

15.647 – Spring 2009

NEW COURSE

SUBPRIME, CREDIT CRUNCH, AND ECONOMIC CRISIS – A LEGAL ROADMAP

Preliminary Syllabus

Room E51-315, Mon/Wed 8:30-10:00
Beginning Monday March 2nd and ending Monday April 27th

Instructor: John Akula

WHAT WE WILL COVER: Our goal is to explore what managers need to understand about law-related aspects of this crisis and the realignments in the business world which this crisis is causing. A preliminary topical outline is set out below.

LOGISTICS: The course will be for 6 units, and will meet for 12 classes on consecutive Mondays/Wednesdays, 8:30-10am, beginning Monday March 2nd, and continuing through Monday April 27th. (Thus 15.647 spans roughly the second half of H1 and the first half of H2.)

EXPECTATIONS OF STUDENTS: You will need to come to class, because there will be materials in the discussion that are not included in the readings. The main deliverable for the course will be a high-quality research paper, which can be done as an individual or, for bigger topics, by a team of two or three students. The topic of the paper will be determined in discussions with the instructor. One goal of the research paper is to produce or synthesize materials that can be used in this course in future years. Another goal is to give you a chance to drill deep into some aspect of this subject in which you have a strong interest.

FORMAT: The material will be presented jointly by the instructor and a group of top-notch practicing lawyers who are active in this area.

RELATIONSHIP TO OTHER LAW COURSES: There are no prerequisites for 15.647. The new course will meet with 15.617, which is a full semester course on “Basic Business Law Tilted towards Finance. So you can take either 15617 or 15647, but not both. However, you may enroll in 15647 if you have taken (or are planning to take) any of my other law courses. My general policy is to discourage students from taking more than one of my courses, but the material in 15.647 will be distinctive and so the general policy does not apply.

15.647 - Sp '09 - Topical Outline

Module I: Financial structures, markets and players – The legal framework.

Classes 1 & 2. Introduction / Some basic financial structures. Overview of course. The basics of securitization. Mortgage-backed securities, collateralized debt obligations, credit default swaps and synthetic bonds – how they work. Expanding leverage. The internationalization of the residential mortgage market.

Class 3. The regulation of mortgages and the growth of the subprime market. Traditional mortgage regulation. The Community Reinvestment Act and consumer protection statutes. Fannie Mae and Freddie Mac. The new mortgage originators. The growth of the subprime market.

Classes 4. Some key financial institutions and regulatory schemes. The reach of the federal securities laws. Investment banks, traders and exchanges. The prudential regulation of banks and insurance companies. Accounting and capital requirements. Pension funds, asset managers and hedge funds. Credit rating agencies. The Federal Reserve. The trend towards deregulation.

Module II: The downturn – A stress test for regulations, companies and deals.

Class 5. The traditional legal framework for managing distressed deals and financial service providers. The basics of creditors' rights and bankruptcy law. Special rules for banks, insurance companies and pension funds. Some earlier tests of the regulatory system, including the S&L failures and Long-Term Capital Management.

Classes 6 & 7. The distress deepens and spreads. Deal protections against asset value declines and why they didn't work. Contagion and cascading defaults. Ratings and valuation. Contractions in related markets. Bear Sterns hedge funds. AIG and credit default swaps. Fannie Mae and Freddie Mac. The Lehman Brothers bankruptcy. The credit crunch. Recession. The international dimension.

Module III: Legal innovation and response.

Classes 8. The law and damage control. Regulatory tools for dealing with system-wide financial distress. TARP. Other legislation. Recapitalizations. Asset purchases. Mortgage relief. The US response in comparative perspective. Transnational regulation and coordination. The response in Europe and Asia. The developing world.

Classes 9 & 10. Allocating responsibility and blame. Lapses of judgment, integrity, and compliance. Major theories of civil liability. Statutory remedies. Breaches of fiduciary duty. Criminal sanctions and deterrence. The US sentencing guidelines for financial crimes. Foreign plaintiffs and US defendants in the US courts.

Classes 11 & 12. Looking forward – Designing a better regulatory framework. The right balance among innovation, risk, and public protection. Solvency, liquidity and the adequacy of credit markets – What have we learned? Individual institution risk vs. systemic risk. The regulation of derivatives. Proposed approaches – the pros and cons. What will be expected of managers and companies in the new environment?

Readings:

There is no textbook. Material will be posted on Stellar, and there may also be a packet at CopyTech.

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