MARKET CRISES AND DODD-FRANK: DOES THE ACT PROTECT AGAINST HAZARDOUS STUDENT LOAN SECURITIZATION?

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Abstract

This note evaluates whether the provisions of the Dodd-Frank Act's Title IX effectively protect the markets from the threat of predatory and toxic securitization through the examination of the student loan asset-backed securities (SLABS) market. Much of Title IX specifically addresses the dangers inherent in mortgage-backed securities, but are other risky forms of asset-backed securities sufficiently guarded against? This paper will compare two market crises: the 2007–08 crisis and the Black Monday crash of 1987 to identify some commonalities, detail how SLABS are formed and sold, and examine how effective the central protections of Title IX have been in preventing risky securities investing. The results lead to a determination that the main reasons that the financial crisis of 2007–08 occurred have either not been addressed, have not been implemented, or have been circumvented. In order to guard against another securities-related financial crisis, the Dodd-Frank Act will need significant amendment and reform.

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I. Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act, Act) is often held up as the answer the financial woes which led to the last global financial market crisis.[1] The Act's proponents insist that it is the only thing standing between the U.S. financial markets and another crisis, such as the one which touched off the Great Recession.[2] Any time that the Dodd-Frank Act is under consideration for reform or repeal, those same proponents can be counted on to proclaim that removing the protection embodied in the

[1] Greg Gelzinis et al., *The Importance of Dodd-Frank, in 6 Charts*, CTR. FOR AM. PROGRESS (Mar. 27, 2017, 9:51 AM), https://www.americanprogress.org/issues/economy/news/2017/03/27/429256/importance-dodd-frank-6-charts/ [perma.cc/9JQ4-TL6Z] ("Dodd-Frank ensures that today's consumers in the financial marketplace are safer and more financially stable than before the crisis.").

[2] Barney Frank, Opinion, *Trump's Financial Plans Promise Another Great Recession*, BOS. GLOBE, Dec. 7, 2016, http://apps.bostonglobe.com/graphics/2016/11/dodd-frank.

Act will send the markets back on a path to financial disaster.[3] Meanwhile, opponents of the law hold forth that instead of protecting the financial markets, Dodd-Frank stifles them, and builds more systemic risk in so doing.[4] However, few have really looked into the Act itself to verify the claims of protection—not against a danger which is known, such as Mortgage Backed Securities (MBS)—but against one which has not yet become a problem, specifically Student Loan Asset Backed Securities (SLABS).

This note will examine the efficacy of the Dodd-Frank Act's protections contained in Title IX of the Dodd-Frank Act (Title IX) against predatory and toxic securitization through a case study of contemporary SLABS. Student loan securitization carries many of the same potential dangers as MBS did before the crisis of 2007–08. This note will determine that Dodd-Frank is ineffective at protecting against the potential abuses of SLABS and their associated systemic risk, and that the SLABS market, while not currently as shaky as the MBS market that led to the 2007 crash, already exhibits the same behaviors and is subject to the same pressures that eventually led the MBS market to cause a global market crisis.

Part II will introduce the topic, briefly describe the issue, and compare two market crises: the recent financial crisis of 2008-09, and the Black Monday market crash of 1987. Part III will detail SLABS, including how they are created and the current state of the market. Part IV will examine and analyze the protections contained in Title IX—the Investor Protection and Securities Reform Act of 2010—and how they apply to SLABS, focusing most heavily on the attempted reformation of credit rating agencies and the rules on risk retention. Part V will examine several potential dangers inherent to SLABS that are distinct

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[3] Jacob Passy & Maria LaMagna, *How the Rollback of Obama-era Financial Regulations Could Affect You*, MARKETWATCH (Mar. 20, 2018, 8:52 AM), https://www.marketwatch.com/story/how-the-rollback-of-the-obama-era-financial-regulations-affects-you-2018-03-19 [perma.cc/3NXD-PJZP] (quoting opponents of a bill containing rollback of some of Dodd-Frank's standards: "There is no doubt that if passed into law, this bill would encourage the finance industry to engage in the types of reckless lending that pulled Americans into a Great Recession . . . .").

[4] *See generally* Peter J. Wallison, *Why Large Portions of the Dodd-Frank Act Should Be Repealed or Replaced*, *in* THE CASE AGAINST DODD-FRANK 11 (Norbert J. Michel ed., 2016) (arguing that Dodd-Frank not only fails to address the causes of the global financial crisis, but actually harms the economy).

from MBS, showing that the Dodd-Frank Act does not address these systemic risks. The piece concludes with Part VI.

