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THE DODD-FRANK ACT:
A NEW DEAL FOR A NEW AGE?

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I. INTRODUCTION

Almost two years ago, I wrote an essay for this journal, in which I attempted to reflect upon the fundamental regulatory challenges in the financial sector brought to life by the recent crisis. In the short period that has passed since that essay was published, the world of finance and financial regulation has gone through many important changes. Perhaps the most significant among them was the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act or the Act), the centerpiece of the post-crisis financial regulation reform in the United States.

This short essay is an attempt to present a few early “big-picture” observations on the broad regulatory philosophy underlying the Dodd-Frank Act. Echoing the title of my 2009 essay, the question raised here is whether the Dodd-Frank Act, in fact, provides a blueprint for the twenty-first-century version of the New Deal – a qualitatively new approach to resolving the regulatory challenges posed by today’s financial markets. Answering this complex question in full is hardly possible at this stage in the process, when many critical details of the new legal and regulatory regime are yet to be determined. Nevertheless, it is

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worthwhile to reflect upon some of the overarching themes built into the foundation of the Act, bound to shape the course of the ongoing reform.

II. ASSESSING DODD-FRANK: FOCUS ON REGULATORY PHILOSOPHY

The Dodd-Frank Act is often characterized as a major overhaul of the U.S. system of financial sector regulation and the most fundamental set of regulatory reforms in this area since the New Deal.4 To a great extent, this is true: the regulatory framework established in principle in the 1930s, in response to the Great Depression and its perceived causes, has been remarkably resilient and survived without major alterations for over seven decades.5 The sheer scope of reforms mandated by the Dodd-Frank Act puts this piece of legislation in a class of its own. This massive document seeks to address some of the most important issues raised by the recent financial crisis and to fill many significant gaps in the pre-crisis regulatory framework.

Despite its great length and undisputed significance, the Act often falls short of achieving its stated ambitions. Among the most common criticisms of the new legislation is the fact that it is simply too unwieldy and contains too many loopholes and too little substantive details on what exactly needs to be done to ensure that financial innovation does not jeopardize financial stability.6 In fact, most of the actual decisions that should reflect

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4. See, e.g., Viral Acharya et al., A critical assessment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, VoxEU.ORG (Nov. 24, 2010), (“In the US, the Dodd-Frank Act passed earlier this year represents the most sweeping set of reforms to the US financial sector since the Great Depression.”), http://www.voxeu.org/index.php?q=node/5692.

5. This is not to say that the regulatory framework remained completely unchanged over the years, as Congress adopted many laws altering or revising it in a variety of ways. One of the most significant legislative changes was the adoption of The Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (2000) (codified as amended in scattered sections of 12. U.S.C.) (commonly referred to as the Gramm-Leach-Bliley Act), which repealed the prohibition on affiliations between commercial and investment banks under the Glass-Steagall Act. See Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12. U.S.C.) (commonly referred to as the Glass-Steagall Act).

6. See, e.g., Cheyenne Hopkins, Despite Claims, Reform Law Provides Plenty of Exemptions, Am. Banker, Aug. 10, 2010,
fundamental public policy choices – a job of the national legislature – are left to the discretion of administrative agencies in charge of implementing the new law.\(^7\) As regulators feverishly work on their rule-making mandated by the Act, scholars and commentators are also hard at work analyzing and criticizing various provisions of the new statute and identifying specific gaps in its coverage.\(^8\)

However, the more interesting question is to what extent the new law actually lives up to its ambitious claim to bring about a fundamental reform of Wall Street. Even though the Dodd-Frank Act did leave too much substance to be filled in by regulators at the implementation phase, which makes an assessment of its potential efficacy or practical impact very difficult, what Congress did say in this piece of legislation provides at least some basis for setting our overall expectations.

