The 2011 Diane Sanger Memorial Lecture
Protecting Investors in Securitization Transactions: Does Dodd–Frank Help, or Hurt?

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Securitization has been called into question because of its role in the recent financial crisis. I examine the potential flaws in the securitization process and compare how the Dodd–Frank Act treats them. Although Dodd–Frank addresses one of the flaws, it underregulates or fails to regulate other flaws. It also overregulates by addressing aspects of securitization that are not flawed.

INTRODUCTION

Securitization has been criticized because of its role in the recent financial crisis. Securitization refers to a category of financing transactions in which companies sell rights to payment under mortgage loans, accounts receivable, lease rentals, and other types of income-producing financial assets to a trust or other special-purpose vehicle (an "SPV," sometimes interchangeably called a special-purpose entity or SPE). The goal is to separate these assets from the risks generally associated with the company—usually called the "originator" to distinguish it from the SPV. The originator then can use these assets, held by the SPV, to raise funds in the capital markets at a lower cost than if it had borrowed the funds.

Securitization accomplishes this cost saving for two reasons. First, by raising funds without having to borrow from a bank or other financial intermediary, the originator avoids the intermediary's profit mark-up. This approach, called "disintermediation," is similar to buying wholesale (rather than retail).

Second, the interest rate payable on the securities issued by an SPV is ordinarily lower than the interest rate payable on corporate securities issued directly by the originator. This interest-rate

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savings reflects that financial assets are usually more creditworthy—and almost always easier to understand and value—than an originator itself, which has all of the business and other risks associated with an operating company.[1]

Most securitization transactions follow a typical sequence of steps. When an originator sells financial assets to an SPV, the SPV issues securities to capital market investors. The SPV uses the cash proceeds of the securities issuance to pay the originator the purchase price of the financial assets. These steps are usually deemed to occur simultaneously.

Investors in the SPV's securities expect to ultimately be paid from collections on the financial assets purchased by the SPV. If, for example, those assets are residential mortgage loans, investors will be paid from mortgage payments made by the homeowners on those loans. Securities of an SPV that are payable from (i.e., backed by) collections on mortgage loans are often called mortgage-backed securities ("MBS"). Securities of an SPV that are payable from collections on other types of financial assets are often called asset-backed securities ("ABS"). References to ABS and asset-backed securities can also more broadly—and in my lecture, will—include MBS and mortgage-backed securities.

The first recognized securitization transactions took place in the United States in the early 1970s and involved pools of mortgage loans originated by savings and loan associations. These companies needed to turn their mortgage loans into cash to continue financing local housing demands. To achieve this, the Government National Mortgage Association (Ginnie Mae) facilitated securitizations through SPVs in the form of trusts holding mortgage loans and issuing securities in the form of trust certificates to investors.

Since then, securitization has become the principal means by which banks and other mortgage lenders turn residential home mortgage loans into cash in order to make new residential home mortgage loans and expand home ownership in the United States.[2]

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1. Thus, securities backed by financial assets are usually more creditworthy than securities issued directly by the originators. STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION § 1:3 (3d ed. & Supp. 2010) (explaining that except for the most highly rated issuers, securities issued in securitization transactions typically are more highly rated than the issuer's own debt securities—and that, even where the latter are more highly rated, securitization provides additional market flexibility to obtain financing).

2. Indeed, securitization more generally had become so important to the American economy that the Securities and Exchange Commission observed in 1992 that it was "becoming one of the dominant means of capital formation in

Securitization has also become an important way for companies of all types to raise low-cost financing.

This lecture focuses on the Dodd–Frank Act's impact on investor protection in securitization transactions. the analysis begins by examining securitization's role in the recent financial crisis. There is, however, an important perspective to keep in mind throughout the lecture. Investors in securitization transactions are generally large financial institutions such as banks, insurance companies, pension funds, and hedge funds. Many of these institutions are so large and sophisticated that they constitute qualified institutional buyers ("QIBs") under SEC Rule 144A,[3] enabling them to freely buy securities from and sell securities to other QIBs as if the securities were issued in a registered public offering.[4] One might question whether Dodd–Frank, or any other legislation, *should* have the goal of protecting these types of investors.[5]

I. SECURITIZATION'S ROLE IN THE RECENT FINANCIAL CRISIS

The securitization of subprime mortgage loans—essentially mortgage loans made to risky borrowers—is widely viewed as a root cause of the financial crisis. Securitization transactions were sometimes backed, at least in part, by these types of loans. Because home prices had generally been increasing in the United States since the Great Depression, the expectation was that continuing home-price appreciation would enable even risky borrowers to repay their loans by refinancing their houses. But this model failed when, in 2007 and 2008, home prices fell significantly.