II. Background: Market Crises and Dodd-Frank

More now than at perhaps any other time in our nation's history, the financial markets seem to be present in the public awareness. How and why they function are still a mystery to many, but most at least grasp the simple truth that a market crash affects us all, not just investors and bankers.[5] Beyond the systemic economic depression that a crisis can touch off, more and more people have their retirement savings in 401(k)s that are directly affected by market health.[6] The last financial crisis hurt the financial well-being and stability of the general public, and left many wondering how and when the next crisis would occur.[7] The Dodd-Frank Act was billed to the public as a cure to Wall Street's ills, containing preventative measures that would ensure the public would never again have to bail out the financial industry.[8]

But what causes market crises in the first place? They can be hard to predict and often seem to emanate from wildly different sources.[9] Comparing, for instance, the financial crisis of 2008–09 and

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[5] *See* Tejvan Pettinger, *How Does the Stock Market Affect the Economy?*, ECONOMICSHELP (Feb. 6, 2018), https://www.economicshelp.org/blog/221/stock-market/how-does-the-stock-market-effect-the-economy-2/ [perma.cc/EJ2C-UNYG].

[6] Paula Aven Gladych, *401(k), IRA Account Balances Rise to Record Levels*, EBN (Feb. 8, 2018, 4:41 PM), https://www.benefitnews.com/news/401-k-ira-account-balances-rise-to-record-levels [perma.cc/E2C4-5NP5].

[7] Marilyn Geewax, *Unhappy 10th Anniversary, Great Recession. You Still Hurt Us*, NPR (Dec. 14, 2017, 6:02 AM), https://www.npr.org/2017/12/14/570556990/unhappy-10th-anniversary-great-recession-you-still-hurt-us [perma.cc/8ZXX-62JR].

[8] James Quinn, *Obama Promises US Taxpayer Will Never Again Foot the Bill for Banks*, TELEGRAPH (July 21, 2010, 8:39 PM), https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7903365/Obama-promises-US-taxpayer-will-never-again-foot-bill-for-banks.html [perma.cc/9UQ4-X77D] (recounting President Obama's declaration that the Dodd-Frank Act would protect consumers and investors from the "dark corners" of the market, and prevent another Wall Street bailout from ever occurring).

[9] John C. Bogle, *Black Monday and Black Swans*, 64 FIN. ANALYSTS J. 30, 30 (2008) ("So, the application of the laws of probability to our financial markets is badly misguided. If truth be told, the fact that an event has never before

the less serious Black Monday crisis of 1987 (Black Monday), there is little similarity to their causes aside from the gross generality that they were probably driven by flawed investing strategies.[10] The problem with preventing flawed investment strategies is that it is often hard to tell in advance that they are dangerous.[11] To demonstrate this point, it is helpful to briefly examine Black Monday, the first truly global financial crisis. While most are familiar with the events of the financial crisis of 2008–09, fewer are well acquainted with Black Monday, and a comparison yields interesting similarities and contrasts.

A. The Black Monday Crisis: The First Great Global Market Crash

On October 19, 1987, known as "Black Monday," the Dow Jones Industrial Average dropped more than 508 points—almost twenty-three percent—the worst crash to date in American history.[12] Subsequently, a Presidential Task Force carefully analyzed the events of Tuesday, October 14, 1987, to Tuesday October 20, 1987, in an attempt to get the best picture of what led up to Black Monday, and what happened in its immediate aftermath.[13] One interesting detail included in their report is that the precipitous decline of Black Monday was preceded by a long period of growth (a bull market) that lasted from August 1982 to December 1986.[14] Another factor was that in

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happened in the markets is no reason whatsoever that is cannot happen in the future.").

[10] Diana B. Henriques, *Those Who Don't Learn from Financial Crises Are Doomed to Repeat Them*, ATLANTIC (Sept. 19, 2017), https://www.theatlantic.com/business/archive/2017/09/financial-crisis-black-monday/539859/ [perma.cc/SC8A-S3ZF].

[11] *Id.* ("There is another stark similarity between the 1987 and 2008 crises. In both cases, those warnings about fundamentally new market risks and a fragmented regulatory system were largely ignored.").

[12] PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, REPORT OF THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS 36 (1988).

[13] *Id.* at 15–42; *"Black Monday," the Stock Market Crash of October 19, 1987: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs on the Turbulence in the Financial Markets Last October, the Functioning of Our Financial Markets During that Period, and Proposals for Structural and Regulatory Reforms*, 100th Cong. 2 (1988) (wherein Senator Proxmire, D. Wis., said that "we came within a gnat's eyelash of complete collapse" and referred to October 20, 1987 as "Terrible Tuesday.") [hereinafter *Hearing*].