The starting point for such a preliminary assessment is simple, albeit not entirely uncontestable. The global financial crisis of 2007-2008 clearly demonstrated that the entire system of financial sector regulation and supervision, in the United States and elsewhere,\(^9\) was woefully inadequate to effectively curb the risks posed by new financial products and markets, which had emerged as a result of technology-driven financial innovation of the preceding decade.\(^10\) The key features of the financial system in

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9. Thus, the crisis exposed major weaknesses in the regulatory and supervisory framework in the United Kingdom's financial sector, where the Financial Services Authority (FSA) was widely criticized for its failure to exercise effective oversight of various financial institutions' activities. *See, e.g.*, United Kingdom's Fin. Serv. Authority, *The Turner Review: A Regulatory Response to the Global Financial Crisis* (2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf. In the aftermath of the crisis, the new U.K. government announced its plans to restructure the FSA.

10. *See, e.g.*, CONGRESSIONAL OVERSIGHT PANEL, *MODERNIZING THE AMERICAN FINANCIAL REGULATORY SYSTEM: RECOMMENDATIONS FOR IMPROVING OVERSIGHT,*
the twenty-first century are its ever-increasing complexity, dynamism, and the seamlessly global nature of financial markets and activities.11 The unprecedented contagion effect of the latest crisis provides a powerful illustration of these new dynamics in global finance.12 Yet, despite the fundamental changes in how financial markets and institutions operate in the era of computerized trading, model-driven financial engineering, and globe-spanning financial conglomerates, the U.S. regulatory system continued to rely on the principles and mechanisms developed many decades ago.13 The latest financial crisis exposed this deep discrepancy between the new economic reality and the old regulatory philosophy.

Does the Dodd-Frank Act, incomplete and lacking in detail as it is, nevertheless successfully overcome this fundamental discrepancy? Does it represent a new regulatory philosophy, which has the potential to effectively address the challenges posed by globalization and the complexity of modern finance? Does it offer a change in the paradigm of financial sector regulation, necessary to prevent future crises of such systemic proportions?

Even at this early point in the implementation process, when many vital details of the new regulatory regime are yet to be determined, it seems unlikely. It is already clear that, in certain fundamental aspects, the Dodd-Frank Act continues to rely on the old, pre-crisis, regulatory principles and assumptions. Some of these general trends in the new statute’s underlying philosophy are briefly outlined below.


11. See Omarova, supra note 1 (arguing that the two key features setting the recent financial crisis apart from all the previous ones are (i) its truly global scope, and (ii) its causal relationship to financial innovation and complexity of financial products).


III. AN OLD DEAL BEHIND THE NEW LAW: FAMILIAR TRENDS IN DODD-FRANK’S REGULATORY PHILOSOPHY

Even a very cursory review of the Dodd-Frank Act reveals at least three areas in which it fails to deliver conceptually innovative solutions and remains firmly planted in the old, pre-crisis way of thinking about financial sector regulation.

A. Regulatory Structure and Institutional Design

Contrary to popular expectations, the Dodd-Frank Act largely retained the existing regulatory structure in the financial services sector. Despite the numerous and persistent criticisms of regulatory fragmentation and increasingly meaningless formal separation lines among various segments of the financial industry, Congress opted against a large-scale structural reform.14

In the years before the crisis, industry experts and academics debated several potential possibilities for such a structural reform.15 Thus, one radical proposal envisioned replacing the existing regulatory agencies with a universal financial regulator, along the lines of the United Kingdom’s FSA or Germany’s BaFin, which would oversee the entire financial services industry under a coherent legal regime.16 Another popular alternative was the creation of a so-called “twin-peaks” system in which business conduct and prudential regulation would be split between two separate agencies.17 Finally, short of a major structural overhaul, many commentators over the years called for consolidation of the existing regulatory agencies in the banking sector, as well as combining the Securities and Exchange

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14. For a description of the regulatory fragmentation and prior efforts to simplify the U.S. regulatory framework, see, for example, CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 29-35 (2d ed. 2006).


Commission (SEC) and the Commodity Futures Trading Commission (CFTC), and creation of a federal regulatory scheme in the insurance industry.  