Many argue that the "originate-to-distribute" model of securitization, enabling mortgage lenders to sell off loans as they are made, led to overreliance on the expectation of repayment through home-price appreciation. According to this argument, the

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the United States." Investment Company Act Release No. 19105, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,062, at 83,500 (Nov. 19, 1992) (provided in connection with the issuance of Rule 3a-7 under the Investment Company Act of 1940).

3. Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373, 385 (2008) (defining QIBs and noting they were the group that lost the most money during the recent financial crisis).

4. 17 C.F.R. § 230.144A (1995).

5. My lecture does not purport to address the narrow issue of mortgagor protection. Much has already been written on that topic, and mortgage loans are only a subset of the financial assets involved in securitization transactions.

originate-to-distribute model created moral hazard because lenders did not have to live with the credit consequences of their loans. Loan origination standards therefore fell.[6]

I will later discuss other possible explanations of why subprime loans were made and securitized. Whatever the explanation, the fall in home prices meant that subprime borrowers who were relying on refinancing for loan repayment could not refinance. Furthermore, many subprime mortgage loans had adjustable rates which increased after an initial "teaser" period. Borrowers who could not afford the rate increases had expected to refinance at lower interest rates. That likewise was stymied by collapsing home prices. For these reasons, risky borrowers began defaulting.

The defaults had mostly localized consequences in ordinary securitization transactions. But, they had larger, systemic consequences in transactions that involved complex and highly leveraged securitizations of ABS already issued in prior securitizations—effectively "securitizations of securitizations."[7] I refer to these collectively as "ABS CDO" transactions.[8]

The distinction can be explained in a simplified manner as follows. In ordinary securitization transactions, payment on the ABS is derived directly from collections on the underlying financial assets owned by the SPV. When the underlying pool of financial assets includes mixed types of assets, such as mortgage loans and non-mortgage loans, the securitization is sometimes referred to as a collateralized debt obligation ("CDO") transaction. Yet, it is still an ordinary transaction, and payment is still derived directly from the underlying financial assets.

Problems began to arise, however, when ABS issued in ordinary securitization transactions *were themselves securitized* in the ABS CDO transactions, under which numerous classes, or "tranches," of securities of descending priority were sold to investors. The resulting leverage caused relatively small errors in cash flow projections—due to unexpectedly high default rates on underlying subprime loans—to create defaults on substantial amounts of low-investment-grade-rated subordinated tranches of these securities, and to cause even AAA-rated senior tranches of these securities to be downgraded.

Why did these transactions degenerate to the point that even relatively small errors in cash flow projections caused defaults and

6. Arguably, the fall was exacerbated by the fact that mortgage lenders could make money on the volume of loans originated.

7. Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211, 220 (2009).

8. These are CDOs of ABS.

downgradings? One explanation is that securitization's focus on mathematical modeling to statistically predict the payments on financial assets underlying ABS CDO securities fostered an overreliance on modeling and an abandonment of common sense.[9] Another explanation is that investors, who seemed as anxious to buy these securities as underwriters were to sell them, were overly complacent.

Whatever the reasons, these defaults and downgradings spooked investors, who believed "AAA" meant iron-clad safety and "investment grade" meant relative freedom from default. Investors started losing confidence in ratings and avoiding the debt markets. Fewer investors meant that the price of debt securities began falling. Falling prices meant that firms using debt securities as collateral had to mark them to market and put up cash. But that required the sale of more securities, causing market prices to plummet further downward in a death spiral.

The U.S. Government's refusal in mid-September 2008 to save Lehman Brothers, and Lehman's resulting bankruptcy, added to this collapse. Investors lost all confidence in debt markets, and even the short-term commercial paper market virtually shut down. The lack of debt financing meant companies could no longer grow and, in some cases, even survive. That affected the real economy and, at least in part, contributed to the financial crisis.

The crisis was also arguably exacerbated by the fact that securitization made it difficult to work out problems with the underlying mortgage loans. The beneficial owners of the loans were no longer the mortgage lenders, but a broad universe of investors in the ABS. Servicers theoretically bridged the gap, tasked with the responsibility to restructure the underlying loans "in the best interests" of those investors. The reality, however, was more problematic.