[14] PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at 9.

1981 Congress had been assured by the heads of the U.S. Securities and Exchange Commission (SEC) and U.S. Commodity Futures Trading Commission that the stock and futures markets were distinct and separate, and thus divided regulation was appropriate.[15] Finally, the events of Black Monday marked a test by fire of an investment strategy called "portfolio insurance."[16] In portfolio insurance, investment companies used computer-generated models to "comput[e] optimal stock-cash ratios at various market price levels."[17] However, instead of buying and selling stocks in response to market movement, portfolio insurance dictated trading futures in the mistaken belief that this would not affect the stock market appreciably.[18] All of these factors combined to create a communal sense of market security and optimism, which Black Monday's events ultimately proved to be hollow.

Black Monday demonstrated that in market crises, the dangers that should be guarded the most assiduously against are often the ones to which no-one is alert.[19] The subject matter experts in the top regulatory agencies were united in their view that central regulation was not needed, and, in their defense, before Black Monday, there was no such thing as an inter-market, global financial crisis.[20] Investment companies championed portfolio insurance not because they thought it would harm their clients or because their greed outweighed their common sense—rather it was seen as the best way to hedge and safeguard their client's funds.[21] Those who study and discuss market

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[15] *Hearing*, *supra* note 13 ("Gentlemen, your SEC and CFTC predecessors came before this committee in 1981 to help us work out who should oversee the financial futures market. At the time, the CFTC chairman stressed that the fledgling financial futures products were distinct from equities; they were moved by general economic factors.").

[16] PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at 17.

[17] *Id.*

[18] *Id.* at 55–56.

[19] *See Hearing*, *supra* note 13, at 12 (finding that areas that were thought to be secure actually posed great dangers).

[20] *Id.*

[21] *See* PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at 17 ("Rather than buying and selling stocks as the market moves, most portfolio insurers adjust the stock-cash ratio within their clients' investment portfolios by trading index futures. Indeed, several major portfolio insurance vendors are authorized to trade only futures, and have no access to their clients' stock portfolios.").

crises should always remember the first lesson of Black Monday: it usually isn't the one you see that gets you.

Considered side-by-side with the 2008–09 financial crisis, clear similarities emerge. Investment companies in the subprime crisis were also pursuing what seemed like a sure thing.[22] Most were not investing in MBS out of reckless greed, but because it seemed the safe, profitable thing to do.[23] It also seems a reasonable conclusion that when the majority of market actors congregate on one particular strategy (such as portfolio insurance) or type of asset (MBS), the mass participation risks priming the market for a collapse.[24] A strong enough shock, such as proposed tax legislation in the case of Black Monday,[25] or the housing bubble bursting in the case of the subprime crisis,[26] can then easily trigger a crisis as the majority of market actors are incentivized to react in the same manner, creating a snowball effect.[27]

After Black Monday, the Task Force recommended legislative and regulatory changes in order to prevent another market crisis.[28] Some recommendations were realized, such as implementing "circuit breakers" for the financial markets to slow down trading on the occurrence of a catastrophic market event.[29] Others were never followed, such as putting a single agency in charge over all the financial

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[22] *See* Dhruv Kumar, *What Caused The Financial Crisis?,* NE. U. ECON. SOC'Y (Feb. 8, 2016), https://web.northeastern.edu/econsociety/what-caused-the-financial-crisis/ [perma.cc/VGP3-LG7L] ("Home prices were always going up and were considered a juggernaut of the American economy. This fact added a sense of security for Wall Street investors because if they wanted to sell a defaulted home they would make a profit and it also convinced them that there would always be an ample supply of American home buyers because everyone wants to owns safe assets that are rising.").

[23] *Id.* ("The reason Wall Street thought this was a good idea was because home loans were very safe investments.").

[24] *See generally* HAROLD L. VOGEL, FINANCIAL MARKET BUBBLES AND CRASHES (2d ed., 2018) (explaining how bubbles lead to market crashes).

[25] PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at v (finding that the crash was partly "triggered" by . . . proposed tax legislation).

[26] Kumar, *supra* note 22.

[27] *Id.*

[28] *See* PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at 63–68 (recommending "clearing and credit mechanisms," "[m]argin requirements," "circuit breaker mechanisms," and "information systems").