None of these proposals have made it into the final reform legislation. Congress chose to eliminate only one agency, the Office of Thrift Supervision (OTS), which is to be merged into the Office of the Comptroller of the Currency (OCC). Other than this merger, the Dodd-Frank Act contains no attempt to consolidate the existing regulatory structure. It leaves intact the much criticized product- or license-based system of regulation and supervision, in which financial institutions are placed in mutually exclusive regulatory categories. This vertical silo-based structure creates opportunities for regulatory arbitrage, particularly within a financial holding company (FHC) structure, which allows the holding company to take advantage of the differences in the regulatory treatment of economically equivalent activities conducted in different subsidiaries. One of the pernicious effects of regulatory arbitrage is that it potentially allows financial conglomerates to incur high levels of risk hidden from the regulators confined to their individual jurisdictional silos. From that perspective, the problem of structural fragmentation, as it exists today, is both a symptom and a cause of the underlying problem of inconsistent and ineffective (and, at times, lacking) substantive regulation of financial activities.

The Dodd-Frank Act failed to eliminate the structural basis for regulatory arbitrage by retaining the fundamental principle of regulatory fragmentation. Instead, it seeks to remedy the key problems posed by such fragmentation by creating a new regulatory body, the Financial Stability Oversight Council.

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19. This step came as no surprise, in large part because the failure of Washington Mutual, the largest savings association under the OTS’s regulatory oversight, effectively left OTS in charge of a far smaller segment of the industry. The OTS’ regulation of federal thrifts is transferred to the OCC, its regulation of state thrifts to the Federal Deposit Insurance Corporation (FDIC), and its regulation of savings and loan holding companies to the Board of Governors of the Federal Reserve System (the Federal Reserve). Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 312, 124 Stat. 1376, 1521-23 (2010) (to be codified in 12 U.S.C. § 5412).
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(FSOC), charged with the task of monitoring and identifying potential system-wide risks across the regulatory division lines. From the perspective of institutional reform, the creation of such a unified systemic risk regulator is arguably the most significant change under the Dodd-Frank regime. However, even that novel feature of the post-crisis regulatory structure has grown out of an old, pre-crisis institutional arrangement, the President's Working Group on Financial Markets (PWG). Much like the new-born FSOC, the PWG was a multi-agency council, which brought together the heads of the Federal Reserve, SEC, and CFTC, under the chairmanship of the Secretary of the Treasury. Although its official charge did not explicitly include systemic risk management, the goals behind the creation of PWG were “enhancing the integrity, efficiency, orderliness, and competitiveness of our Nation's financial markets and maintaining investor confidence.” During market crises, such as the East Asian crisis of 1997 and the recent financial market meltdown, the PWG effectively performed the functions of a systemic risk council. Over the years, the PWG published several reports on a variety of financial market and policy issues, but generally kept its deliberations out of the public eye.

By contrast, the FSOC is envisioned as a more transparent regulatory body with more strictly formalized functions and

20. Id. § 111 (to be codified at 12 U.S.C. § 5321). The voting members of the FSOC, headed by the Secretary of the Treasury, include primarily the heads of the key financial regulatory agencies, such as the Federal Reserve, the SEC, CFTC, OCC, and so forth.


23. Id. In addition to its permanent members, the Comptroller of the Currency and the head of the Federal Reserve Bank of New York (FRBNY) also often attended the PWG's meeting.

24. Id.

broader jurisdictional mandates. Yet, it represents the same fundamental institutional choice as the old PWG: in a fragmented, silo-based regulatory system, the best (or, perhaps, the most convenient, from a political standpoint) source of a unified system-wide risk management is collective wisdom of the existing silo-based regulators.

Time will tell if that choice was the right one. The key point here is that it was not a radically innovative choice. Tinkering with the old structure by refurbishing the PWG as the new systemic risk regulator, enhancing the Federal Reserve’s regulatory powers, creating new research and information-gathering offices within the existing agencies, and even establishing the much-heralded Bureau of Consumer Financial Protection inside the Federal Reserve – none of these measures really amount to a break with the old regulatory philosophy, which in turn rests on certain outdated assumptions about different financial institutions’ business and risk profiles and the efficacy of keeping them in separate regulatory silos.

B. Reliance on Statutory Firewalls

Another important, albeit not immediately obvious, trend in the Dodd-Frank Act’s regulatory philosophy is its continuing reliance on statutory firewalls as the key mechanism safeguarding the stability of the U.S. banking system.

