Works* (Penguin Books, 2008) – written by a journalist, this is an accessible account for the non-specialist. It is highly recommended to read this book before coming to the course. Price around 10.00 GBP.
- S. Valdez and P. Molyneux, *An Introduction to Global Financial Markets* 7<sup>th</sup> or 8<sup>th</sup> edition (Palgrave Macmillan) - this is a more detailed and technical introduction to financial markets which serves as a reference work during the course. It is recommended to purchase this book (it will be useful also after the course, a really good investment). Price around 30.00 GBP.

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## Course outline (Lectures only, the follow-up classes correspond in substance)

### General Part:

- Day 1 Introduction: The Anatomy of the Financial Market
  - What is the financial market?
  - Who is regulated, and why?
  - Introduction to the 2007-2010 Financial Crisis
  - Identification of main crisis accelerators
- Day 2 The 'Why': Rationales for Regulating the Financial Market
  - Counterparty risk, operational risk and systemic risk
  - Market Integrity and fairness
  - The principal/agent problem
  - Competition, market segmentation and infrastructures

- Day 3      The 'How': Key Elements and Tools of Financial Regulation
- The efficiency of 'Value at Risk' and other risk models
  - Disclosure to retail and institutional clients
  - Resilience of intermediaries and infrastructures
  - Rules imposing risk-conscious internal management
- Day 4      The 'Who': Global and EU Regulatory and Supervisory Structure
- Financial Stability Board and G20
  - Basel Committee and IOSCO
  - EU Institutions and ECB
  - National Supervisors and Regulators
- Day 5      Reading day

#### Specific Policy Areas:

- Day 6      Banking and Financial Stability: The Core of all Regulation and Supervision
- The role and importance of banks
  - Soundness, safety and resilience of banks
  - The role of regulatory capital
- Day 7      The Basel Bank Capital Accords: Sophistication vs. Efficiency?
- From Basel I to Basel II
  - Basel III: Post-crisis developments
  - From capital standards to leverage and liquidity standards
  - Critique and outlook
- Day 8      The EU Banking Union: Aspirations and the Achievable
- Rationale for common rules and supervision
  - The 'Single Rulebook'
  - The 'Single Supervisory Mechanism'
  - Common Deposit Guarantee Scheme
  - Critique and outlook
- Day 9      Pulling the Shadow Banking Sector out of the Dark
- 'Shadow banks' and shadow banking
  - Main concern: maturity and liquidity transformation
  - Other concerns
  - Regulation under FSB standards
  - Critique and outlook

- Day 10 Reading day, preparation of formative essay
- Day 11 Wild West Banking vs. Utility Banking: Structural Reforms
- Risk implication of universal banks
  - The Vickers, Liikanen and Volcker Models
  - The US Dodd-Frank Act and EU Regulation proposal
  - Recent industry-friendly setbacks
  - Critique and outlook
- Day 12 Rating Agencies: Disdained Gatekeepers
- Rating agencies' pre-crisis implications
  - Inefficiencies of the concept
  - Conflict of interests
  - Recent regulatory measures, EU CRA Regulation
  - Critique and outlook
- Day 13 From OTC Derivatives to CCP Clearing
- Cleared and un-cleared OTC derivatives
  - Pre-crisis implications of the OTC market
  - Approaches to reduce systemic risk
  - How does CCP clearing work?
  - The EU EMIR Regulation and the Dodd-Frank Act
  - Critique and outlook
- Day 14 Wrap-up: The Financial Crisis, Systemic Stability and Ethics in Finance
- The global financial system: boon and bane
  - How to set ethical standards for finance?
  - The role of 'bankers'
  - The role of regulators
  - Medium and long-term outlook
- Day 15 Exam

**Credit Transfer:** If you are hoping to earn credit by taking this course, please ensure that you confirm it is eligible for credit transfer well in advance of the start date. Please discuss this directly with your home institution or Study Abroad Advisor.

As a guide, our LSE Summer School courses are typically eligible for three credits within the US system and 7.5 ECTS in Europe. Different institutions and countries can, and will, vary. You will receive a digital transcript and a printed certificate following your successful completion of the course in order to make arrangements for transfer of credit.

If you have any queries, please direct them to [summer.school@lse.ac.uk](mailto:summer.school@lse.ac.uk)