[29] *See* Julie E. Cohen, Lochner *in Cyberspace: The New Economic Orthodoxy of "Rights Management*", 97 MICH. L. REV. 462, 562–63 (1998).

markets.[30] It is interesting to note that the Dodd-Frank Act too mandated action in some areas that was never taken.[31] Perhaps the second lesson we can garner from the comparison of these two crises is simply to follow through on addressing the problems identified after the crisis.

B. Dodd-Frank's Protection Against Future Market Crises

If the Dodd-Frank Act does prevent the financial markets from suffering another crisis, exactly what behavior is being prevented or controlled? An unhelpful answer to the question of what causes market crises, although one that is often given, is that they are caused by greed.[32] Financial markets are, by their very nature, driven by a desire for profit. Every would-be retiree who puts their savings into a 401(k) that includes stocks is counting on that desire to work in their favor, which it currently does.[33] Pension funds often deride corporate greed, yet their investment strategies often prioritize high rates of return over all other considerations in order to fulfill their benefit obligations.[34] Certainly, the implications of market growth and profits become staggeringly large when one examines institutional investors and others at the top, but the principle remains the same.[35] A market crisis occurs when that desire for profit is channeled in unsafe directions,

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[30] PRESIDENTIAL TASK FORCE ON MKT. MECHANISMS, *supra* note 12, at 62–63.

[31] *See* discussion *infra* Section III.A.

[32] David Weidner, Opinion, *Sorry, Schwarzman, but Greed, Not Regulation, Causes Financial Crises*, MARKETWATCH (June 10, 2015, 1:58 PM), https://www.marketwatch.com/story/greed-not-regulation-causes-financial-crises-2015-06-10 [perma.cc/7T4C-5JCG].

[33] Gladych, *supra* note 6 ("The soaring stock market helped drive IRA and 401(k) account balances to record levels in 2017.").

[34] *See, e.g.,* Michael G. Trotsky, *PRIM Board Quarterly Update Fourth Quarter 2017* (Feb. 15, 2018), http://www.mapension.com/files/5915/1914/1475/20171231_Quarterly_Update.pdf [https://perma.cc/DS79-P2VR] ("We are guided by our mandated rate of return . . . [which] makes it necessary to have a relatively aggressive portfolio with significant equity risk.").

[35] Scott Stoddard, *Know How to Follow the Big Money in Stock Investing*, INV.'S BUS. DAILY (Apr. 24, 2012), https://www.investors.com/how-to-invest/investors-corner/institutional-sponsorship-is-key-to-finding-best-stocks/ [perma.cc/6WFB-YVNH] ("[B]anks, pension funds, and hedge funds have millions, even billions of dollars at their disposal.").

often without many of the market participants being aware that their behavior is unsafe.[36] Thus, in order to try and prevent another market crisis, one must recognize and penalize or prevent unsafe behaviors before they reach the point where they cause a systemic collapse.[37]

Does the Dodd-Frank Act sufficiently defend against new permutations of unsafe investing? Since the last market crisis was touched off by unsafe investing in MBSs, those securities and the process by which they were made and sold were understandably a primary focus of the Act.[38] But market crises, like lightning, rarely strike in the same place twice, as we observed in our discussion of the Black Monday crisis.[39] If the Dodd-Frank Act is truly the silver bullet that its proponents would have us believe, it would have to be just as effective at protecting the financial markets against unsafe investing along different lines. Indeed, some would argue that it is even more important to guard against other unsafe investing, since most investors are, post-crisis, understandably cautious around MBS investing, and perhaps even more so than necessary.[40]

Widening the lens on the cause of the last financial crisis from its narrow focus on MBS, it could be more generally stated that the last financial crisis was caused by unsafe investing in asset backed securities (ABS).[41] If the Dodd-Frank Act provides protection against

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[36] *See* Steve Fiorillo, *What Was the Subprime Mortgage Crisis and How Did It Happen?*, THESTREET (Sep. 7, 2018 1:26 PM), https://www.thestreet.com/personal-finance/mortgages/subprime-mortgage-crisis-14704400 [https://perma.cc/AWZ9-UHPA] (finding that lenders and investment bankers were confident in the subprime housing market because of past successes, but in reality were taking on an unsustainable amount of risk).

[37] Ari Mushell, Opinion, *Mortgage-Backed Securities and Dodd-Frank: Inconsistent and Possibly Dangerous*, MKTS. MEDIA (Sep. 30, 2016), https://www.marketsmedia.com/mortgage-backed-securities-dodd-frank-inconsistent-possibly-dangerous-by-ari-mushell/ [perma.cc/P6AU-QJWQ].

