NOTE: This course is jointly offered by Law and Business. The materials are hosted on the Law course materials site: courseworks.columbia.edu (Law course # L6939).

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Financial Crises and Regulatory Responses

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Fall 2020: Tuesday, Thursday, 3:50-5:20

Over the last couple of years (just after the 10 year anniversary of the Great Financial Crisis of 2007-09 had passed) discussions on financial regulation were dominated by reforms aimed at rolling back some of the new regulations that had been introduced immediately after the crisis. The financial system was deemed to be sound, economic fundamentals were better than they had ever been since the crisis. The focus had shifted to financial innovation and to the regulatory constraints that were standing in the way of the development of FinTech, BigTech, cryptocurrencies, etc.

An impending crisis was not on analysts’ radar screens. Certainly a pandemic such as the one we are going through, and the economic disruption it brought, was an unforeseen event. How well did the financial system withstand the shock so far? How did the response to the Great Financial Crisis shape the response to the economic shock caused by COVID-19? This is a natural starting point for this year’s class.

The pandemic is a reminder of the fact that crises are inevitable and that they manifest themselves in many different ways. There have been more than a dozen financial crises in the world since 1980, including three in the United States alone.

What are the common elements among these crises, what are the differences? In some instances, crises have brought about significant regulatory reform. Yet how is it that financial crises seem to recur with such frequency? And recur despite regulatory efforts to avoid them.

Over the past ten years that we have given our course, each time the class has faced a major crisis or regulatory development unfolding in real time, making our course particularly lively and relevant.
One year our course was confronted with the developing Eurozone crisis. Five years ago the boom in FinTech and the Lending Club crisis was one of the most relevant developments discussed in class. During the last couple of years dynamics shifted towards deregulation and increasingly forceful initiatives to repeal the Dodd-Frank Act of 2010.

This year we are facing a global pandemic and an economic contraction not seen since the great depression. The pandemic is not over and it is too soon to say whether a global financial crisis can be avoided. In short a special quality of this course is the application of the material and general principles to crisis-related problems and regulatory developments unfolding in real time.

Using a mix of economic history, finance, and law-related materials we plan to address the following themes:

1) Are financial crises foreseeable or unforeseeable? Do they arise from processes internal to the financial sector (such as the “leverage cycle”) or from external events, such as changes in the political landscape that change the terms of financial globalization?

2) Are there more or less stable structures for the financial system? The financial system aims to match suppliers of capital (savers) and users of capital (business users and consumers). From a stability point of view, is such financial intermediation better done through financial institutions or through markets?

3) Is there an optimum size for financial institutions? Should certain financial market activities be combined (for efficiency and diversification) or separated?

4) Are we better off with rigorous schemes of crisis avoidance or efficient resolution mechanisms, if long periods of financial stability inevitably lead to increased leverage, asset price inflation and a resulting steeper crash? Perhaps we are better off by focusing attention on mopping up smaller, more frequent crashes?

5) Do recurrent crises flow from the political constraints on optimum regulation? There are two facets to this question. First is the desire of incumbent political leaders to promote reelection chances by producing economic growth or greater home ownership, which favors expansionary credit policies. Second is the firm-level competition within the financial sector to protect and expand rents. Both of these elements bear on regulatory outcomes.

6) The financial environment is driven by the interplay of legislation, regulation, governance and monetary policy. To what extent can independent central bank intervention through monetary policy correct for legislative or regulatory debility?

7) Do the goals of differently tasked regulators conflict in a way that may undermine systemic stability? How does the disclosure focus of securities regulators fit with the safety and soundness goals of financial regulators, as evidenced for example in Bank of America and Merrill merger or the crisis-era manipulation of Libor?

8) The importance of international coordination and its limits.
9) Last but not least, what are the economic, social, and political costs of financial crises?

**Course Requirements:** You will be asked to write a final take-home exam, which will count towards 80% of the final grade. The other 20% will be based on class participation. You are expected to have read the starred readings in advance.

*What follows is a tentative syllabus that may be altered during the semester depending on events and the availability of guest speakers.*

**Required Textbook:**


**Additional Required Books:**


Articles that are [*] are required reading. Other readings are recommended or for reference.

