

DODD-FRANK AND THE FUTURE OF FINANCIAL REGULATION

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I. Introduction

Dodd-Frank¹ represents the most sweeping changes to the financial regulatory environment in the United States since the Great Depression. While its enactment was important, the Act is seriously flawed. It does not deal with regulatory fragmentation, sidesteps international coordination, and is overly optimistic in dealing with too-big-to-fail. Going first doesn't mean you get it right.

To consider my criticisms, we must put Dodd-Frank in context. Major changes to financial institution regulation have been called for by the G-20 on a coordinated basis.² Given the reality that major financial institutions increasingly conduct significant portions of their business in many different countries, consistency and cooperation are essential, especially between the US and the EU.³ Dodd-Frank is not a good example of the necessary paradigm. I will first review the international response and recommendations, the US response, and then highlight some key differences in other markets.

In the aftermath of the crisis, regulators from around the world convened to discuss solutions and outline a framework for reform on an international basis.⁴ This

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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act].

² See, e.g., Enhancing Sound Regulation and Strengthening Transparency (Report of G20 Working Group 1, 2009), available at http://www.g20.org/Documents/g20_wg1_010409.pdf.

³ See Allen N. Berger et al., *To What Extent Will The Banking Industry be Globalized? A Study of Bank Nationality and Reach in 20 European Nations*, (Bd. of Governors of Fed. Reserve Sys., Int'l Fin. Discussion Paper No. 725, 2002), available at, <http://www.federalreserve.gov/pubs/ifdp/2002/725/ifdp725.pdf>.

⁴ Press Release, SEC, Chairman Cox Statement on Meeting of IOSCO Technical Committee (Nov.

development was, in part, a recognition of the global causes and the global scale of the problem. Since that time, however, as lawmakers and regulators have begun to implement reform in their own countries, we have witnessed some loss of the coordination and cooperation that is critical to creating the framework needed to regulate systemically significant financial institutions operating internationally.

II. Causes of the Crisis

Market participants, government officials, and academics have not reached a consensus as to the causes of the crisis. Despite this, there is general agreement that the regulatory framework in place prior to the crisis was inadequate.

1. *Systemic Risk and Too-Big-To-Fail*

The shortcomings of the pre-crisis regulatory framework were illustrated by its failure to detect systemic risk posed by “too-big-to-fail” institutions. Of course, the problem with too-big-to-fail firms is that if the market believes that the government will be compelled to bail them out with taxpayer money, it will not exert sufficient oversight or discipline to control or mitigate risky behavior.⁵

2. *Resolution Authority*

The pre-crisis regulatory regime was also insufficient with respect to managing the failure of large, interconnected, cross-border financial institutions. The system did not have an effective and expeditious resolution authority.

The experience with the Lehman Brothers’ bankruptcy convinced almost all observers that bankruptcy proceedings generally, and in the US in particular, are not suitable for complex financial institutions.⁶

3. *Shadow Banking*

A third conspicuous shortcoming of the pre-crisis regulatory framework was the large number of non-financial firms that fell outside its scope – the unregulated, shadow-banking sector.⁷ Many market actors – including Special Investment Vehicles, so called SIVs, certain mortgage originators, hedge funds and private equity funds, and derivatives

24, 2008), available at <http://www.sec.gov/news/press/2008/2008-279.htm>.

⁵ E.g. James Bullard, Christopher J. Neely, and David C. Wheelock, *Systemic Risk and the Financial Crisis: A Primer*, 91 FED. RESERVE BANK ST. LOUIS REV. 403, 403 (2009); Ben S. Bernanke, Chairman, Federal Reserve Board of Governors, Address to Council of Foreign Relations: Financial Reform to Address Systemic Risk (Mar. 10, 2009), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20090310a.htm>.

⁶ See Sheila C. Bair, Chairman, FDIC, Lecture at the Harvard university John F. Kennedy Jr. Forum: Ending Too Big To Fail: The FDIC and Financial Reform (Oct. 20, 2010), available at <http://www.fdic.gov/news/news/speeches/chairman/spoct2110.html>.