The U.S. regulatory system often relied on the concept of statutory firewalls preventing certain categories of financial

26. Of course, potential significance of the new council’s powers should not be underestimated. Thus, the FSOC has the statutory authority to identify systemically important non-bank financial companies, which would then be subject to regulation and supervision by the Federal Reserve, and to recommend heightened prudential standards applicable to all systemically important entities and to any activities that increase systemic risk. The FSOC also has other powers and responsibilities, including information-gathering, reporting to Congress, and making recommendations on supervisory and regulatory matters of systemic importance.

27. In the run up to the Dodd-Frank Act, academics and policy-makers discussed several alternative forms of a systemic risk regulator, including the delegation of systemic risk monitoring functions to the Federal Reserve and the creation of an entirely new systemic risk regulatory agency. For a discussion of these alternatives, see Roberta S. Karmel, The Controversy over Systemic Risk Regulation, 35 BROOK. J. INT’L L. 823 (2010) (discussing in detail different approaches to the issue of systemic risk regulation).
institutions from engaging in certain types of activities or investments or significantly limiting their ability to do so. Perhaps the most important example of such a wall is the principle of separation of banking and commerce, which to this day constitutes one of the foundational elements of U.S. banking law. Under this principle, deposit-taking institutions are generally prohibited from conducting any non-financial, purely commercial activities. The Glass-Steagall Act’s infamous prohibition on affiliation between commercial and investment banks was another such example of an institutional divide meant to keep depository institutions and securities firms distinctly apart. The quantitative and qualitative limitations on banks’ transactions with affiliates under Sections 23A and 23B of the Federal Reserve Act also serve as a statutory firewall intended to protect the depository system’s safety and soundness and to prevent the transfer of the federal subsidy to securities firms and other non-bank entities.

The Dodd-Frank Act continues this tradition, among other things, by creating new important statutory firewalls under the Volcker Rule and the bank derivatives push-out provisions. The Volcker Rule, named after the former Chairman of the Federal Reserve who championed the idea, amended the Bank Holding Company Act of 1956 by prohibiting certain “proprietary

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30. See 12 U.S.C. §§ 371c, 371c-1. This list of examples of statutory firewalls is far from exhaustive and includes only some of the more prominent legal mechanisms explicitly aimed at protecting safety and soundness of the banking system. There are numerous other examples of such “walls,” including various statutory and regulatory provisions aimed at limiting or eliminating potential conflicts of interest in the financial services sector.


32. Id. § 716 (to be codified at 15 U.S.C. § 8305).
trading” activities by bank holding companies (BHCs).\textsuperscript{33} This provision also prohibits BHCs, depository institutions, and their affiliates from investing in hedge funds and private equity funds, subject to certain exemptions.\textsuperscript{34} Not surprisingly, the Volcker Rule was one of the more controversial provisions of the new law.\textsuperscript{35}

The bank derivatives push-out provision of the Dodd-Frank Act effectively mandates that federally-insured depository institutions limit their derivatives activities to hedging or similar risk mitigation directly related to their activities or derivatives involving assets permissible for banks.\textsuperscript{36} In effect, that allows banks to retain interest rate and currency derivatives, as well as instruments referencing gold and other precious metals, government securities and certain other investment-grade debt securities. Equity-linked and commodity-linked derivatives will have to be “pushed out” of the bank and conducted by non-bank affiliates within the holding company structure.

A detailed analysis of the pros and cons of the Volcker Rule or the derivatives push-out requirements is beyond the scope of this essay. What is of interest here is the fundamental regulatory principle underlying these measures. Thus, both of these provisions aim explicitly at curbing risk-taking by depository institutions, which enjoy access to the federal subsidy,\textsuperscript{37} by walling them off from other market actors that conduct certain high-risk activities – private investment funds and derivatives dealers. On

