PSC 234: THE PAST AND FUTURE

OF OUR FINANCIAL SYSTEM

Fall 2019

Tuesdays, 5-7:30 pm

Harkness 329

This is a seminar in which each student will be asked to write a research paper on a topic related to our financial system. Our readings largely will be derived from a book that I am writing entitled Misalignment: The New Financial Order and the Failure of Financial Regulation. Misalignment opens with the financial meltdown of 2007-2009, retraces how our financial system was developed beginning with the Continental Congress, describes the legislative response to the 2007-2009 meltdown, the 2010 Dodd-Frank Act, and then offers an analysis of why the Dodd-Frank Act was inadequate.

PLEASE DO NOT REPRODUCE, CITE OR QUOTE MISALIGNMENT OUT OF CLASS. MISALIGNMENT IS A NEAR FINAL DRAFT OF A BOOK THAT WILL BE PUBLISHED NEXT YEAR.

Your papers can focus on any mutually agreeable topic related to the course. Before choosing a topic, I will ask each of you to submit a two page proposal and meet with me to discuss the proposal. Proposals must be selected by October 1. I will hold office hours on Tuesdays beginning Tuesday, September 3 from 2 to 4 pm in my office in Harkness 336. On December 3 and 10, each student will present her, his or their paper to the seminar.

Our financial system today has many players, many products and many regulators. Let me offer a thumbnail of how the system works to help frame the course.

The United States has a large and complex financial system, principally composed of commercial banks and other depository institutions, securities firms, which include broker-dealers and mutual funds, insurance firms, hedge funds, pension plans and real estate finance.

Commercial banks are familiar to many of us because of bank accounts, checks and mortgage services. Depository institutions either can charter at the national or state level in the form of banks, savings and loans or credit unions. Most banks and savings and loans are insured by the Federal Deposit Insurance Corporation. As of mid-2018, there were 5,542 insured commercial banks and savings institutions with total assets of $17.5 trillion. There also were 5,480 federally insured credit unions with aggregate assets of $1.4 trillion.

Banks often are held by a Bank Holding Company such as JP Morgan Chase, Goldman Sachs, Citicorp, Morgan Stanley or Wells Fargo. A holding company also can own a securities or insurance affiliate and be a Financial Holding Company. As of mid-2018, Bank and Financial Holding Companies held $19 trillion in assets.

There were 3,800 broker-dealer firms as of June 2018 registered with the federal Securities and Exchange Commission with total assets of $4.4 trillion. Mutual funds which largely hold stock or debt securities held $16.6 trillion in September 2018. Money market mutual funds compete with banks for passbook accounts and long have been formed by mutual fund complexes. Money market funds are sometimes derided as “shadow banks” because they are not subject to the same level of regulation as national banks. As of October 2018, money market assets totaled $3.2 trillion.

Hedge funds provide many of the same services that SEC registered mutual funds provide, but with less regulation and can engage in transactions forbidden to mutual funds. Hedge fund customers typically are wealthy individuals or institutional investors. The gross asset value of hedge funds in 2017 was $7.3 trillion.

Pension plans provide retirement income, often by investing in stocks or debt. Pension plans can be public or private and are in addition to Social Security. As of the second quarter of 2018 the combined total assets of pension funds were $23 trillion. There are individual pension plans such as Individual Retirement Accounts which today account for approximately 28 percent of the retirement services market.

Insurance companies insure lives and property and offer retirement plans in the form of annuities which provide annual payments when they vest in competition with pension plans. The insurance industry is highly concentrated. By 2001, more than 40 percent of life insurance premiums were received by the top ten firms. Insurance firms such as Prudential, Travelers or Metropolitan invest in a wide range of securities. As of 2017, total assets for the life insurance industry were $7.18 trillion.