⁷ For an overview of shadow banking and the risks it poses, see Morgan P. Ricks, *Regulating Money Creation After the Crisis*, 1 HARV. BUS. L. REV. 75 (2011).

market participants – were subject to little or no regulation.

III. International Institutions: G-20 and FSB

1. *Group of Twenty (G-20)*

At the height of the crisis, there was general recognition of the global nature of the problem and the need for a global response. The G-20 emerged as a leading forum for addressing it. The G-20 strongly recommended that international guidelines and frameworks be developed and that the efforts of national regulators be coordinated.

In terms of strengthening the regulation of systemically important firms, the G-20 recommended: (i) heightened prudential requirements to reflect higher costs of failure; (ii) a requirement to develop firm-specific contingency plans (so-called living wills); (iii) establishment of crisis management groups for major cross-border firms to strengthen international cooperation on resolution; and (iv) strengthening the legal framework for crisis intervention and winding down firms.⁸

The G-20 leaders also called for an international framework of reform which should: (i) build high-quality capital requirements and mitigate pro-cyclicality; (ii) reform compensation and governance practices to support financial stability; (iii) improve transparency and mitigate systemic risk in the OTC derivatives markets; (iv) address cross-border resolution; and (v) adopt a single set of generally accepted and accounting standards.⁹

2. *Financial Stability Board*

Other international organizations – including the Basel Committee on Banking Supervision, the Financial Stability Board (“FSB”) and the International Monetary Fund (“IMF”) – have also been active participants in leading global financial regulatory reform efforts, in part at the request of the G-20.

Specifically, the Financial Stability Board has set forth a five-prong policy framework to address the risk associated with systemically important financial institutions: (i) improve resolution regimes to ensure the winding down of any financial institution without disrupting the financial system and without taxpayer support; (ii) require systemically important institutions to maintain loss absorption capacity beyond Basel III standards; (iii) enhance the supervisory oversight of systemically important institutions; (iv) strengthen standards for core financial infrastructure; and (v) engage in

⁸ G-20 Finance Ministers and Central Bank Governors, *Declaration on Further Steps to Strengthen the Financial System* (Sept. 5, 2009), available at http://www.g20.org/Documents/FM__CBG_Declaration_-_Final.pdf.

⁹ G-20 Finance Ministers and Central Bank Governors, *Leaders’ Statement: The Pittsburgh Summit* (Sept. 25, 2009), available at http://www.g20.org/documents/pittsburgh_summit_leaders_statement_250909.pdf.

peer reviews of the effectiveness and consistency of national policy measures applicable to global systemically important institutions.¹⁰ The Financial Stability Board is in the process of identifying which institutions are globally significant, which raises interesting issues of moral hazard.

IV. Comparing US and Non-US Implementation of Reform

Reform efforts in the United States, however, have made only a modest effort to assure coordination with the G-20 recommendations or the responses proposed or adopted by other regulators, in particular, the EU. Thus, there is the “danger of divergence”, also the title of a report of The Atlantic Council reading, which will have unfortunate consequences.¹¹

1. New Systemic Risk Monitors

The G-20 leaders called for regulators to have better access to information about activities and counterparty exposures that pose systemic risk to the financial system.¹² They noted that, while in the past regulators had adequate information about the financial conditions of individual regulated entities, no single regulatory body was charged with overseeing and assessing the risks generally posed to the financial system by both the activities (i.e., derivatives) and interconnectedness of individual financial institutions.¹³ There was as well a dearth of information about generally unregulated key players such as hedge funds and private equity funds.

To address this issue, Dodd-Frank created the Financial Stability Oversight Council. Its members include the heads of Treasury, the Federal Reserve Board, the SEC, and the CFTC, and the federal banking regulators, among others. One of its primary charges is to identify risks to financial stability.¹⁴

The Council is mandated to gather information to identify gaps in regulation or activities that should be subject to more-stringent regulation.¹⁵ To this end, the Council may require reports from any non-bank financial company or bank holding company to assess whether that company, or any financial activity or market in which it participates, is systemically important.¹⁶ The Council may also recommend heightened prudential and

¹⁰ Letter from Mario Draghi, Chairman, Financial Stability Board, to G20 Leaders, Progress of Financial Regulatory Reform (Nov. 9, 2010), *available at* http://www.financialstabilityboard.org/publications/r_101109.pdf.

