**DOES THE DODD-FRANK ACT ADDRESS THE PROBLEMS IN THE FINANCIAL MARKETS?**

**By DAVID FRANASIAK, REBECCA KONST, and ERIC ROBINS (AUGUST 2012)**

The Dodd-Frank Act ("Dodd-Frank"), enacted in the wake of the financial crisis of 2008, aims to address problems in the markets that government regulators face. During this recent financial crisis, large financial institutions including, but not limited to, Bear Stearns and American International Group, Inc. (AIG), required governmental assistance to stem the systemic impact on the markets from problems generated by their institutions. Though government officials acted to stem the systemic risks in these cases, others cases such as Lehman Brothers, for which government officials did not intervene, exposed the risk that some of these large financial institutions posed to the market. The intent of Dodd-Frank, at least from the point of its sponsors, was to prevent the occurrence of these sorts of events again.

The financial market events which occurred in 2008 followed by the election of President Barack Obama and the start of the 110th Congress in 2009, lead to the House and then the Senate, moving forward to pass financial reform legislation known as the Dodd-Frank Act in 2010. Signed into law on July 21, 2010, the Dodd-Frank Act made it through Congress with support mostly from Democrats. When Republicans gained control of the House in 2011, efforts were undertaken to modify the law or restrict funding of the regulators who were tasked with implementing the rules under the Dodd-Frank Act.

More than 2 years after the Dodd-Frank Act became law, only slightly more than one-third of its rules are in place.[1] Despite efforts to move rulemakings forward, many areas of the law are still not in place and it is unclear when others will be. Still, it is not the inability of regulators to move forward with these rulemakings or increased Congressional oversight that has hampered this rulemaking process. There are other issues such as challenges both to: (1) the constitutionality of key provisions of the Dodd-Frank Act; and (2) the economic cost-benefit analysis that agencies have undertaken to move forward with their rules. For instance, in July 2011, the D.C. Circuit Court invalidated the Securities and Exchange Commission (SEC) "proxy access" rule under Dodd-Frank Act section 971.[2] This rule would have authorized the SEC to adopt a rule allowing shareholders who may nominate directors or officers to a company's board to have their nominees included in the company proxy materials sent to all of a company's shareholders. The D.C. Circuit Court invalidated this rule, based on the lack of economic support considered by regulators during the adoption of the rule. Since this decision, the rulemaking process at the SEC slowed, and at least for this rule SEC Chairman Mary Schapiro decided not to revisit it.[3] Earlier this year, the SEC, bowing to pressure from Congress in addition to the courts, moved forward with guidance on "Economic Analysis in SEC Rulemakings."[4] This guidance seeks to structure the process for SEC rulemakings

[1] Dodd-Frank Progress Report, Davis Polk Regulatory Tracker (July 18, 2012), *available at* http://www.davispolk.com/files/Publication/15a76992-d82a-4d15-a2db-fcde9effc3d0/Presentation/PublicationAttachment/b82f9d23-0edc-49eb-af02-ff97ff34bd56/071812_Dodd.Frank.Progress.Report.pdf.
[2] *Chamber of Commerce of U.S. and Business Roundtable v. SEC,* No. 10-1305 (D.C. Cir. July 22, 2011).
[3] Statement by SEC Chairman Mary Schapiro on Proxy Access Litigation (Sept. 6, 2011), *available at* http://www.sec.gov/news/press/2011/2011-179.htm.
[4] Current Guidance on Economic Analysis in SEC Rulemaking (Mar. 16, 2012), *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

so that appropriate economic analysis is included in the rules from start to finish. While the SEC has been one of the more high profile regulators under attack for its lack of cost-benefit analysis, the Commodity Futures Trading Commission (CFTC) has faced similar criticism.[5] Once the Dodd-Frank Act became law, the CFTC moved quickly in proposing rules to meet its statutory deadlines. But the reality of this process led to problems in that rules were considered in no general order, which then led to confusion among market participants and the need to correct some rules that had been earlier proposed. When the CFTC finalized a rule on position limits late last year that would limit holdings in certain physical commodity futures and swaps,[6] trade groups, Securities Industry and Financial Markets Association (SIFMA) and International Swaps and Derivatives Association (ISDA), challenged this rule in the D.C. Circuit Court[7] based upon the potential costs that the rule would impose on their industry. Similar to the SEC, the CFTC has indicated that it considered cost-benefit analysis in its rules and brought in specific staff to handle this analysis.[8] Despite efforts to appease Congress and the D.C. Circuit Court,[9] neither of these agencies has a statutory requirement to consider cost-benefit analysis in their rulemakings.