Servicers were reluctant to engage in restructurings when there was uncertainty that their costs would be reimbursed. Foreclosure costs, in contrast, were relatively minimal. Servicers also preferred foreclosure over restructuring because foreclosure was more ministerial and thus had lower litigation risk.[10] As a result,

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9. *See* Steve Lohr, *In Modeling Risk, the Human Factor Was Left Out,* N.Y. TIMES, Nov. 5, 2008, at B1 (describing how the models failed to keep pace with the complex securities); Steven L. Schwarcz, *The Future of Securitization*, 41 CONN. L. REV. 1313, 1323–24 (2009).

10. Restructuring can involve difficult decisions. For example, in a mortgage securitization transaction in which cash flows deriving from principal and interest are separately allocated to different investor classes, or tranches, a restructuring that reduces the interest rate would adversely affect investors in the

foreclosure was artificially favored, forcing many homeowners from their homes and further driving down property values.

II. DODD–FRANK'S RESPONSE

The Dodd–Frank Act[11] addresses securitization, by focusing, essentially, on three issues: (i) adequacy of disclosure, (ii) conflicts between securitizers and investors, and (iii) rating agency information. In discussing Dodd–Frank, I will occasionally use the Act's term, "securitizer." The term is somewhat imprecise, meaning either the issuer of ABS or a person who organizes and initiates an ABS transaction by selling or otherwise transferring financial assets, directly or indirectly, to the issuer.[12] Because issuers of ABS are virtually always SPVs, the real securitizer impacted by the Act would usually be either the originator itself or an investment bank that pools financial assets into an SPV for eventual issuance of CDO or ABS CDO securities.

(i) Adequacy of Disclosure: The Act directs the SEC to require more standardized disclosure of information regarding the underlying financial assets, including information on the assets underlying each class of ABS.[13] This disclosure requirement is intended to facilitate an easier comparison of classes.[14] The Act also directs the SEC to require securitizers to engage in a due-diligence review of the underlying financial assets and to disclose to investors the nature of the review.[15]

(ii) Conflicts between Securitizers and Investors: The Act attempts to limit conflicts of interest between securitizers and investors by requiring securitizers, in transactions that are not backed entirely by qualified residential mortgage loans,[16] to retain an unhedged economic interest in the credit risk of each class of ABS.[17] This is colloquially known as keeping "skin in the game."

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interest-only tranche (and likewise, a restructuring that reduces principal would adversely affect investors in the principal-only tranche).

11. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 941–946, 124 Stat. 1376 (2010) [hereinafter Dodd–Frank Act].

12. *Id*. § 941(b) (codified as amended at 15 U.S.C. § 78o-11 (2010)).

13. *Id.* § 942(b) (codified as amended at 15 U.S.C. §77g(c) (2010)).

14. *Id.*

15. *Id.* § 945 (codified as amended at 15 U.S.C. § 77g(d) (2010)).

16. The SEC and other governmental agencies are directed to collectively define what constitutes qualified residential mortgage loans, taking into account mortgage risk factors. *Id.* § 941(b) (codified as amended at 15 U.S.C. § 78o-11 (2010)).

17. *Id.* § 941 (codified as amended at 15 U.S.C. § 78c(a) (2010)).

The minimum retained interest is generally five percent,[18] although it may be less if the financial assets meet quality standards to be announced by government agencies.[19]

(iii) Rating Agency Information: Dodd–Frank also requires the SEC to adopt regulations requiring rating agencies to explain, in any report accompanying an ABS credit rating, the representations, warranties, and other enforcement rights available to investors, including a comparison of how these rights differ from rights in similar transactions.[20]

In addition to these securitization-targeted provisions, Dodd–Frank attempts to generally increase investor protection. For example, it enables the SEC to impose a fiduciary standard on broker–dealers providing personalized investment services.[21] It also provides special protections for investors who are older individuals.[22] These more general protections, however, would not appear to be significant to investors in securitization transactions, who are usually financial institutions that choose their investments through internal financial analysts rather than acting through broker–dealers or other fiduciaries.

Much of the substance of the Dodd–Frank Act will be realized through administrative rulemaking by the SEC and other federal government agencies.[23] The Act also creates a Financial Stability Oversight Council to examine and monitor possible sources of systemic risk[24] and to identify any regulatory gaps.[25]

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18. When an originator retains some risk, that risk subtracts from the 5% risk that the securitizer would otherwise have to hold.

19. These agencies are the Office of the Comptroller of the Currency, Federal Reserve Board, and Federal Deposit Insurance Corporation.