[38] *Id.* (speaking to the Dodd-Frank Act's mandates on the MBS market).

[39] *See* discussion *supra* Section I.A (explaining that market crises often emerge from where people are not looking).

[40] Alexandra Zendarian, *Invest In . . . Mortgage-Backed Securities?*, FORBES (Sept. 9, 2009, 6:00 AM), https://www.forbes.com/2009/09/08/mortgage-backed-securities-intelligent-investing-spreads.html#23d9fb831d64 [perma.cc/KNL7-TUPN] ("[I]nvestors try and avoid these troubled assets . . . many investors [are] running away (screaming). . . .").

[41] Adam Goldstein & Neil Fligstein, *Catalyst of Disaster: Subprime Mortgage Securitization and the Roots of the Great Recession* 2 (Inst. for Research on Labor and Emp't, Working Paper No. 113-12, 2011).

future crises, one could reasonably expect, given the cause of the last financial crisis, that the Act's protections against unsafe investing in securities beyond MBS would be strong, since their danger is already well-known. If the Dodd-Frank Act does not sufficiently defend the financial markets from even a threat so closely-related to the one which caused the last crisis, then its efficacy at preventing another crisis is thrown sharply into doubt.

Enter the SLABS market. SLABS are a current topic of contention, with some highlighting them as a low-risk investment with great returns,[42] while others warn that the growth of the SLABS market is unhealthy and carries with it the risk of another systemic market collapse.[43] Our area of concern is whether the Dodd-Frank Act addresses the risks of the SLABS market and prevents investment in unsafe securities that could lead to another disaster. This note will focus on the major provisions involving the securities market. As we will see, the protections of the Dodd-Frank Act do not even extend to this closely-related market threat, a troubling realization with significant ramifications for our nation's financial security and stability.[44]

III. Student Loan Asset-backed Securities

ABS are bonds or notes backed by different forms of debt.[45] Investors buy these securities to gain access to the flow of debt payments.[46] SLABS are securities created from student loans, either

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[42] Eric Reed, *Should You Invest in Student Loan Asset-Backed Securities?*, THESTREET (May 20, 2017, 1:20 PM), https://www.thestreet.com/story/14142296/1/should-you-invest-in-student-loan-asset-backed-securities.html4 ("The upshot is a financial vehicle viewed by many investors as highly reliable in a growing market, and as a result, SLAB investment has been increasingly popular.").

[43] Austin Smith, *The Looming Collapse of Student Loan Asset Backed Securities*, BLOOMBERG BNA (Dec. 13, 2017).

[44] *See* discussion *infra* Section III.A (arguing that the Dodd-Frank Act does not protect against risks present in the SLABS market).

[45] Thomas Kenny, *Asset-Backed Securities (ABS)?*, BALANCE (Jan. 28, 2019), https://www.thebalance.com/what-are-asset-backed-securities-abs-416909 [perma.cc/A5GC-XB4C].

[46] *What Is an Asset-Backed Security?—TheStreet Definition*, THESTREET (2018), https://www.thestreet.com/topic/46023/asset-backed-security.html [perma.cc/FBS2-XZG2].

public or private.[47] Non-traditional securitizations, a category that includes SLABS, were a significant factor in the 2007–08 financial crisis, with the blame largely laid at the feet of subprime MBS.[48] However, while much scrutiny and analysis has been devoted to preventing the dangers associated with subprime MBS, little has been done to guard against subprime SLABS.[49] Indeed, "[s]tudent loan debt, both federal and private, is the only category of consumer debt that continued to rise through the financial crisis and beyond."[50] Meanwhile, the financial industry celebrates as SLABS offerings grow larger, with all the biggest players lining up for a piece of the action.[51]

A. The Convoluted Path of SLABS Creation

The creation of a SLABS starts simply, with a student borrower taking out a loan with either the government or a private lender.[52] The lender then packages multiple loans and sells them to a company called a special-purpose vehicle (SPV) whose only purpose is to buy assets in order to securitize them, and the SPV in turn sells the securitized asset to a trust company.[53] The trust company is the one which issues the SLABS, employing yet another company to handle

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[47] Samuel Taube, *How Student Debt Becomes an Asset-Backed Security*, INV. U (Apr. 7, 2017), https://www.investmentu.com/article/detail/54209/how-student-debt-becomes-asset-backed-security#.WoEVvOdG1hE [perma.cc/4N24-P7WQ].