However, some financial regulators have made efforts to demonstrate that their rulemaking processes include cost-benefit analysis.[10] Notably, one of the agencies created by the Dodd-Frank Act, the Consumer Financial Protection Bureau (CFPB), has made great efforts to show that it considers cost-benefit analysis in its rulemakings.[11] CFPB Director Richard Cordray testified before the House Oversight and Government Reform Committee's Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs on July 24, 2012 that the CFPB considers "potential alternative approaches to exercising [ ] discretionary authority,…the benefits and costs of these alternatives for consumers and providers, including whether what kinds of effects different alternatives would have on access to consumer financial products and services."[12] Other regulators

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[5] An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act, Office of the Inspector General of the CFTC (April, 25, 2011), *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_041511.pdf; *see also* An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act, Office of the Inspector General of the CFTC (June 13, 2011), *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_investigation_061311.pdf.

[6] Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 (Nov. 18, 2011) (to be codified at 17 C.F.R. pt. 1, 150 and 151), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-28809-1a.pdf.

[7] *ISDA/SIFMA v. CFTC*, No. 11-2146-RLW (D.D.C.) (filed Dec. 2, 2011).

[8] Statement by CFTC Chairman Gary Gensler at an Open Meeting to Consider Dodd-Frank Act Rules (May 10, 2012), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement051012.

[9] The D.C. Circuit Court has issued several rulings striking down SEC rules based upon claims of failing to include cost-benefit analysis considerations. *See generally, Chamber of Commerce of U.S. v. S.E.C.,* 412 F.3d 133 (D.C. Cir. 2005) and 443 F.3d 890 (D.C. Cir. 2006) (Court ruled to vacate provisions of the SEC's mutual fund "governance" rule); *American Equity Investment Life Insurance Company v. S.E.C.,* 572 F.3d 923 (D.C. Cir. 2009 and 2010 WL 2813600 (D.C. Cir. July 12, 2010) (Court vacated SEC Rule 151A aimed to expand oversight of fixed indexed annuities); and *NetCoalition v. S.E.C.,* 2010 WL 3063632 D.C. Cir. Aug. 6, 2010) (Court remanded to the SEC its order approving the NYSE Arca ArcaBook fees rule for failure to adequately explain the basis for the approval).

[10] GAO Report to Congress, *Dodd-Frank Act Regulations: Implementation could Benefit from Additional Analysis and Coordination* (Nov, 2011), *available at* http://www.gao.gov/assets/590/586210.pdf (pages 9-12).

[11] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, section 1022, 124 Stat. 1376-2223 (2010).

[12] Written Testimony of CFPB Director Richard Cordray to the House Oversight and Government Reform Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs (July 24, 2012), *available at*

such as the Federal Deposit Insurance Corporation (FDIC) and Financial Stability Oversight Council (FSOC) have noted efforts at cost-benefit analysis in their rulemakings too. Of course, there is a challenge to the authority of the CFPB and the FSOC in the D.C. Circuit Court on grounds that these agencies "violate the Constitution's separation of powers by creating independent agencies that are unaccountable because they are not susceptible to constitutional checks and balances."[13]

The effectiveness of the Dodd-Frank Act will not be known until there is another financial disaster. To at least have an idea as to the effectiveness of Dodd-Frank, it is important to examine features of the law that were intended to anticipate problematic areas in the markets and separate political and financial decisions. These include: orderly liquidation authority; Volcker rule; data standardization; derivatives; and international regulatory impacts.