\begin{itemize}
\item \textsuperscript{33} The Bank Holding Company Act of 1956 defines a BHC essentially as any company that “owns or controls” a U.S. bank. 12 U.S.C. § 1841(a) (2006).
\item \textsuperscript{34} Generally, the Dodd-Frank Act permits a banking entity to invest in hedge funds or private equity funds to the extent such entity’s investment does not exceed 3% of the total ownership interests in each fund and the banking entity’s aggregate interests in all such funds do not exceed 3% of its Tier I capital. \textit{Id.} § 619 (to be codified at 12 U.S.C. § 1851).
\item \textsuperscript{35} Thus, some commentators supported the rule’s prohibitions as necessary restrictions on financial institutions’ risk-taking. See, \textit{e.g.}, Acharya, \textit{supra} note 4. Others criticized the rule, as enacted, for leaving too many loopholes for banks to continue engaging in risky trading activities. See, \textit{e.g.}, Daniel Indiviglio, \textit{Dodd-Frank Bill’s Volcker Rule a Win for Big Banks}, \textit{THE ATLANTIC}, June 25, 2010, (arguing that the statutory exemptions from the Volcker Rule’s prohibitions could make banks’ trading activities even riskier), \textit{available at} http://www.theatlantic.com/business/archive/2010/06/dodd-frank-bills-volcker-rule-a-win-for-big-banks/58747/.
\item \textsuperscript{36} \textit{Id.} § 716 (to be codified at 15 U.S.C. § 8305).
\item \textsuperscript{37} The federal subsidy, available to banks and certain other deposit-taking institutions, generally consists of the federal deposit insurance and access to the Federal Reserve’s lender-of-last-resort facilities.
\end{itemize}
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the surface, these are quite radical reform measures, designed to separate the vitally important banking sector from the so-called shadow banking system, the source of many of the causes of the recent crisis.\(^{38}\) However, these new statutory prohibitions rest on an old fiction that corporate entities within a single holding company structure are truly separate economic enterprises, and that the key sources of financial risk to banks can be effectively controlled through imposing certain formalistic, institution-based restrictions on their investments or activities. These assumptions tend to over-simplify the dynamics of modern financial services business. They often clash with the realities of a fully integrated economic enterprise, where risk is produced, transferred, managed, and magnified in ways transcending formal intra-company divisions and legal boundaries.

Ironically, statutory walls that are built on wrong or unrealistic premises may have the unintended effect of encouraging the dangerous risk-shifting and regulatory arbitrage they purport to minimize. Over-reliance on these types of provisions may contribute to an increase in the cumulative systemic risk level. For example, pushing out equity and commodities derivatives trading to a BHC’s non-bank subsidiaries, which will make conducting such activities more costly, may also create incentives for the BHC to invent new regulatory arbitrage techniques to lower such additional costs. This new round of financial engineering may result in the emergence of new types of financial instruments and transactions that defy statutory definitions. That may further increase the level of unnecessary complexity in financial market and thus make effective regulation even more difficult to achieve.

In addition, regulatory agencies’ power to define certain critical terms, to interpret the key requirements, or to grant exemptions from statutory prohibitions may further weaken the potential efficacy of a statutory firewall.\(^{39}\) The lack of substantive

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38. The Volcker Rule and the derivatives push-out provisions may appear particularly radical because they zero in on derivatives and hedge funds – previously unregulated and opaque financial instruments and institutions widely perceived as key drivers of market complexity and instability.

39. For an analysis of this phenomenon in the context of other statutory firewalls, see, for example, Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the ‘Business of Banking’*, 63 U. MIAMI L. REV. 1041 (2009).
detail in the Dodd-Frank Act makes this kind of regulatory dilution of the legislative intent a distinct possibility.\(^{40}\)

Thus, despite their high profile and aspirations, the Volcker Rule and the derivatives push-out rules fall short of offering new, potentially more effective, solutions to the central problem of regulating complex risk-generating activities of a modern financial conglomerate. Instead of identifying innovative ways to limit upfront the overall level of risk in the system, Congress chose to rely on the familiar technique of creating statutory firewalls around depository institutions, based on formalistic and inherently static criteria and an over-simplified concept of risk transfer.\(^{41}\) While it may have been the most readily available conceptual tool, a bold shift in regulatory philosophy it was not.

C. Public-Private Balance

Another important "legacy" aspect of the Dodd-Frank Act's regulatory philosophy, both implicit and pervasive, is the normative concept of the proper balance between public and private interests – and functions – in the financial sector.