¹¹ ATLANTIC COUNCIL, THE DANGER OF DIVERGENCE: TRANSATLANTIC COOPERATION ON FINANCIAL REFORM (2010) [hereinafter DANGER OF DIVERGENCE], *available at* http://www.acus.org/files/publication_pdfs/403/ACUS_TR_Danger_Divergence_Report.pdf.

¹² *Id.*

¹³ *Id.*

¹⁴ Dodd-Frank Act §§ 111-112, 12 U.S.C. §§ 5321-5322.

¹⁵ DANGER OF DIVERGENCE, *supra* note 11.

¹⁶ *Id.*

capital standards, which must be considered by the primary financial regulator.¹⁷

The EU has created a similar body, the European Systemic Risk Board.¹⁸ Unlike the Council, it has no regulatory authority. While responsible for monitoring and assessing potential threats to financial stability, the ESRB can only issue warnings and make recommendations to national regulators, who are obligated to explain reasons for not acting upon ESRB proposals, and notify the European Commission if appropriate actions are not taken.¹⁹

There are many questions one could ask about these new councils. In the case of the United States, would it not have been more effective to consolidate the fragmented financial regulatory structure rather than to further fragment oversight of financial markets? Will the complicated structure and mandated decision-making process of the Council hamper crucial efforts to act promptly? What will the costs be to collect information in a standardized format? How will the US and EU councils work together to coordinate oversight and regulation? With respect to the EU, shouldn't the Systemic Risk Board have the power to intervene directly and not have to rely entirely on national regulators?

2. Solutions for Too-Big-To-Fail

In addition to enhanced oversight of a wider range of systemically important financial institutions, Dodd-Frank mandates more rigorous capital, liquidity and leverage requirements, as well as restrictions on certain activities to help address the problem of too-big-to-fail. Most importantly, it does not restrict size by growth, only by acquisition.²⁰ This is a critical judgment since the five largest US financial institutions have grown 20% since the onset of the crisis and currently have over \$6 trillion in assets.²¹ The judgment was made that size is not necessarily the only concern; many small, sufficiently interlinked institutions engaging in the same activity could pose a systemic risk if that activity should prove riskier than appreciated.²² But size can be critical, because of the contagion effect of failure.

a. Capital, Liquidity and Leverage Requirements

The Federal Reserve Board has been given the primary responsibility for supervising and regulating systemically important institutions. These institutions include all bank holding companies with more than \$50 billion in assets and all Council-designated systemically important non-bank financial companies doing business in the

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.* at 24.

²¹ Thomas M. Hoenig, *Too Big to Succeed*, NY TIMES, Dec. 1, 2010, <http://www.nytimes.com/2010/12/02/opinion/02hoenig.html>.

²² DANGER OF DIVERGENCE, *supra* note 11, at 22.

US.²³ These entities will be subject to heightened capital, liquidity and other prudential standards, risk-management requirements, concentration limits for credit exposure to customers, and will have an obligation to prepare living wills as well as to undergo periodic stress tests.²⁴ And if an insurance company is so designated as a systemically significant non-bank financial company, it will have for the first time a federal regulator, the FRB.²⁵

Regulators have additional tools as well to restrict the size, growth and activities of these systemically important companies, in particular those determined to pose a “grave threat” to financial stability. The regulators, for example, can prohibit these companies from acquiring or merging with other companies and compel the divestiture of assets, and must impose a strict 15:1 debt-to-equity leverage ratio on them.²⁶

Dodd-Frank further restricts the ability of large bank holding companies and systemically important non-bank financial companies to grow by acquisition. No financial company will be permitted to merge with or otherwise acquire another if the total consolidated liabilities of the combined company would exceed 10 percent of the total financial consolidated liabilities of all financial companies, unless the institution proposed to be acquired is in default or in danger of default and the FRB approves the acquisition.²⁷ Of course, at times of crisis, the largest financial institutions are likely to be the only candidates to acquire smaller failing institutions.