20. Dodd–Frank Act § 943 (2010). Dodd–Frank also has provisions, indirectly affecting securitization, aimed at increasing the reliability of credit ratings issued by rating agencies. *See, e.g.*, *id.* §§ 931–939H. Dodd–Frank also includes provisions regulating credit rating agencies.

21. *Id.* § 913 (codified as amended at 15 U.S.C. § 78o (2010)).

22. *Id.* § 989A (codified at 12 U.S.C. § 5537 (2010)).

23. *Cf.* Lois L. Weinroth & Richard L. Fried, *Securitization Provisions of the Dodd–Frank Act*, J. STRUCTURED FIN., Fall 2010, at 38, 43 (observing that "it is impossible to predict at this time the full range of regulations that will be applicable to the asset-backed securitization industry").

24. Dodd–Frank Act § 111 (2010) (codified at 12 U.S.C. § 5321 (2010)). The Secretary of the Treasury chairs the Council, which has nine additional voting members (all but one of whom is a federal agency head, including the Chairman of the Federal Reserve Board). Because the Council meets only periodically, its day-to-day operations are run through a new Office of Financial Research within the Department of the Treasury. This office is responsible for collecting data from regulators and market participants, issuing reports on potential regulatory gaps, and making supervisory recommendations. *Id.* §§ 116, 152–154.

III. DOES DODD–FRANK ADDRESS SECURITIZATION'S FLAWS?

I believe that Dodd–Frank inadequately addresses securitization's flaws. Although it addresses one of the flaws (or, at least, alleged flaws), it underregulates or fails to regulate other flaws. It also overregulates by addressing aspects of securitization that are not flawed.

A. Dodd–Frank Addresses One of Securitization's Flaws

Dodd–Frank addresses one of securitization's flaws—or at least one of its alleged flaws. I mentioned that the originate-to-distribute model of securitization is believed to have fostered an undisciplined mortgage lending industry, including the making of subprime loans. The Dodd–Frank Act addresses the originate-to-distribute model by requiring securitizers to retain skin in the game, i.e., to retain some realistic risk of loss.[26] The theory is that by aligning the incentives of securitizers—meaning in this case the originators of the loans—and investors, the lending industry will become more disciplined.

A remaining issue is the extent to which the originate-to-distribute model actually caused mortgage underwriting standards to fall. Some argue standards fell because of U.S. governmental pressure on banks and other mortgage lenders to make and securitize subprime mortgage loans to expand homeownership.[27] The fall in standards also may reflect distortions caused by the liquidity glut of the time when lenders competed aggressively for business,[28] or it may have been caused by conflicts of interest between lending firms and their employees in charge of setting lending standards, such as employees being paid for booking loans regardless of the loans' long-term performance.[29] Blaming the originate-to-distribute model for lower mortgage underwriting

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25. *Id.*

26. *See supra* text accompanying notes 16–19.

27. *See generally* Peter J. Wallison, *The Lost Cause: The Failure of the Financial Crisis Inquiry Commission*, AEI FINANCIAL SERVICES OUTLOOK (January–February 2011), *available at* http://www.aei.org/files/2011/02/10/FSO-2011-02-g.pdf.

28. *Id.* at 3–4 (noting the deterioration of mortgage underwriting standards in the years prior to the bubble's collapse).

29. Carlos Garriga, *Lending Standards in Mortgage Market*, FEDERAL RESERVE BANK OF ST. LOUIS ECONOMIC SYNOPSES (2009), *available at* http://research.stlouisfed.org/publications/es/09/ES0923.pdf (describing generally that lending standards were too loose).

standards also does not explain why standards were not similarly lowered for originating non-mortgage financial assets used in other types of securitization transactions. Nor does it explain why the ultimate beneficial owners of the mortgage loans—the investors in the ABS—did not govern their investments by the same strict lending standards that they would observe but for the separation of origination and ownership.

The extent to which the originate-to-distribute model actually contributed to the financial crisis may never be known. If that model was not a significant causal factor, Dodd–Frank's skin-in-the-game requirement may well constitute overregulation.