*You should acquire books from a bookstore or an on-line bookseller. Other Materials are web-posted*
Week 1: Introduction

Financial crises are common throughout history including recent history. What accounts for their frequency? Do they arise from causes internal to the financial system, or do they result from external events, unexpected and not foreseeable? What are the social, economic and political consequences of financial crises?

Session 1.1:

a. The COVID-19 crisis and the legacy of the Great Financial Crisis


[*] Adam Tooze “How coronavirus almost brought down the global financial system” The Long Read, The Guardian 14 April 2020

Session 1.2: The Inevitability of Crises? Structural Forces


Minsky, H.P. (1992), The financial instability hypothesis, Working Paper 74, Jerome Levy Economics Institute, Annandale on Hudson, NY

[*] Jeffrey N. Gordon & Christopher Muller, Confronting Financial Crisis: Dodd-Frank’s Dangers and the Case for a Systemic Emergency Insurance Fund, Yale J. Reg, 2011, pp. 155-177

Weeks 2 and 3: Primer on the Financial Crisis of 2007-09

Is the crisis of 2007-08 an out-of-the-blue, once-in-a-century episode, or is it just a larger scale manifestation of common causes underlying episodic financial crises? Has the crisis been made worse because of novel organizational structures of modern financial institutions and global markets?

Session 2.1: Setting the Stage: The U.S. Savings and Loans Crisis

At least 3 separate factors were at work in the S&L crisis: (i) an exogenous shock (here: high inflation (attributable at least in part to oil price shocks) and high short term interest rates); (ii) regulation and regulatory distortion that made the financial system vulnerable to the particular shock; and (iii) the politics of forbearance that exacerbated the crisis. Are these elements common to all crises?


Session 2.2: Securitization and the Shadow Banking Sector

[*] PFR, Ch. 20.3.1, pp. 439-440; Ch. 21.3, 460-466; Ch. 20.4, pp. 442-444

[*] Joshua Coval, Jakub Jurek & Erik Stafford, The Economics of Structured Finance, 23 J. Econ. Persp. 3 (2009)

Session 3.1: The Subprime Panic

[*] PFR, Ch. 21.2, 452-460


Session 3.2: The Unfolding of the crisis of 2007-2008

First three chapters in:

[*] Timothy F. Geithner (2014), STRESS TEST, and

[*] Ben S. Bernanke (2015), THE COURAGE TO ACT
**Week 4: The First Responses to the Financial Crisis of 2007-09**

How did policymakers respond to the crisis? What were their immediate concerns and how were their interventions restricted by the existing regulatory framework?

**Session 4.1: The Bear Stearns Rescue and section 13(3) of the Federal Reserve Act**

[*] Timothy F. Geithner (2014), STRESS TEST: REFLECTIONS ON FINANCIAL CRISES [chapters 4, 5, 6]

[*] Ben S. Bernanke (2015), THE COURAGE TO ACT: A MEMOIR OF A CRISIS AND ITS AFTERMATH, Norton [chapters 10, 11, 12, 13]


**Session 4.2: The Lehman Brothers Collapse, AIG, the run on Money Market Mutual Funds, TARP, Fed Swap Lines**

[*] Gordon & Muller, Avoiding Eight Alarm Fires, 41-48

[*] Jeffrey N. Gordon & Christopher M. Gandia, Money Market Funds Run Risk: Will Floating NAV Fix the Problem?, 2014 CBLR 313, 314-316

[*] Mathew Klein, How the U.S. Saved the World from Financial Ruin, Barron’s, August 3, 2018

**Week 5: Liquidity Transformation and Crises**

Are financial markets and financial intermediaries fundamentally unstable? Is greater financial stability achieved by matching investments and investors through financial institutions or through markets? (The readings below are more technical than other readings on the syllabus. Students are not expected to master all the details of the analysis in these papers. Reading the introductions of these articles should be sufficient. A key article is Diamond & Dybvig.


Weeks 6-7: The Political Economy of Financial Crisis

The focus of the next 2½ weeks will be the interaction of political economy and regulation in financial regulation. Political economy plays a critical role in four respects: first, as shaping government behavior that creates the pre-conditions for a financial crisis; second, in limiting enforcement under existing laws that could constrain excesses of market actors; third, in shaping the reform proposals in the legislative phase; fourth, in shaping the implementation of the proposals in subsequent regulation. We will consider this interaction generally and then turn to two specific depression era reforms, deposit insurance and Glass-Steagall. Along the way we will also consider the “fitness” of the adopted reforms for their intended purpose.