b. The Volcker Rule

One of Dodd-Frank’s most controversial provisions has been the Volcker Rule. In brief, the Volcker Rule prohibits banking entities from engaging in some types of proprietary trading and imposes limits on sponsoring or investing in hedge funds or private equity funds.²⁸

Both US banking institutions and internationally headquartered banking organizations with US banking operations will be subject to the rule. There is an exception for foreign banking institutions for trading that is solely outside the US. The imprecision in and generality of many of the terms and exceptions as to permitted activities used in the Volcker Rule will require clarification by the regulators. Because the regulators will have a great deal of discretion in how they are defined and applied,

²³ Authority to Designate Financial Market Utilities as Systematically Important, 76 Fed. Reg. 44,763, 44,763 (July 27, 2011).

²⁴ *Id.* at 44,767.

²⁵ *See id.* at 44,773.

²⁶ Dodd-Frank Act § 165(j). *See also* Steven L. Schwarcz, *Identifying and Managing Systemic Risk: An Assessment of Our Progress*, 1 HARV. BUS. L. REV. ONLINE 94, 98 (2011), <http://www.hblr.org/?p=1412>.

²⁷ DANGER OF DIVERGENCE, *supra* note 11, at 24.

²⁸ For an overview of the Volcker Rule, see Charles K. Whitehead, *The Volcker Rule and Emerging Financial Markets*, 1 HARV. BUS. L. REV. 39 (2011).

they will be under pressure to be expansive as to permitted activities, not restrictive.

Across the Atlantic, the EU and Switzerland have refused to consider banning this type of activity. Instead, they would use enhanced capital requirements to address risk. On the other hand, the Independent Commission on Banking appointed by the UK government has, in its preliminary issues paper, broadly included among its list of reform options limits on proprietary trading and investing by deposit-taking institutions.²⁹

c. The Swiss Approach

The Swiss have taken an interesting approach. They have rejected size limitations for banks under any circumstances. Rather, they have proposed reforms to capital requirements and organizational form to control systemic risk. With respect to capital, the Swiss have developed a four-part approach: first, there must be a minimum amount of capital required for the maintenance of normal business activities; second, a capital buffer, allowing banks to absorb losses without falling short of the minimum capital requirement; third, a progressive component of capital, which rises with the degree of an institution's systemic importance; and finally, convertible or contingent capital which would automatically convert into equity when an institution's financial condition has materially deteriorated.³⁰ And indeed, Credit Suisse has recently issued a contingent capital security,³¹ a so-called Co-Co, which was oversubscribed, has been keenly followed and which will influence regulators in other markets.

The Swiss proposal also requires banks to have an organizational structure that would allow them, if their capital ratio fell below a certain level, to execute an emergency plan to swiftly transfer their systemically important functions to an independent and new corporate entity, called a bridge bank.³² Thus, the Swiss believe capital assessment and organizational simplicity are the solution, not activity restriction or size limitations.

3. New Resolution Authority Regime: OLA

To address the concerns about the inability of the existing resolution regimes to handle the failure of a systemically important financial company, Dodd-Frank created a new special insolvency regime, known as the Orderly Liquidation Authority (“OLA”).³³

²⁹ Independent Commission on Banking, Issues Paper: Call for Evidence (Sept. 2010), available at <http://bankingcommission.independent.gov.uk/bankingcommission/wp-content/uploads/2010/07/Issues-Paper-24-September-2010.pdf>.

³⁰ Commission of Experts (appointed by the Swiss Federal Council), Final Report of the Commission of Experts for Limiting the Economic Risks Posed by Large Companies (Sept. 30, 2010), available at <http://www.sif.admin.ch/dokumentation/00514/00519/00592/index.html?lang=en>.

³¹ Jane Merriman, *Swiss Give Fresh Momentum to Contingent Bonds*, REUTERS, Oct. 4, 2010, <http://blogs.reuters.com/financial-regulatory-forum/2010/10/04/snap-analysis-swiss-give-fresh-momentum-to-contingent-bonds>.

³² Press Release, Swiss Commission of Experts, Commission of Experts submits package of measures to limit "too big to fail" risks, Oct. 4, 2010, available at <http://ow.ly/6ha7L>.