As of May 2019, there was $33.9 trillion in residential real estate and $18.4 trillion in commercial real estate, of which $10.3 trillion in mortgage debt was provided for residential real estate and $2.4 trillion in mortgage debt was provided for commercial real estate. Mortgages today are arranged through banks and nonbank mortgage originators for both residences and commercial real estate. Since the 2007-2009 debacle, nonbank mortgage origination market is dominated by a new generation of Internet firms such as Quicken Loans. Mortgage loans often are sold in groups of loans or tranches through a process called securitization which converts them into securities that can be resold to investors, rather than the traditional mortgage loans which were held by the bank or savings and loan.

As of 2016 all financial firms and investors held:

$33 trillion in stock, sometimes called equities. Stock can be held directly or through derivative instruments such as options or futures. Publicly held stock is traded on exchanges such as the New York Stock Exchange or the Nasdaq.

$14 trillion in marketable United States debt, typically through government issued securities called Treasuries. As of June 2019, total United States debt was larger, some $22 trillion.

$3.3 trillion in corporate bonds.

$8.9 trillion in mortgage related securities and $1.3 trillion in other securitized assets.

Today finance is regulated by Federal, State and private regulators.

Banks and depository institutions are regulated both at the Federal and State level.

The Federal Reserve System is an independent regulatory agency that regulates Bank and Financial Holding Companies and State banks that receive Federal Deposit Insurance.

The Comptroller of the Currency, which is part of the United States Treasury, regulates national banks.

The Federal Deposit Insurance Corporation administers deposit insurance and bank liquidations.

The National Credit Union Administration oversees nationally chartered credit unions.

Each state also regulates banks and credit unions.

Securities, financial commodities and pension plans respectively are regulated at the Federal level by the Securities and Exchange Commission, the Commodities Futures Trading Commision and the Department of Labor.

Securities regulation also occurs in each state and is buttressed by self-regulatory agencies, the most of important which today is the Financial Industry Regulatory Authority.

Insurance regulation today solely occurs at the state level.

Housing finance is regulated at the federal level by the Federal Housing Administration. The mortgage market long has received key support from two Federal agencies popularly known as Fannie Mae and Freddie Mac which at times have issued or held a majority of mortgages in this country.

READING ASSIGNMENTS

September 3: Introduction: Framing the Issues: Pages 1-15.

September 10: The Financial Debacle of 2007-2009: Part 1: The Meltdown: Pages 16-76.

September 17: The Financial Debacle of 2007-2009: Part 2: Firefighting and Longer Term Solutions: Pages 76-159.

September 24: Before the New Deal: The National Banks, the Jackson War on the Bank, Comptroller of the Currency, the Federal Reserve System: Pages 186-235, 255-260, 276-318, 328-342, 366-373, 403-430.

October 1: Before the New Deal: Securities Regulation, Insurance, the 1929-1933 Crash and Banking Regulation: Pages 431-476, 490-557.

October 8: The New Deal Revolution: Pages 557-625, 669-694, 709-720, 726-729.

October 15: Fall Break

October 22: The Deterioration of the New Deal Model: World War II, Bretton Woods and the Gold Standard, William McChesney Martin, “Independence” at the Fed, the Bank Holding Company Act of 1956, Keynesianism, Vietnam and the Return of Inflation: Pages 758-852.

October 29: The End of the Gold Standard, Wage and Price Controls, Hyperinflation, the Humphrey-Hawkins Act of 1978, the Age of Volcker: Pages 852-970, 1001-1003.

November 5: The S & L Crisis, Deregulation, Alan Greenspan, FIRREA, Clinton and the 1993 Budget Deal: Pages 970-1001, 1003- 1068.

November 12: Gingrichism, the Committee to Save the World, the End of Glass-Steagall, Securities and Insurance Regulation, the New Financial Order: Pages 1068-1112.

November 19: Restructuring Finance Post 2007-2009: The Treasury Department Blueprint, the Volcker Alliance and the Dodd-Frank Act: Materials to be assigned later.

November 26: Materials to be assigned later.

December 3: Student Presentations

December 10: Student Presentations