## ORDERLY LIQUIDATION AUTHORITY

This is a framework under Title II of the Dodd-Frank Act that would allow for a resolution of a financial company and permit the Federal Deposit Insurance Corporation (FDIC) to act as a receiver of that company. The FDIC has moved forward with a framework to clarify the claims process and priorities for secured and unsecured creditors and the FDIC and the Federal Reserve have coordinated a process for the drafting of living wills (which would provide for how an entity could be resolved).

As with many of the Dodd-Frank Act rulemakings, only some of the rules for orderly liquidation authority have been finalized.[14] Concerns need to be addressed about firms that operate across jurisdictions with different rules as well as for banks that have become "too big to fail" (TBTF). Since the financial crisis, many financial institutions have grown in size and some have argued that regulators have developed a vested interest in preserving such firms because the failure of such a large firm could lead to a bigger crisis than in 2008. Some House Republicans, such as Spencer Bachus (R-AL), have argued that Dodd-Frank makes "the problem of 'too big to fail' even worse and taxpayers are more exposed to bailouts than before."[15] Securities law expert and Columbia University Law School Professor John Coffee asserts in a recent paper on the Dodd-Frank Act that "regulatory action to liquidate a TBTF institution could never occur quickly because it would require high coordination and unanimity among regulators."[16]

Still, the real test will come when a bank or non-bank needs to be resolved. The problematic resolution of Lehman Brothers may not serve as a model for orderly resolution. After all, though the process in the U.S. may have run smoothly, the process overall was disjointed since it took a

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http://www.consumerfinance.gov/speeches/written-testimony-of-richard-cordray-before-the-house-oversight-and-government-reform-subcommittee-on-tarp-financial-services-and-bailouts-of-public-and-private-programs/.

[13] *State Nat'l Bank of Big Spring v. Geithner*, No. 1:12-cv-01032-ESH (D.D.C. filed June 21, 2012), *available at* http://cei.org/sites/default/files/SNB%20v%20Geithner%20-%20Complaint.PDF.

[14] Certain Orderly Liquidation Authority Provisions under Title II of the Dodd-Frank Act (July 15, 2011), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-07-15/pdf/2011-17397.pdf.

[15] Protecting Taxpayers by Ending Bailouts, Statement by Representative Spencer Bachus (R-AL) (May 31, 2012), *available at* http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=297809.

[16] John C. Coffee Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated,* Columbia Univ. Sch. Of Law Working Paper No. 414 (Jan. 9. 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1982128.

long time to resolve. Lehman Brothers had assets in the U.K. and the U.S., and problems arose from both jurisdictional complications and the complexity of the U.K. bankruptcy laws. To this day, unresolved issues relating to outside lawsuits arising from this bankruptcy remain. But suppose that a TBTF institution is about to fail. The argument all along is that the law allows for the FDIC to pick winners and losers among the creditors and could decide to favor those with name recognition or those that offer some political benefit to the party in power. Essentially, the FDIC has the authority to decide the type of financing available to a bridge company that acquires the institution's failed assets. Despite claims that this authority would end TBTF, the FDIC is likely to promote TBTF as it will have to choose who to support. There is no clear road to resolution under Dodd-Frank because Congress did not, for Congressional and jurisdictional reasons, "mirror" this to the well-established bankruptcy laws and specialized courts. Without this connection to the U.S. Bankruptcy Code, case law and precedent has been lost.[17]

## VOLCKER RULE

This rule, devised by the former Federal Reserve Chairman Paul Volcker, seeks to limit the risk that financial institutions take on. As proposed, the Volcker rule prohibits a bank or institution that owns a bank from engaging in proprietary trading that is not at the behest of its clients, and from owning or investing in a hedge fund or private equity fund, as well as limiting the liabilities that the largest banks could hold. The Volcker rule has become one of the more contentious rules in the Dodd-Frank Act. When the rule was to come into effect this past July, many in industry raised concerns with the ability to meet such statutory requirements and the inability of regulators to define "proprietary" after the rule was proposed in October 2011. Regulators eventually gave in to the pressure from Congress and industry and in April 2012 clarified that the effective date of the rule would be pushed back from July 2012 to July 2014.[18] In the end, the Volcker Rule may not be too effective because of the numerous complexities in the rule's application, vague definitions, and the possibility that the exemptions to the rule could overwhelm the rule itself. Furthermore, there is a lack of evidence that proprietary trading contributed to the failure of any institution during the 2008 financial crisis.[19]