Also, it is ironic that skin-in-the game can even lull investors into a false sense of security. In the financial crisis, for example, there is some evidence that investors purchased senior tranches of ABS because underwriters retained the most subordinated interests—creating what I have termed a "mutual misinformation" problem.[30]

To its credit, though, Dodd–Frank mandates that the Financial Services Oversight Council submit a report to Congress on the macroeconomic effects of the skin-in-the-game requirements, including possibly proactively regulating mortgage origination as an alternative or supplement.[31]

B. Dodd–Frank Underregulates and Fails to Regulate other Flaws

Dodd–Frank underregulates, and in some cases fails to regulate, other flaws of securitization. For example, Dodd–Frank fails to meaningfully address the danger of mixing politics and finance, as occurred before the financial crisis with the governmental pressure to securitize subprime mortgage loans to expand home ownership.[32]

Dodd–Frank also does not directly address the problem of overreliance on mathematical modeling. Mathematical models are not inherently problematic. To the contrary, if the model is realistic and the inputted data are reliable, models can yield accurate predictions of real events. However, if the model is unrealistic or the inputted data are unreliable—as occurred when unexpectedly high default rates due to the housing collapse undermined the value of ABS CDO securities—it can be misleading.

Because the financial crisis has shaken faith in the market's ability to analyze and measure risk through models, this

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30. Schwarcz, *supra* note 7, at 241–42.
31. Dodd–Frank Act § 946 (2010).
32. *See supra* note 27 and accompanying text.

overreliance on mathematical models should, to some extent, be self-correcting. In the long term, however, I fear that, as market experience has often shown, investor memories will become short.

Dodd–Frank also fails to address the complacency problem.[33] I am not sure, however, that regulation is an effective method of changing human behavior. Because there is a perceived safety in numbers, market participants will inevitably engage in herd behavior. And, if others are doing it, some people will continue to invest in high-yielding securities they cannot understand. When I was a law student, I took a seminar in legislation with the great legislative scholar, Frank Grad. He would often observe that the real problem is not statutory drafting per se but the fact that statutes apply to, and are applied by, people.

Dodd–Frank also does not address the servicing problem, but I find that less troublesome. Parties can—and should have incentive to—write underlying deal documentation that sets clearer and more flexible guidelines and more certain reimbursement procedures for loan restructuring, especially when restructuring appears to be superior to foreclosure. Parties can also minimize allocating cash flows to investors in ways that create conflicts. Furthermore, parties can agree, when appropriate, to subject servicers to more realistic performance standards, perhaps akin to a business judgment rule that allows them to restructure loans in good faith without being exposed to liability.[34]

C. Dodd–Frank Overregulates by Addressing Aspects of Securitization that are Not Flawed

Dodd–Frank overregulates by addressing some aspects of securitization that are not flawed. I have already indicated that the skin-in-the-game requirement might constitute overregulation. Dodd–Frank also may overregulate in its requirements for more standardized disclosure of information. In principle it should be helpful for investors to get that information, including information

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33. *Cf.* RANDALL S. KROSZNER & ROBERT J. SHILLER, REFORMING U.S. FINANCIAL MARKETS: REFLECTIONS BEFORE AND BEYOND DODD-FRANK 16 (2009) (comparing the current complacency with that of the Great Depression era); Scott McCleskey, *The Scott McCleskey Report: Assessing Dodd–Frank: Systemic Risk*, GOVERNANCE, RISK AND COMPLIANCE: DODD FRANK WATCH, 1 (July 10, 2010), http://www.complinet.com/dodd-frank/news/analysis/article/the-scott-mccleskey-report-assessing-dodd-frank-systemic-risk.html (noting there is a complacency issue in the models used to assess market risk).

34. *Cf.* Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037 (2008) (arguing this standard should apply to indenture trustee duties after default).

about the financial assets underlying each class of ABS. In my experience, though, prospectuses usually already provide this type of information.[35] Furthermore, although Dodd–Frank will require securitizers to engage in a due-diligence review of the underlying financial assets and to disclose to investors the nature of the review, that too, in my experience, is already routinely done.

The larger problem is that investors do not always read and understand the disclosed information.[36] There are at least two reasons for this. One reason is complacency, discussed above. The second reason is a conflict of interest within investing firms. As investments become more complex, conflicts of interest are increasingly driven by short-term management compensation schemes, especially for technically sophisticated secondary managers.[37]

For example, as the VaR, or value-at-risk, model for measuring investment-portfolio risk became more accepted, financial firms began compensating secondary managers not only for generating profits but also for generating profits with low risks, as measured by VaR. Secondary managers therefore turned to investment products with low VaR risk profiles, like credit-default swaps that generate small gains but only rarely have losses. The managers knew, but did not always explain to their seniors, that any losses that might eventually occur would be huge.

