Financial Market Regulation

Professor: Eudald Canadell  
E-mail: eudald.canadell@gmail.com  
Office hours: by appointment

Course Description

This course will focus on the economic principles underlying the regulation and supervision of the financial sector and its evolution over time with a particular focus on non-banking sector or activities.

We will examine in some detail the different pillars of financial sector regulation: prudential, conduct of business rules, markets infra-structure, corporate governance, and financial stability, and their different translation in particular into the regulation and supervision of financial markets and their actors.

Financial Stability and Macroprudential Policy stand nowadays in the core and center of the work and concerns of regulators, supervisors and politicians around the world, including all the major multilateral international organisations and, thus, we will devote one whole section of the course to the associated issues which, in turn, permeate most of the parts of this syllabus.

While recognizing that prudential regulation and supervision (or, more generally, all those elements designed to prevent or contain the failure of financial entities and the financial system) constitute always the core of any financial markets regulation program, we will in this course devote also special attention to the economic foundations of conduct of business rules (including but not limited to disclosure, transparency, know-your-client rules, etc).

Particular attention will be devoted to a number of issues raised in the last decade of the 20th century extending to the present days. We will analyze the roots of the deep de-regulatory process undergone throughout that period along with the generalized de-regulation of the economy, its effects, and the movement towards re-regulation and enhanced supervision underway at present.

Finally we will address some current topics and challenges in regulation which have captured the public eye in the recent years due to the social impact of the issues underlying them: role of rating agencies and regulation of their activity; benchmarks (in particular interest rates), their use and how to avoid their manipulation; the impact of some financial products designed to mitigate risk (in particular default risk) and else.

Methodology

There will be ten one and a half-hour lectures where we will discuss the actual financial market regulation that addresses market failures or inefficiencies. In particular we will discuss those aspects of financial markets regulation that are specific to non-banking entities or activities. Special attention will be devoted to those aspects of financial markets that have an impact on economic and financial stability and the mechanisms currently used or devised (macroprudential policies) to achieve or restore stability. Lectures will consist of a brief exposition of the topics followed by discussion of the papers covering them. Student participation is especially encouraged.

Students are expected to present cases of specific financial markets regulation, including examples of inadequate regulation or cases in which the regulation did not achieve its goal or
prompted adverse reactions. They will also discuss a paper of their choice on non-bank financial regulation.

**Evaluation criteria**

To pass the course, you must earn at least 50 points out of 100, according to the following distribution:

- Class participation: 10 points.
- Exam: 50 points (a minimum of 35 is required to pass the course).
- Presentation: 40 points.

Students are required to attend 80% of classes. Failing to do so without justified reason will imply a Zero grade in the participation/attendance evaluation item and may lead to suspension from the program.

As with all courses taught at the UPF BSM, students who fail the course during regular evaluation will be allowed ONE re-take of the examination/evaluation. Students that pass any Retake exam should get a 5 by default as a final grade for the course. If the course is again failed after the retake, students will have to register again for the course the following year.

In case of a justified no-show to an exam, the student must inform the corresponding faculty member and the director(s) of the program so that they study the possibility of rescheduling the exam (one possibility being during the “Retake” period). In the meantime, the student will get an “incomplete”, which will be replaced by the actual grade after the final exam is taken. The “incomplete” will not be reflected on the student’s Academic Transcript.

Plagiarism is to use another’s work and to present it as one’s own without acknowledging the sources in the correct way. All essays, reports or projects handed in by a student must be original work completed by the student. By enrolling at any UPF BSM Master of Science and signing the “Honor Code,” students acknowledge that they understand the schools’ policy on plagiarism and certify that all course assignments will be their own work, except where indicated by correct referencing. Failing to do so may result in automatic expulsion from the program.