Though House Financial Services Committee Ranking Member Barney Frank (D-MA)[20] called on regulators to finalize this rule by early September 2012, regulators have indicated that the completion of this rule could be possible later this year. It appears that whatever the outcome of the rule, it is likely to be challenged either through a legislative modification or in the courts. Legislation introduced by Senator Mike Crapo (R-ID), S. 2223, in March 2012, already sought to postpone the effective date of the Volcker rule.[21] House Financial Services Committee Chairman Spencer Bachus (R-AL), who has raised concerns with this rule, recently solicited from the public "ideas and suggestions on how to formulate a less burdensome legislative alternative to the Volcker Rule" setting a deadline of September 7, 2012 so that the Committee could prepare for a hearing on this

[17] United States Code Title 11- Bankruptcy.

[18] Volcker Rule Conformance Period Clarified (April 19, 2012), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20120419a.htm.

[19] *See* Coffee, *supra* note 16.

[20] Statement of Representative Barney Frank (D-MA) on Volcker Rule Implementation (Mar. 22, 2012), *available at* http://democrats.financialservices.house.gov/FinancialSvcsDemMedia/file/BF%20Statements/3_22_2012%20BF%20Statement%20on%20Volker%20Rule%20Imiplementation.pdf.

[21] S. 2223, 112th Cong. §2 (2012), *available at* http://thomas.loc.gov/home/gpoxmlc112/s2223_is.xml (proposed Mar. 22, 2012).

rule.[22] Organizations such as SIFMA[23] and the U.S. Chamber of Commerce,[24] have already voiced concerns in their comment letters and reports. As in other Dodd-Frank related cases (such as rules on position limits and proxy access), this could lead to a challenge of the rule in the D.C. Circuit Court.

## DATA STANDARDS

An issue that has dogged regulators' abilities to address serious financial issues in the markets is the availability and understanding of data. The lack of a "universal global entity identification system" has been a problem for decades and the financial crisis exposed the depth of the problem. The fall of Lehman Brothers in 2008 demonstrated that there was no one "able to view the total extent to which important market participants were exposed to Lehman and its many legal entities, nor how market participants were connected to each other in global markets."[25] Senator Jack Reed (D-RI) cited this as a reason for the Office of Financial Research (OFR) in the Dodd-Frank Act. He stated that:

> "[f]or far too long, those charged with keeping the banking system stable have lacked the data and analytical power to keep up with complex and constantly evolving financial markets and products…The OFR gives regulators the tools to evaluate the stability of the entire financial system, not just individual banks. There will always be risks in the market, but if properly managed and staffed, this office can help spot where risk is building up in the system and perhaps help deflate them before they burst on taxpayers."[26]

Though the Federal Reserve has traditionally been a leader in this area, and even set up an office following the enactment of Dodd-Frank focused on monitoring global financial risks and analyzing the implications of those risks called the "Office of Financial Stability Policy and Research,"[27] supporters of Dodd-Frank clamored for a new centralized agency. This new agency is the OFR, which is located within the Treasury Department. It is a particularly unique agency because it is independently funded (through assessments on industry), issues its annual reports to Congress (without approval by the Treasury Department), and requires a Senate-confirmed agency head (which is still pending).

Internationally, there have been efforts to standardize data through the use of the "Legal Entity Identifier" (LEI), which "is a unique code to identify legally distinct entities that engage in financial market activities." The 2012 OFR annual report noted that "[l]ongstanding issues with incompatible systems have contributed to delays and errors in risk assessments for both supervisors and industry