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35. *Cf.* 17 C.F.R. § 230.421 (1994) (noting there must be a clear presentation of information to potential investors); JAMES D. COX ET AL., SECURITIES REGULATION CASES AND MATERIALS 143–47 (2009) (discussing disclosure requirements).

36. The Dodd–Frank Act does attempt to address other possible flaws that have been associated with securitization: that investors in securitization transactions may over-rely on rating-agency ratings, and that derivatives are largely unregulated. The extent of appropriate reliance on ratings, and indeed the integrity of the ratings process itself, are matters of concern to debt markets generally, not merely to securitization markets. Similarly, the question of derivatives regulation goes far beyond securitization, and, in my experience, virtually only non-standardized derivatives—a type not the primary focus of Dodd–Frank, which requires standardized derivatives to be traded in centralized clearing houses—tie into securitization transactions. The Dodd–Frank Act requires that standard derivatives be cleared through central clearinghouses. Dodd–Frank Act § 956 (2010) (codified at 12 U.S.C. § 5641 (2010)). Certain customized derivative transactions, as well as derivatives transactions by non-financial companies, however, are not subject to centralized clearing. Dodd–Frank Act §§ 723, 727, 731, 763, 764, 766 (2010). I therefore will not focus on rating agencies or derivatives.

37. *See* Steven L. Schwarcz, *Conflicts and Financial Collapse: The Problem of Secondary-Management Agency Costs*, 26 YALE J. ON REG. 457 (2009); Schwarcz, *supra* note 7, at 261–62.

This is an intra-firm conflict, quite unlike the traditional focus of scholars and politicians on conflicts between managers and shareholders. Dodd–Frank attempts to fix the traditional type of conflict but completely ignores the problem of secondary-management conflicts.[38] The regulatory response should require that the compensation of managers of financial institutions, *including secondary managers*, be based more on long-term firm performance.

Dodd–Frank's focus on disclosure may also be insufficient.[39] Disclosure itself can never be a complete answer to complexity.[40]

In the foregoing context, Dodd–Frank's mandate to the SEC—to adopt regulations requiring rating agency reports on securitization transactions to explain the rights available to investors and compare those rights with rights in similar transactions—is somewhat incongruous because it places disclosure obligations on rating agencies. To the extent this information is material, its inclusion should already be required in any prospectus accompanying the sale of ABS. Requiring rating agencies to also disclose this information is, to that extent, overregulation.[41]

CONCLUSION

At the outset of this lecture, I questioned whether Dodd–Frank or any other legislation *should* have the goal of protecting the largest and most sophisticated investors. I certainly do not believe these investors need protection as a matter of governmental paternalism. On the other hand, their failures can cause terrible externalities, potentially having systemic consequences to the

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38. Dodd–Frank's attempt to fix the traditional conflict might actually backfire. Recent research by Professor Iman Anabtawi at UCLA suggests that shareholders, even more than senior executives, want companies to take risks.

39. The other market imperfections—complacency and a type of tragedy of the commons in which the benefits of exploiting finite capital resources accrue to individual market participants, each of whom is motivated to maximize use of the resource, whereas the costs of exploitation are distributed more widely—are matters of concern to debt markets generally, not merely to securitization markets, so I won't focus on them.

40. *See, e.g.,* Steven L. Schwarcz, *Disclosure's Failure in the Subprime Mortgage Crisis*, 2008 UTAH. L. REV. 1109 (2008) (arguing that disclosure is a necessary but insufficient response to complexity); Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1 (2004) (same).

41. Although, I can see an argument that rating agencies are likely to have broader industry knowledge, enabling them to more easily prepare that disclosure.

financial system. To that extent, protecting those investors will protect others.

I also observed that some financial products, such as securitization, have become so complex that disclosure can never be a complete answer. Because of this increasing complexity, failures are and will continue to be inevitable. Ex post regulatory responses, such as financial market stabilizers, will therefore become increasingly important to supplement ex ante regulatory restrictions.[42]

Finally, although Dodd–Frank imperfectly addresses securitization, we can hope that the administrative rulemaking it delegates will eventually curtail some of the *over*regulation, and that the Financial Stability Oversight Council created by Dodd-Frank will eventually recommend fixes for the *under*regulation.

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42. *See, e.g.*, Steven L. Schwarcz, *Ex Ante Versus Ex Post Approaches to Financial Regulation: The Chapman Dialogue Series and Law Review Symposium Keynote Address*, 15 CHAP. L. REV. 257 (2011).