³³ Dodd-Frank Act §§ 201–217.

OLA is intended to avoid the serious, adverse effects of the liquidation of a systemically important financial company that would result if it were resolved under the Bankruptcy Code.

The new OLA regime, however, does not replace existing insolvency regimes. Instead, all companies eligible for orderly liquidation under the new regime remain subject to otherwise applicable insolvency law (generally the Bankruptcy Code) unless federal regulators determine, at the time of the financial company's impending failure, that the company should be liquidated under OLA.³⁴

Under OLA, a failing financial company will be placed into a receivership administered by the FDIC, the sole purpose of which is the liquidation of the financial company. Sick institutions cannot be rescued with interim aid – they must die. When appointed as receiver, the FDIC can borrow from the Treasury to finance a liquidation. If the proceeds from liquidation are insufficient to repay the Treasury borrowings, the FDIC will first recover from creditors any amounts received in excess of what they would have received in an ordinary liquidation. If there is any remaining shortfall, the FDIC can levy an assessment on all Council-designated systemically important non-bank financial companies and all other bank holding companies with \$50 billion or more in consolidated assets.

In the US, the decision was made after extensive debate not to create a fund in advance to be available for future crises but rather to impose a post-crisis levy on remaining, viable institutions to fund unmet costs of liquidations.³⁵ By contrast, the IMF has proposed a “financial stability contribution” to be paid by the industry prior to any failure, and linked to an effective resolution regime, to pay for the cost of any future governmental support to the financial sector.³⁶ A number of European governments are also considering “bank taxes” that would impose an assessment on financial institutions to create a fund that could be used for future “bail outs”. For example, the European Commission has launched a consultation regarding taxes on financial transactions and financial activities, and it is also seeking input on the introduction of separate bank levy.³⁷ In addition, the German government has adopted a bank tax and will use those revenues for its Restructuring Fund, which will be used to address future financial

³⁴ See Harvey Miller & Maurice Horwitz, *One Way That Dodd-Frank's Liquidation Authority Could Achieve Parity With The Bankruptcy Code*, 1 HARV. BUS. L. REV. ONLINE 1 (2010), <http://www.hblr.org/?p=350>.

³⁵ Jackie Calmes, *Taxing Banks for the Bailouts*, NY TIMES, Jan. 14, 2010, <http://www.nytimes.com/2010/01/15/us/15tax.html>.

³⁶ International Monetary Fund, *A Fair and Substantial Contribution by the Financial Sector: Final Report for the G-20 (June 2010)*, available at www.imf.org/external/np/g20/pdf/062710b.pdf.

³⁷ European Commission, *Consultation Paper on Financial Sector Taxation (Feb. 22, 2011)*, available at http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/financial_sector/consultation_document_en.pdf.

crises.³⁸

These flexible approaches should be contrasted to Dodd-Frank. OLA and Dodd-Frank restrict any funding that might allow weakened institutions to recover. The only choice is liquidation. Before Dodd-Frank, government aid often served to maintain a company's operations and to restore its health – as was seen in the infusions of taxpayer funds into AIG, Citibank and Bank of America, among others, as well as guarantees of debt issuances by the FDIC. In the face of public anger about “the bail out of Wall Street”, government aid on an individual basis is no longer available, even though the government has received significant returns from its investments.³⁹ Some have argued that restricting pre-insolvency assistance, comparable to TARP, and requiring liquidation, will, in fact, exacerbate the consequences of any individual failure because of contagion; instead, they call for an industry tax to create a fund permitting assistance to failing institutions⁴⁰. The new limitations on the FRB and the FDIC to assist individual failing companies and the resulting lack of flexibility under OLA are thought by some to be serious flaws of Dodd-Frank, especially since many believe Dodd-Frank has not adequately addressed too-big-to-fail.⁴¹ I agree with their critiques.

Another difficulty with OLA is that it does not apply to the significant non-US subsidiaries of systemically significant financial companies. Even if OLA had been in place at the time of the Lehman Brothers' insolvency, Lehman Brothers' UK entity would still have been resolved under the UK regime. While that regime has been changed, it is not the same as ours.