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[22] MJ Lee, *Bachus Considering Volcker Alternatives,* POLITICO, Aug. 7, 2012, *available at* http://www.politico.com/news/stories/0812/79461.html.
[23] SIFMA and Oliver Wyman, Study -The Volcker Rule: Considerations for Implementation of Proprietary Trading Regulations (Dec. 22, 2010), *available at* http://www.sifma.org/issues/item.aspx?id=22888.
[24] Anjan Thakor and John Simon, U.S. Chamber of Commerce Center for Capital Markets Competitiveness, *The Economic Consequences of the Volcker Rule* (July 19, 2012), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/17612_CCMC-Volcker-RuleFINAL.pdf.
[25] Office of Financial Research 2012 Annual Report (July 2012), *available at* http://www.treasury.gov/initiatives/wsr/ofr/Documents/OFR_Annual_Report_071912_Final.pdf (page 118).
[26] Senator Jack Reed (D-RI), Statement on Nomination of Richard Berner to Lead New Office of Financial Research (Dec. 16, 2011), *available at* http://www.reed.senate.gov/news/release/reed-statement-on-nomination-of-richard-berner-to-lead-new-office-of-financial-research.
[27] Press Release, Federal Reserve Creation of the Office of Financial Stability Policy and Research (Nov. 4. 2010), *available at* http://www.federalreserve.gov/newsevents/press/other/20101104a.htm.

participants."[28] The OFR worked with the Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system, on this global initiative to address the issue. In May 2012, as noted in the 2012 OFR annual report, the International Organization for Standardization (ISO) published a LEI standard, consisting of a 20-character alphanumeric code and a minimal set of reference data. In June 2012, the G20 endorsed the FSB's recommendations calling for the implementation of a global LEI by mid-2013, consistent with the ISO standard.[29]

In the interim, the U.S.'s CFTC established the CFTC Interim Compliant Identifier for reporting, as a transition to the global LEI.[30] It was finalized in a July 2012 order[31] and designates the DTCC-SWIFT as the provider of the legal entity identifiers (LEI), which will be used by registered entities and swap counterparties in complying with the CFTC's swap data reporting regulations. These identifiers are essential tools for the aggregation of derivatives data. Once the global LEI system is implemented and operational, the CFTC anticipates that the interim identifier will transition into the global LEI.[32]

The OFR cites the need for standardized data so as to allow regulators to understand and properly oversee markets and to "analyze threats to financial stability." So far, concerns regarding the ability of regulators to maintain the confidentiality of the data they collect have been muted. Should there be an unauthorized release of data, industry could raise concerns as to the safety and security of the data that regulators collect from them.

## DERIVATIVES

Title VII of Dodd-Frank creates a mechanism to deal with the trading of derivatives. The aim was to make the trading of these instruments more transparent and to reduce risk. Rules under Dodd-Frank provide for the trading of these instruments through a centralized clearinghouse. But some critics argue that these rules merely shifted the risk from traders to the clearinghouse and that failure of such a clearinghouse could cause a systemic event. In order for such a system to work, the clearinghouse would need to have a degree of control over the market. With the end-user trading exemption to the rule,[33] many firms that use the derivatives markets for ordinary hedging are not required to trade through clearinghouses and therefore do not need to meet margin or other requirements. As these firms are a larger part of the market than they disclose, much of the trading of derivatives could be exempt from this market. This has led some to assert that the legislation and the lobbying behind these rules created "a strange hybrid that could either reduce or exacerbate systemic risk."[34] This could then be compounded by "non-standardized swap contracts that cannot be easily cleared" and that moving complex derivatives into a clearinghouse could increase "the

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[28] OFR 2012 Annual Report, *supra* note 25, at 117.
[29] G20 Leaders Declaration, Point 44 (June 2012), *available at* http://g20.org/images/stories/docs/g20/conclu/G20_Leaders_Declaration_2012_1.pdf
[30] Press Release, CFTC Announces Designation of DTCC-SWIFT as the Provider of CFTC Interim Compliant Identifiers (July 24, 2012), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6310-12.
[31] CFTC Order Determining the Availability of a Legal Entity Identifier (July 24, 2012), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/ciciorder.pdf.
[32] CFTC Press Release, *supra* note 30.
[33] 17 C.F.R. §39.6 (2012) GPO Access, *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;rgn=div2;view=text;node=20120719%3A1.4;idno=17;sid=6eccbcbbad8223b568e674ad0aa1616f;cc=ecfr;start=1;size=25.
[34] *See* Coffee, *supra* note 16.

operational risk for the clearinghouse because it will be required to clear products that it cannot easily price."[35]