**Calendar and Contents**

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<tr>
<th>Principles, history and goals of financial regulation</th>
<th>1 session</th>
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<td>- Economic foundations of regulation</td>
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<tr>
<td>- Brief history of financial regulation</td>
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<tr>
<td>- The overarching goals of financial regulation:</td>
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<tr>
<td>✓ Efficiency in market organization</td>
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<td>✓ Integrity in financial markets transactions</td>
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<td>(conduct of business rules) and in the</td>
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Note: This document is only informational, detailed contents and faculty may change.
relationships between financial entities and their clients and among themselves.

✓ Solvency of the financial system (micro-prudential supervision applied to individual financial entities)

✓ Monitoring the stability of the financial system (macro-prudential supervision, applied to the so-called systemic entities, markets, trading platforms and payment systems, etc.)

✓ Integrity and safety of the trading and post-trading infra-structures

✓ Macroeconomic stability

<table>
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<tr>
<th>Regulations common to banking and non-banking activities</th>
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<tr>
<td>Prudential rules for securities markets entities mirroring those applicable to banks, and conduct of business rules applied to banks in their function as providers of investment services</td>
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<tr>
<th>Securities markets regulation</th>
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<tr>
<td>In comparison to the banking model and its regulation, the key to the appropriate performance of securities markets and their regulation lies on the availability of complete and verifiable information (disclosure), the transparency in the operations and the strict observance of the conduct of business rules amongst market agents and between them and their clients.</td>
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</table>

- **Primary markets**
  - a. Regulation of information contained in prospectuses, accounting standards, relevant information, shareholding, etc.
  - b. Debt issues and complex products.
    - Examples (CDS, structured products, swaps, complex derivatives, ...)
  - c. Credit rating agencies regulation
  - d. Regulations applicable to managers and administrators of publicly listed companies
  - e. Corporate governance

- **Secondary markets**
  - a. Regulation of systems and trading mechanisms, exchanges, derivatives exchanges, multilateral trading matching systems, etc.

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<td>b. Self-regulation</td>
<td>c. Prevention and detection of market abuse and price manipulation</td>
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<tr>
<td>d. Insider trading and other financial markets abuses (front running, etc.)</td>
<td>e. Market infra-structure regulation</td>
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**Investment Services Firms**

| a. Regulation of conduct with the clients and in the markets     | b. Front-running and client discrimination                        |
| c. Review of practices designed to alter the orderly functioning of markets | d. Prudential measures applied to financial intermediaries, segregation of clients assets |
| e. “Know your client” rules, assessment of suitability and convenience of investments offered to clients, fair treatment, disclosure of information provided to clients, advisory services, ... |

**Collective Investment Vehicles**

| a. UCITS regulation and its translation into the Spanish regulation on collective investment vehicles and institutions | b. Investment Funds and ETFs                                      |
| c. Alternative Investment vehicles: Hedge funds, Venture Capital etc.                                             |

**Clearing and Settlement Systems**

- **MIFID II Directive and application**
  - **MIFID II and sales of financial products**
    - a) General review of the requirements on commercialization of financial products derived from MIFID II and its transposition into domestic regulations. Assessment of suitability and convenience: procedures, formats and interaction with clients.
    - b) Follow up and monitoring on a continuous basis of the suitability of clients investments to their investment profile
    - c) Training, knowledge and competence of the employees of the investment firms, in particular those providing financial advice and information on financial products. Evaluation of this competence by the firm and the authority

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d) Information to be made available and criteria for the commercialization of complex products. Overview of the different criteria and channels, voluntary and compulsory, made available by the regulatory authorities.

e) Disclosures relative to retail financial products linked to or based on insurance products (PRIIPS)

f) Responsibility of Investment services firms in the sales of complex products and, in particular, contracts for differences and products subject to the banking resolution regime (BRRD)

g) UCITS commercialization and other products beyond EU Passport

h) Remuneration policies for sales personnel at the Investment services firms. Conflicts of interest or perverse incentives in the remuneration.

i) The crucial and independent role of Compliance in the investment Services firms