Undoubtedly, the Dodd-Frank Act significantly expanded regulatory presence and imposed a host of new, or newly enhanced, regulatory requirements in many areas of financial institutions' activities. However, many of these new provisions are based on the same normative view of the role and purpose of government regulation that underlies much of the financial sector

\(^{40}\) For instance, some commentators note that the Volcker Rule may not necessarily limit banks' practical ability to invest in hedge funds and private equity funds, in great part because of definitional loopholes, and that the rule's practical impact depends significantly on regulators' approach to implementing it. *See e.g.*, Francesca Guerrera & Justin Baer, *Wall Street to sidestep "Volcker Rule,"* FIN. TIMES, Nov. 10 2010, http://www.ft.com/cms/s/0/3d49f12e-ed03-11df-9912-00144feab49a.html#axzz19Thl79NT.

\(^{41}\) The danger of this approach is that, without a firm foundation in the realities of the modern financial marketplace and a comprehensive substantive regulatory framework supporting them, such firewalls may be ineffective and even counter-productive in the long run. Not only do such ill-conceived statutory prohibitions tend to encourage regulatory arbitrage and potentially elevate the level of systemic risk, but their very existence may create a false sense of security and thus impede productive debate on broader regulatory reform. For a case study of the recent history and regulatory dilemmas raised by the operation of one such statutory firewall, Section 23A of the Federal Reserve Act, see Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act,* 89 N.C. L. REV. ___ (forthcoming 2011).
regulation before the Dodd-Frank Act. They operate on an assumption that the most preferable, and effective, form of government intervention in financial activities seeks to ensure an optimal environment for the proper functioning of the free market and, as much as possible, to avoid substantive interference with market dynamics.

However, one of the critical lessons of the recent crisis is the potential danger of unquestioning reliance on this assumption in an era when individual profit-seeking actions of private firms in global financial markets potentially pose a direct threat to vital public policy goals, ranging from economic fairness to economic survival. To the extent that excessive risk-taking on the part of individual financial institutions may cause a precipitous market meltdown, ultimately leading to economic crisis or recession, it becomes more difficult to sustain a normative claim that the public should have as little say as possible in such institutions’ private business decisions. Moreover, as financial globalization ties together previously relatively discrete national and regional economies, this social, public interest aspect of financial markets and activities becomes even more important and difficult to ignore. As the burden of saving the financial sector and the broader economy from collapse falls heavily on taxpayers around the globe, it requires serious rethinking of the existing balance between the government’s duty to protect the public from economic harm and the private actors’ right to pursue economic gain in the market as free from government interference as possible.

The Dodd-Frank Act does not attempt to redefine this balance. Most of its provisions generally rest on the familiar notion of the public-private balance in regulation, which strongly favors the private side. Thus, even in introducing new regulatory requirements or strengthening the existing ones, the Act relies primarily on such tried and true methods as disclosure and data reporting, mandatory central clearing and exchange trading, or registration and capital requirements for financial intermediaries. While all of these measures are important steps in the right direction, they merely set up (or improve) legal infrastructure for, and impose certain conditions on, the operation of financial institutions and markets. In other words, they determine how much capital individual firms should hold, what type of information they should provide to whom, what types of
transactions they can negotiate bilaterally and which instruments they can buy and sell on organized exchanges. Ultimately, however, none of these regulatory methods seeks to impose directly any substantive limitations on the nature and level of risk embedded in specific financial products and activities.

Regulation of over-the-counter (OTC) derivatives exemplifies this approach.\textsuperscript{42} Thus, the most significant aspects of the OTC derivatives regulation provisions in the Act include (i) mandatory clearing of derivatives through regulated central clearing organizations and mandatory trading through either regulated exchanges or so-called swap execution facilities, in each case, subject to important exceptions, and (ii) introduction of new regulatory categories of financial actors, swap dealers and major swap participants.\textsuperscript{43} The regulatory oversight of OTC derivatives markets is split between the SEC and CFTC in a manner that largely reflects the historical jurisdictional divisions between these agencies.\textsuperscript{44} The Act requires that market participants report their swap transactions to the regulators and special data repositories and charges the SEC and CFTC with the task of promulgating rules on real-time public data reporting of swap transactions.\textsuperscript{45} Regulatory agencies are also required to develop new business conduct requirements for swap dealers and major swap participants, as well as special capital and margin rules for various types of swaps.\textsuperscript{46}