However, exchange trading through these clearinghouses could also ensure "that price and other trade-related information is publicly displayed and is directly available to all market users"[36] which in turn could ensure "efficient price discovery and pricing of assets"[37] and encourage those who are exempt under Dodd-Frank from trading through these clearinghouses (such as end-users) to seek to clear trades on exchanges and through these clearinghouses. Regulators such as the CFTC have sought to reduce risks with trading via these clearinghouses, citing the completion of rules establishing new derivatives clearing organization risk management requirements, as well as rules on client clearing documentation and risk management.[38]

## INTERNATIONAL REGULATORY IMPACTS

With multiple U.S. financial regulators implementing a variety of Dodd-Frank Act rules, not only are there coordination concerns among the regulators in the U.S., there are concerns that many of the rules could conflict with standards followed abroad.  Though many of the U.S. regulators have claimed to be working with their counterparts overseas, it is unclear how conflicts will be resolved. Some regulators such as CFTC Chairman Gary Gensler have noted the need for strong protections in rules implemented under the Dodd-Frank Act because of the need to protect U.S. markets from the so-called less regulated markets abroad.[39] It is entirely unclear how issues that arise in foreign countries (such as the U.K.) that impact the U.S. will be resolved.  Recent issues such as with London Interbank Offered Rate (LIBOR), trading at JP Morgan Chase, problems with the AIG financial products unit and Standard Chartered, have led to possible division among regulators.  It is unclear in cases such as Standard Chartered where state regulators individually seek to challenge federal regulators on the international stage, how this could impact relations among national regulators, particularly at a time where coordination among regulators is necessary to fully implement financial reform rules.  It is also unclear where there are conflicts between regulators in different countries over a multi-jurisdictional entity where ultimate authority and rule of law lie.  For example, an entity such as AIG is based in the U.S., yet the problems arose from a subsidiary of AIG located in the U.K., that impacted AIG in the U.S.  Other examples include the trading problems at JP Morgan Chase that were based in the U.K. but again showed up on the bottom line of JP Morgan Chase in the U.S.  Somewhat different are the issues arising from the LIBOR case. LIBOR is a bank lending rate set primarily by banks mostly in the U.K. but is relied upon as a short term benchmark by banks and financial institutions worldwide.  With alleged falsified rate reporting by banks in the U.K. that determine the LIBOR, it has been a challenge for U.S. regulators to pursue this matter.

But with the Dodd-Frank Act itself, there are inherent conflicts with standards agreed to internationally.  Notably the rules concerning the credit rating requirements under the Dodd-Frank Act conflict with the Basel Capital Standards ("Basel").  While Basel sought to standardize

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[35] *See* Coffee, *supra* note 16.
[36] Committee of European Securities Regulators (CESR), Consultation Paper: "Standardisation and exchange trading of OTC derivatives" (July 19 2010), http://www.esma.europa.eu/system/files/10_610.pdf (pages 17-18).
[37] *Id.*
[38] Testimony of CFTC Chairman Gary Gensler before the House Committee on Agriculture (July 25, 2012), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-119.
[39] *Id.*

requirements that banks hold capital of certain standards, section 939 of the Dodd-Frank Act called for alternative standards to determine the creditworthiness of capital held by U.S. institutions. But as with other Dodd-Frank rulemakings, not all of the U.S. regulators have finalized their rules in this area. So of course, uncertainty remains.

**OTHER MARKET VULNERABILITIES**

Despite the aims of Dodd-Frank, there are areas of the market that were not addressed including, but not limited to: housing; tri-party repos; money market funds; cyber security; and high speed trading. While there has been discussion about addressing these, most remain areas that the Financial Stability Oversight Council cited as "ongoing vulnerabilities" in its annual report.[40]

