Syllabus

Preliminary Caveat: The dates provided here are based on the pace that we anticipate. If variations from this schedule are needed, they will be noted in class.

I. The Institutions & Economics of Securities Markets

The course will begin with a survey of the different types of securities markets, the persons who participate in them, and the fundamental mechanics of their operation. The social functions of securities markets – providing investors with liquidity, allocating risk, and aggregating information through pricing – will be considered followed by an exploration of how markets perform these functions, i.e., market microstructure analysis. The role played by regulation will be introduced by case studies of markets that have failed and disappeared.

A. Class #1 – Tuesday, Sept. 3

1. Course Outline

2. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 1 (Introduction)

3. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 2 (Trading Stories) (only read pp. 11-22; do not read past 2.6 at the bottom of p. 22)

B. Class #2 – Thursday, Sept. 5

1. Freidrich Hayek, The Use of Knowledge in Society, American Economic Review, XXXV, No. 4, pp. 519-30 (September 1945)

2. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 9 (Good Markets)


C. Class #3 – Tuesday, Sept. 10

2. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 8 (Why People Trade)

D. Class #4 – Thursday, Sept. 12
1. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 5 (Market Structures) and Chapter 19 (Liquidity)

E. Class #5 – Tuesday, Sept. 17
1. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 14 (Bid/Ask Spreads)

F. Class #6 – Thursday, Sept. 19
1. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 27 (Floor Versus Automated Trading Systems)

G. Class #7 – Tuesday, Sept. 24
1. Previous class readings continued

H. Class #8 – Thursday, Sept. 26
3. NASDAQ of the North (Dec. 2, 1999)

I. Class #9 – Tuesday, Oct. 1
1. MIDTERM EXAM FOR FIRST 50 MINUTES OF CLASS
2. Previous class readings continued

J. Class #10 – Thursday, Oct. 3
1. Previous class readings continued. You may wish to begin reading the large assignment for Class #11 at this time.

II. The Regulation of Market Structure

The rules by which a securities market operates are important determinants in how well it performs its various social functions, its real costs of operation, who among the participants – the various types of traders and market actors such as brokers, dealers and exchanges – profit and who do not, and the capacity of market institutions to innovate to perform these functions better and/or at less real cost. One such set of rules relates to transparency: who knows (and when) the prices at which securities are being offered and sold (“bid” and “ask” quotes) and the prices at which actual trades occurred. A second set concerns execution by brokers of customer orders: the broker’s best execution and fiduciary duties to its customer, the abandonment of fixed commissions, rules covering the special situation where a broker matches its own customers’ buy and sell orders (“internalization”), and the receipt by brokers of payment to steer their customers’ order flow to a particular market. A third set of rules concerns the size and disclosure of markups when a customer directly buys from, or sells to, a dealer rather than through a broker. A fourth set of rules concerns procedures to assure that the parties to an executed trade actually perform their respective contractual obligations (clearance and settlement and broker and exchange guarantees of performance).

A. Class #11 – Tuesday, Oct. 8


2. Craig Pirrong, The Thirty Years War, Securities & Investment, Regulation (Summer 2005)


Regulation NMS Do?”; stop reading just before the problem at the bottom of p. 586).


10. Section 11A of the Securities Exchange Act of 1934

B. Class #12 – Thursday, Oct. 10

1. Please be prepared to answer up through question #5 in the Problem Set


C. Class #13 – Tuesday, Oct. 15

1. Please be prepared to answer up through Question #11 in the Problem Set

D. Class #14 – Thursday, Oct. 17

1. Please be prepared to answer the up through the final question in the Problem Set (Question #21)

2. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 5 (pp. 101-02 on transparency only)


E. Class #15 – Tuesday, Oct. 22

1. Previous class readings continued

F. Class #16 – Thursday, Oct. 24
1. Previous class readings continued

III. The Regulation of Liquidity Provision & Related Services

Buy and sell orders from traders do not always arrive in a way that permits simultaneous matches. In such situations, liquidity providers (i.e., market makers) supply liquidity services by buying and selling securities for their own account. The role of specialists in reducing systemic risk, including a review of their performance during the 1987 crash and liquidity-provision obligations then and now, will also be considered. The move from quotations in increments no smaller than an eighth of a dollar to quotations in increments of one cent and the effects of this move on investor costs of trading (the “bid/ask spread”) and on market quality will also be considered. We will also consider the role of brokers as the agents who allow traders to access markets, examining their legal obligations to their clients.