**MIFID II and the markets and their agents**

a) Management and corporate governance

b) Organization requirements and conduct of business rules

c) Approval process for financial instruments

d) Trade and operations registry

e) Pre and post-trade transparency

f) Algorithmic trade (e.g. high frequency trading)

g) Market structure

h) Organized trading systems

i) Creation and regulation of new services providers: data provision, authorized publication agents, consolidated information providers, etc

j) Control of positions in commodities derivatives

**Financial Stability and Macroprudential Policy**

Context and relevance of financial stability and macroprudential policy:

- Concept of financial stability
- Macroprudential policy
- Examples of crisis related to systemic risk

2 sessions
Central banks in the origin of the tasks to identify and follow systemic crisis

- Entity size: key to systemic risk
- Macroprudential tools: capital requirements, countercyclical provisions, LTV limits etc

The financial crisis changes perception of systemic risk and broadens the spectrum of regulators and supervisors to play a relevant role

- Sources of systemic risk: interconnectedness, substitution degree, concentration, lack of transparency, hedging, complexity, etc
- The role of confidence
- New definitions of financial stability
- New principles of IOSCO
- Shadow banking
- Money market funds and fixed income funds
- Financial intermediaries
- Securitizations

Financial stability at the international level

- FSB
- ESRB
- IOSCO / ESMA
- Architecture of macroprudential policy in particular countries or jurisdictions

<table>
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<th>Discussion on specific topics on market regulation</th>
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<td>Credit Rating Agencies</td>
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<tr>
<td>Manipulation of interest rates, indices and other benchmarks in international markets.</td>
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<tr>
<td>FinTech, DLT, Crowdfunding</td>
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**The future of financial intermediation and regulation**

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<tr>
<th>Paper presentations</th>
<th>2 sessions</th>
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Reading Materials

- Dirk Heremans, Alessio Paces: Regulation of Banking and Financial Markets. April 2011, Rotterdam Institute of Law and Economics
- IOSCO: Credit Rating Agencies: Internal controls designed to ensure the Integrity of the credit rating process and procedures to manage conflicts of interest. 2012. (www.iosco.org )
- ICE LIBOR: Calculating ICE LIBOR. https://www.theice.com/iba/libor
- The role of credit rating agencies in structured finance markets. OICV-IOSCO, Final Report, May 2008
- IOSCO Objectives and Principles of Securities Regulation

Selected papers from:

- IOSCO: (www.iosco.org )
- ESMA: (www.esma.europa.eu )
- Basel Committee on Banking Supervision (www.bis.org)
- European Banking Authority (www.eba.europa.eu)
- Financial Stability Board (www.fsb.org )

Other papers to be announced prior to corresponding lectures

Bio of Professor

Eudald Canadell is Director of Research and Statistics at the CNMV (Comisión Nacional del Mercado de valores), the Spanish financial markets regulatory and supervisory agency. He has spent most of his career working in the international regulatory and financial markets field. He holds a degree in Economics from the University of Barcelona and an MSc in Economics from the University of Minnesota, where he focused on Financial Economics and Econometrics, and taught (T.A) Managerial Economics and Microeconomics. He has also completed advanced management courses at several business schools including the INSEAD (AMP 2008).

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Prof. Canadell had been at an early stage of his professional career a director at the CNMV, where he was responsible for economic analysis and international relations, having intervened in the negotiation of several European directives in finance. Subsequently he was appointed Secretary General of IOSCO, a position he held for four years. During his tenure IOSCO developed and approved, among other policies, the first Principles for the Regulation and Supervision of Securities Markets (1998), adopted subsequently by the IMF to assess the quality of regulatory and supervisory systems around the world.

Prof. Canadell has also served as a senior executive at financial markets and international financial companies, including the Financial Derivatives Exchange in Spain (MEFF), and Standard & Poor’s Index Services, where he held the position of Managing Director for Europe during 6 years. Subsequently he work on compliance related matters at a spanish major bank, and as a senior vicepresident at the consultancy Company Compass Lexecon, immediately before re-joining the CNMV.