\textsuperscript{43} DAVIS POLK & WARDWELL, LLP, SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, ENACTED INTO LAW ON JULY 21, 2010 53 (2010), available at http://www.davispolk.com/files/Publication/7084f9fe-6580-413b-b870-b7e025ed2e5f/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786db90464a/070910_Financial_Reform_Summary.pdf The third significant aspect of the OTC derivatives regulation under the Act is the “push-out” from banks into bank affiliates of many derivatives activities, discussed above. While the push-out provisions may, in some sense, be viewed as imposing direct limits on derivatives activities, they still merely mandate the shift in where such activities are conducted within an FHC, rather than any substantive change in the nature of such activities.

\textsuperscript{44} Id. at 52. Among other things, the SEC and CFTC have the authority to determine which swaps are subject to mandatory central clearing and, therefore, mandatory trading on an exchange or through a swap execution facility.


\textsuperscript{46} Id. § 719 (to be codified at 15 U.S.C. § 8307).
These new requirements, hailed as a comprehensive framework for regulation of OTC derivatives,47 are designed to introduce a degree of transparency and efficiency into these previously unregulated and opaque markets and to encourage private actors to manage risks better. However, they fail to address directly the critical policy issues in this area: how much risk in derivatives markets is too much for the public to bear, and what should be done to prevent such excessive risk from being created in the first place.48 At the most fundamental level, the statute's primary focus on establishing new market infrastructure and disclosure requirements reflects the continuing adherence to the deeply rooted principle of limited and indirect government regulation. To the extent the new law seeks to restrain potential risks posed by derivatives, it does so only indirectly, through demanding ever more disclosure and rationalizing the clearing and settlement process, at least for sufficiently standardized instruments.49 The Act does not actively seek to shape the markets' risk profile and to eliminate or control the ultimate sources of potential instability in the financial system, in order to protect the broader public from the failure of the market forces. In that sense, despite all of its accomplishments, this new legislation remains part of the old, pre-crisis regulatory order.

IV. Conclusion

Even a brief sketch of certain “legacy” aspects of the Dodd-Frank Act's regulatory philosophy illustrates some of the potential limitations of the new legislation. Although the Act is bound to

47. See, e.g., CCH, DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: LAW, EXPLANATION AND ANALYSIS 248 (2010).

48. For example, Congress could have imposed explicit limits, or even outright prohibitions, on certain derivative transactions, based on their riskiness from a systemic perspective. Thus, one such alternative approach would be mandatory pre-approval of OTC derivative instruments, which would effectively put the regulators in the position to decide what level of risk is socially acceptable, as a matter of public policy. Regardless of their desirability or potential effectiveness, such measures would have signaled a significant normative shift in the regulatory process.

49. To what extent these provisions of the Dodd-Frank Act are likely to bolster the resiliency of derivatives markets is subject to some doubt. Thus, the sheer amount of new data to be disclosed under the new regime may be overwhelming, and the practical usefulness of such disclosure may be quite limited. Similarly, the fact that the more complex, and more risky, bespoke derivatives are not subject to mandatory exchange trading and central clearing significantly limits the potential effectiveness of the Act's approach to derivatives regulation.
produce many important changes in the operation of the U.S. financial markets, it falls short of offering a new conceptual framework for meeting today's, and tomorrow's, regulatory challenges. Many of the Act's solutions to specific problems continue to rely on the last century's regulatory principles and assumptions.

Of course, such continuity in regulatory philosophy may be viewed as a positive sign. There is a lot to be said for incremental reforms and time-tested solutions, if they are properly tailored to the changed circumstances. However, it is essential that any such solutions are the result of careful and open-minded analysis and deliberation, which does not limit the range of potential choices to what is already there. Despite the many months of academic discussions and congressional bargaining preceding its enactment, the Dodd-Frank Act does not exhibit signs of such a deep deliberative process of critical rethinking of the basic principles guiding financial regulation in the United States. The truly New Deal of the twenty-first century may not take shape until after the next big crisis.