A repo or repurchase agreement is "a sale of securities by a dealer to an investor, accompanied by a contract to repurchase the securities for an agreed upon price at a later date."[41] Tri-party repo transactions "are a type of repurchase agreement involving a third party, the tri-party agent…who facilitates settlement between dealers (cash borrowers) and investors (cash lenders)."[42] The tri-party agent "maintains custody of the collateral securities, processes payment and delivery between the dealer and the investor and provides other services, including settlement of cash and securities, valuation of collateral, and optimization tools to allocate collateral."[43] With the market for tri-party repos valued at $1.7 trillion,[44] FSOC claimed that the market remains "a significant source of potential contagion" because of: (1) reliance on participants for intraday credit extensions; (2) weak risk management practices; and (3) a lack of an orderly liquidation mechanism of tri-party repo collateral of a defaulting dealer.[45] The OFR also noted that an understanding of the repo market "is crucial to assessing the vulnerabilities in the financial system and designing policy tools to mitigate them."[46]

Money market funds, with a U.S. market of $2.56 trillion in assets as of May 2012,[47] rely on short term funding and have been promoted as stable investments. Regulators in the U.S. however point to the problems with the Reserve Primary Fund in 2008 which "broke the buck" after it was unable to maintain a stable net asset value (NAV) following a number of redemptions of its shares in light of the fund's exposure to Lehman Brothers. Since 2008, rules adopted by the SEC for money market funds have improved investor protections and during the Eurozone crisis in 2011, there were little to no problems associated with these funds. Still, regulators, led by SEC Chairman Mary Schapiro, have cited the need for reforms to these funds because of the potential systemic threat

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[40] FSOC 2012 Annual Report (July 18, 2012) *available at* http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf (page 133).

[41] Karen B. Peetz, Vice Chairman and Chief Executive Officer, Financial Markets and Treasury Services, The Bank of New York Mellon Before the Subcommittee on Securities, Insurance and Investment Committee on Banking, Housing and Urban Affairs United States Senate (August 2, 2012), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=f3d7bda6-1e10-4a64-83e4-88390a1daab4.

[42] *Id.*

[43] *Id.*

[44] FSOC 2012 Annual Report, *supra* note 40.

[45] FSOC 2012 Annual Report, *supra* note 40.

[46] OFR 2012 Annual Report, *supra* note 25, at 124.

[47] FSOC 2012 Annual Report, *supra* note 40, at 75.

they pose to the taxpayer.[48] The FSOC report also notes the concern that money market funds could be subject to runs if the net asset value exceeds the liquidation value of the fund.[49]

Housing still remains a major issue. Many point to it as the cause of the financial crisis, as many financial firms such as Lehman Brothers were highly involved in the securitization market for mortgages. Yet despite the importance of this issue and the central role that housing played in the financial crisis, housing market reform was not addressed by Dodd-Frank. Instead, the Obama Administration addressed housing reform separately through a series of programs that have largely been unsuccessful. Legislation reforming the regulation of Fannie Mae and Freddie Mac will be a high priority of Congress in the future. Issues that will have to be addressed include whether secondary mortgages markets will function efficiently without a government guarantee, preservation of the thirty year fixed interest rate mortgage, and whether government should incentivize homeownership as national policy. These issues dovetail with tax reform and banking reform, and are the successor issues to Dodd Frank.

There are of course other market vulnerabilities, including: (1) cyber security attacks, whether countries such as Iran will retaliate against sanctions with cyber-attacks on financial institutions; and (2) potential risks from high speed trading, that are "difficult to assess" under non-normal market conditions because this type of trading "is opaque and difficult to monitor (particularly in real time)."[50]

## CONCLUSION

Still, the Dodd-Frank Act and its subsequent rulemaking represent great strides in addressing the vulnerabilities in the financial system. Even if all of the rules are implemented in accordance with the law, it would not likely prevent another crisis as there are areas beyond the scope of the law that need to be addressed. The real issue with Dodd-Frank now is the ability of regulators to implement rules: (1) without exemptions to the rules overwhelming the rules themselves; and (2) that can withstand the legislative modifications and/or judicial challenges.

[48] Testimony of SEC Chairman Mary Schapiro before the Senate Banking Committee, *Perspectives on Money Market Mutual Funds Reforms* (June 21, 2012), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=66f4ddb5-4823-4341-bad9-8f99cdf5fe9a.

[49] FSOC 2012 Annual Report, *supra* note 40, at 132.

[50] FSOC 2012 Annual Report, *supra* note 40, at 136.