In response to the G-20's call, the IMF and the FSB are acting to develop a framework for a coordinated resolution regime. However, it is not clear how it will be implemented domestically.

Critical to coordination and cooperation concerning resolution of global systemically significant institutions is colleges of supervisors, who are expected to consult about coordinated resolution. In this regard, the development of living wills is essential for coordinated resolution in the absence of an international resolution authority. However, there are a number of open questions about how “living wills” will work for non-US financial institutions that have US operations and how US and non-US regulators will cooperate with respect to the companies in their respective jurisdictions over which

³⁸ See Germany, National Reform Programme 2011 15, (Apr. 6, 2011), available at http://ec.europa.eu/europe2020/pdf/nrp/nrp_germany_en.pdf.

³⁹ Yalman Onaran and Alexis Leondis, *Bank Bailout Returns 8.2% Beating Treasury Yields*, BLOOMBERG, Oct. 20, 2010, <http://ow.ly/6hb3G>.

⁴⁰ See, e.g., Steven L. Schwarcz, *Identifying and Managing Systemic Risk: An Assessment of Our Progress*, 1 HARV. BUS. L. REV. ONLINE 94, 103 (2011), <http://www.hblr.org/?p=1412>.

⁴¹ E.g. Victoria McGrane and Deborah Solomon, *Debating Dodd-Frank: Is 'Too Big to Fail' Gone?*, WALL ST. J., July 21, 2011, <http://online.wsj.com/article/SB10001424053111904233404576458381947014162.html>.

they have supervisory authority.

Absent further coordination in cross-border insolvencies of systemically important financial institutions, we are left with the dilemma of an uneven treatment of creditors and shareholders and a tendency for the regulators of markets in which large institutions operate to require operations to be conducted through subsidiaries, to ring-fence assets in those domestic subsidiaries, to impose liquidity requirements to protect domestic creditors and to avoid the transfer of assets prior to insolvency. Dodd Frank is silent on this issue.

4. Other Significant US-EU Differences

There are a number of other areas of financial regulatory reform in which the approaches of the US and EU diverge significantly.

a. Derivatives Market Reforms

In particular, the US proposals to reform the derivatives market differ in important ways from the reforms under consideration in the EU, including which types or classes of swaps will be subject to mandatory clearing requirements and how to reduce financial institutions' interconnectivity risk. Dodd-Frank also includes a controversial "push-out" provision, which prohibits certain forms of Federal assistance—including access to the FRB's discount window and FDIC deposit insurance—from being provided to swap dealers and major swap participants.⁴² The EU almost certainly will not adopt anything similar.⁴³ The US regime could also end up being more restrictive in areas such as the governance of central clearing counterparties.

In addition, the scope of the exemption from the clearing requirement in the US for "end users" of swaps that use them to hedge or mitigate commercial risk, whether US regulators will defer to EU margin requirements for non-cleared swaps, and how the US reporting requirements can be reconciled with EU privacy laws remain areas of uncertainty. Finally, Dodd-Frank authorizes the CFTC to impose position limits; there are no equivalent provisions in the EU.⁴⁴ In the absence of further international coordination, the EU proposes mutual recognition and cooperation arrangements with non-EU

⁴² See Dodd-Frank Act §716.

⁴³ See Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties, and Trade Repositories, COM (2010) 484 final (Sept. 15, 2010), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0484:FIN:EN:PDF> (containing no such provision); Kian Abouhossein et al., Regulatory Arbitrage Series: OW European over US IBs, JP Morgan Cazenove 3 (2011) ("... all major European banks (except from HSBC) will be unaffected whilst US banks would have to set up a new swap entity to comply with Section 716."), available at https://mm.jpmorgan.com/stp/t/c.do?i=5930E-12&u=a_p*d_558208.pdf*h_-2igf3ms.