Session 6.1: The Political Economy of Crisis Creation


Session 6.2: Ex Post Intervention and the Political Economy of Crisis Resolution:
The Case of Mortgage Foreclosure Relief for the Crisis of 2007-09


Session 7.1: Ex Ante Regulation and the Political Economy of Shaping Legislation:
The Examples of Deposit Insurance and Glass-Steagall separation of commercial and investment banking


[*] Glass-Steagall, §§ 16, 20, 21, 32
Session 7.2: The Political Economy of Implementation: Glass-Steagall; its loopholes and its unravelling


[∗] McCoy, §§7.01, 7.02[1]; 7.04[2]

[∗] ICI v. Camp, 401 U.S.617 (1971)

Weeks 8-10: The Regulatory Response to the Financial Crisis of 2007-09

The three weeks devoted to the regulatory responses to the financial crisis of 2007-09 will discuss the main goals of policy makers and assess the main changes in the financial regulatory landscape. What are the new tools available to regulators? How do the new regulations resolve the main weaknesses in the financial system before the crisis? Have the new regulations overreached and excessively stifled the financial industry? Where are the remaining loopholes and areas of vulnerability?

Session 8.1: Dodd-Frank, Title 1: Ensuring the Stability of the Financial System as a whole

[∗] Dodd-Frank §§ 101-123, 151-156, 165-176; as codified at 12 USC 5321-33; 5341-45; 5363-5374.

[∗] Dan Tarullo, (2013) “Macroprudential Regulation”

[∗] PFR, Ch. 19, pp. 409-430

Session 8.2: Dodd-Frank: Systemic Stability through Regulation of Large Banks and other Systemic Financial Institutions

[∗] Dodd-Frank § 165, 12 USC sec. 5365.


[∗] Davis Polk memo on 2019 FSOC Guidance on SIFI designations (Jan. 2020)

[∗] Gordon, Stress Testing in the US (Feb. 2020)
Session 9.1: Dodd-Frank, Title II: Resolution Option and the end of bailouts?

[*] Dodd-Frank, Title II, §§ 204, 206; 203(a),(b), (c)(4); 202 (a), (d); 210 (a)(1)(A)-(N); 210(a)(2)(A),(B); 210(a)(3)(A)(i),(D); 210(a)(11),(12); 210(b)(1),(2)(4),(5); 210(c)(8)(A),(C),(D)(i),(F),(G); 210(c)(9); 210(c)(11); 210(c)(3)(C); 210(c)(12),(13),(16); 210(f); 210(g); 210(n); 210(o); 210(s).

[*] Cutbacks in pre-existing rescue authorities outside of OLA: Federal Reserve Act §13(3); FDIC guarantee authority.


Session 9.2: Bank Resolution, Bail-outs, and Bail-ins

[*] PFR, Ch. 16, pp. 340-369


[*] Chapter 3 in Bolton, Cecchetti, Danthine and Vives (2019), SOUND AT LAST?

Session 10.1: Bank Regulation: Regulating the Asset Side – the Volcker Rule and TBTF

[*] Dodd-Frank, § 619, Volcker Rule

[*] PFR, Ch. 15, pp. 316-332 [Liquidity]

Session 10.2: Bank Regulation: The Right Hand Side of the Balance Sheet

[*] PFR, Ch. 14, pp. 290-315 [Capital Regulation]

[*] Chapter 2 in Bolton, Cecchetti, Danthine and Vives (2019), SOUND AT LAST?

Session 11.1: The “Shadow” Banking System: Credit Intermediation outside the Official Banking Sector; Money Market “Reform” & Its 2020 Failure

[*] PFR, Ch. 20, pp. 433-448
[*] Tobias Adrian & Bradley Jones, Shadow Banking and Market-Based Finance (2018)
[*] SEC Money Market Fund Reform Summary (2014)

The COVID-19 Crisis

A common criticism of crisis responses is that the new regulations and policies that are put in place are “always fighting the last war”. To what extent was this the case with the COVID-19 first response? Relatedly, did the protections put in place after the Great Financial Crisis do the job in helping avoid another financial crisis?


Session 12.1: The Fed’s Ad Hoc Response – Global Dimensions

[Readings to be assigned later]

Session 12.2: How to Regulate: Cost Benefit Analysis or Not?