A. Class #17 – Tuesday, Oct. 29

1. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 7 (Brokers) and Chapter 25 (Internalization, Preferencing, and Crossing)

2. Kevin Haeberle, Structural Inconsistency: Reconciling the SEC’s Nascent Stock-Trading Regime with the Securities Regulation Canon (article to be emailed to students or provided on Courseweb)

B. Class #18 – Thursday, Oct. 31

1. Previous class readings continued

C. Class #19 – Tuesday, Nov. 5


2. Securities Act of 1933, Section 17(a)


4. Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (2d Cir. 1943)

5. Newton v. Merrill Lynch, 259 F.3d 154 (3rd Cir. 2001)

D. Class #20 – Thursday, Nov. 7

1. Lehl v. SEC, 90 F.3d 1483 (10th Cir. 1996)

E. Class #21 – Tuesday Nov. 12

2. Shivangi v. Dean Witter, 825 F.2d 885 (5th Cir. 1987)

F. Class #22 – Thursday, Nov. 14


G. Class #23 – Tuesday, Nov. 19

1. Hanly v. SEC, 415 F.2d 589 (2d Cir. 1969)
2. Sample Brokerage Trade Confirmation
4. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – pp. 166-68
5. FINRA Rule 2310. Recommendations to Customers (Suitability)
6. FINRA Rule 2510. Discretionary Accounts
7. Rule 15c1-7
8. David Raymond Koos, Former Registered Representative, New York Stock Exchange Hearing Panel Decision 01-122, August 1, 2001
9. Hotmar v. Listrom & Company, Inc., 808 F.2d 1384 (10th Cir. 1987)

H. Class #24 – Thursday, Nov. 21

3. Upton v. SEC, 75 F.3d 92 (2d Cir. 1996)
IV. The Regulation of Traders (including manipulation, short selling, & trading on non-public information)

The economics of market microstructure can help our understanding of a variety of kinds of regulations relating to traders. Traders may try to influence prices in ways that permit them to buy low and sell high when there has been no change in the economic fundamentals of the securities involved. The meaning of “manipulation” will be considered both in terms of market microstructure economics and under the Exchange Act. Practical difficulties of proof will be assessed as well. Rules restricting short selling, including the deregulatory oriented Reg SHO and temporary short sale reregulation of the shares of financial intermediaries, will be considered from an economic theory perspective as well. Lastly, persons who trade on the basis of non-public information can make supernormal profits. This highly regulated phenomenon will also be considered from the market microstructure point of view, including a non-conventional examination of areas of legal, yet controversial trading based on non-public information.

A. Class #25 – Tuesday, Nov. 26

1. Securities Exchange Act, Section 9 and Section 15(c)(1)
2. Securities Act of 1933, Section 17(a)
3. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 12 (Bluffers and Market Manipulation)
5. Excerpts from Thomas Lee Hazen, Securities Regulation Cases and Materials (Seventh Edition), Chapter 13 (Manipulation) (pp. 862-866)

[THANKSGIVING BREAK]

B. Class #26 – Tuesday, Dec. 3

1. United States v. Mulheren, 938 F.2d 364 (2d Cir. 1991)

3. Markowski v. SEC, 274 F.3d 525 (D.C. Cir. 2001)


C. Class #27 – Thursday, Dec. 5


2. Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners, Oxford University Press 2003 – Chapter 29 (Insider Trading)