⁴⁴ STATEMENT BEFORE THE H. COMM. ON AGRI. SUBCOMM. ON GENERAL FARM COMMODITIES AND RISK MGM'T (MAY 25, 2011) (STATEMENT OF CFTC COMM. JILL E. SOMMERS), AVAILABLE AT <HTTP://WWW.CFTC.GOV/PRESSROOM/SPEECHTESTIMONY/SOMMERSSTATEMENT052511.HTML>.

regulators if their regimes are deemed to be equivalent.⁴⁵ Unfortunately, however, Dodd-Frank does not have a similar provision for mutual recognition.

b. CRAs, Compensation, Hedge Funds & Accounting

Despite being criticized for their role in contributing to the crisis, the US has mandated little reform of credit rating agencies; by contrast, the EU has adopted rules that significantly affect the way credit rating agencies operate.⁴⁶ Similarly, the EU reforms to executive compensation and the regulation of hedge fund and private equity funds are much more prescriptive than those in the US. Finally, the different accounting standards between GAAP in the US and IFRS in the EU remain an ongoing point of divergence and contention.

V. Conclusion: Assessing Dodd-Frank's Impact and the Perils of Divergent Regimes

Although there are many open questions surrounding the ongoing implementation of regulatory reform, we can begin to assess Dodd-Frank's effectiveness in addressing the problems that led to the crisis as well as the US efforts to coordinate with the international community. Unfortunately, by either measure, Dodd-Frank does not, in my opinion, do well.

Critically, Dodd-Frank fails to reconfigure in any significant way the fragmented US regulatory structure. Rather than consolidating existing agencies into one or two regulators, each able to act quickly and efficiently, we now require regulators with a history of disagreement and difficulty in operating together to sit collegially around the Council's table and make key decisions by a vote of a majority or two-thirds of its members, depending on the issue. A single federal regulator may not be the answer, but the number of federal regulators we now have is surely not the right result either. The notion of one bank regulator, one markets regulator and one consumer regulator for all products remains, unfortunately, wishful thinking in the US.

But, more importantly, Dodd-Frank does not address adequately the issue of moral hazard. Despite the many provisions to monitor and reduce systemic risk, it remains unlikely that the Government will allow an institution that is the size of one of the US's five largest financial institutions to fail, especially in the absence of effective coordinated and consistent resolution mechanisms in key markets. The market will likely make that judgment as well, and those firms will continue to have financing advantages that only increase the likelihood of their failure.

There is also a serious question about whether Dodd-Frank will undermine the

⁴⁵ See EUROPEAN COMMISSION: BANKING, http://ec.europa.eu/internal_market/bank/index_en.htm (last visited Aug. 30, 2011).

⁴⁶ Andrew Willis, *EU Outlines New Credit Rating Agency Plan*, BLOOMBERG BUSINESSWEEK, June 4, 2010, http://www.businessweek.com/globalbiz/content/jun2010/gb2010064_765856.htm.

competitive position of major US financial institutions. Certain of its provisions, clearly, will not be followed in other key jurisdictions such as the EU – for example, the Volcker Rule. The universal bank model is now accepted globally as the way to do business, and the Volcker Rule is not consistent with that model and is not likely to be replicated elsewhere. Furthermore, the size limitation imposed with respect to growth by acquisition could disadvantage US institutions if the industry consolidates globally.

Regulatory arbitrage remains a real issue as nations enact their financial reforms. Funding resolution and bailout expenditures have been a point of international divergence. As noted earlier, the OLA is not pre-funded, given the desire to avoid the appearance of a bailout. Further, Dodd-Frank restricts regulators' other tools for financial assistance, such as government guarantees. Meanwhile, the IMF and European governments seem to be moving in the direction of imposing bank taxes to create resolution funds. Thus, the US may face a challenge in coordinating to resolve failing, international institutions if its only choice is liquidation, but other countries have a fund available to provide financial assistance to stave off insolvency.

Dodd-Frank is not as responsive as it should have been to the call of the G-20 for global, harmonized standards. The Atlantic Council's report on "The Danger of Divergence" surveys the proposed reform proposals in the US and the EU, noting the areas of convergence but also highlighting the many areas in which significant differences remain. The report also sets forth recommendations of how regulators in the US and EU can work together to harmonize reform efforts. In light of the continuing integration of the world's capital markets, international cooperation in implementing financial regulatory reform is essential if it is to be effective, especially between these two markets.