[48] Sergey Chernenko et al., *The Rise and Fall of Demand for Securitizations* (Nat'l Bureau of Econ. Research, Working Paper No. 20777, 2014).

[49] *See* Anya Kamenetz, *Private Student Loans: The Rise And Fall (and Rise Again?)*, NPR (July 18, 2017, 3:49 PM), https://www.npr.org/sections/ed/2017/07/18/537921324/private-student-loans-the-rise-and-fall-and-rise-again [perma.cc/3T2B-Y6UK].

[50] *Id*.

[51] *Sofi Closes the Biggest Loan Securitization Yet*, STUDENT LOAN REP. (Oct. 27, 2017), https://studentloans.net/sofi-closes-biggest-loan-securitization-yet/ [perma.cc/KUA4-CSE2] (announcing a $777 million SLABS, in partnership with Deutche Bank, Bank of America Merrill Lynch, Goldman Sachs, and Morgan Stanley).

[52] Stacy Cowley & Jessica Silver-Greenberg, *As Paperwork Goes Missing, Private Student Loan Debts May Be Wiped Away*, N.Y. TIMES (July 17, 2017), https://www.nytimes.com/2017/07/17/business/dealbook/student-loan-debt-collection.html.

[53] *Asset-Backed Securities (ABS)*, MONEY-ZINE (Feb. 5, 2019), https://www.moneyzine.com/investing/investing/asset-backed-securities/ [perma.cc/MS26-TT9Q].

collecting the loan payments.[54] With the SPV acting as an intermediary, the original lender is insulated from the trust.[55] The SPVs are set up in this manner (called "bankruptcy remoteness") to protect the assets forming the security in case the original lender goes bankrupt, which in theory lets investors judge the creditworthiness of the underlying securities rather than worrying about the solvency of the institution that issued them.[56] As we can already see, the sheer number of actors in this process seems to raise the chance that one of them may be operating recklessly or in bad faith.[57]

When issuing the new securitization, the trust company separates the SLABS into segments called tranches.[58] Tranches are separated by risk and return: each securitization would thus offer investors the chance to invest in tranches ranging from low risk and low return, to high risk and high return.[59] This tranche methodology makes securitizations attractive to a wide variety of investor preferences.[60] SLABS are marketed to institutional investors, and therefore they are split into tranches of very high denominations.[61] However, some individual investors profit from SLABS securitization by instead investing in companies that service SLABS, and thus riding their coattails to profit and linking their financial well-being into the larger mosaic.[62]

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[54] Cowley & Silver-Greenberg, *supra* note 52.
[55] *Asset-Backed Securities (ABS)*, *supra* note 53.
[56] Sarah K. Kam, *The Not-So-Remote Possibility of the Bankruptcy of a Bankruptcy Remote Entity*, REED SMITH LLP (Feb. 18, 2015), https://www.lendinglawreport.com/2015/02/articles/bankruptcy/the-not-so-remote-possibility-of-the-bankruptcy-of-a-bankruptcy-remote-entity/ [perma.cc/TJ7Q-WTUE] ("Bankruptcy remote entities are intended to separate the credit quality of assets upon which financing is based from the credit and bankruptcy risks of the entities involved in the financing.").
[57] Cowley & Silver-Greenberg, *supra* note 52 (illustrating that the process of securitization involves multiple actors which can lead to complications).
[58] Taube, *supra* note 47.
[59] *Securitisation and Tranching*, ACCA (Feb. 2, 2018), http://www.accaglobal.com/us/en/student/exam-support-resources/professional-exams-study-resources/p4/technical-articles/toxic-assets.html# [perma.cc/R7UH-QMZ6].
[60] *See* GUGGENHEIM INVS., THE ABCS OF ASSET-BACKED SECURITIES (Aug. 8, 2017), https://www.guggenheiminvestments.com/perspectives/portfolio-strategy/asset-backed-securities-abs [perma.cc/S7LF-JDSL].
[61] Taube, *supra* note 47.
[62] *Id.*

The problem with securitizations is that they can look like terrific investments, right up until they crash.[63] Unsafe securitizations build on themselves in unstable positive feedback loop.[64] Loosening debt standards can lead to an increase in the amount of hard asset value available to the lenders, which is then promptly reinvested in what seems to be a winning strategy.[65] Meanwhile, the actual value of the loans made is decreasing; ironically, the lender is losing money during this process under the illusion of making it.[66] One of the prevailing means of providing some "cushion" against downturns in value is "overcollateralization," the general practice of an SPV ensuring it issues less debt than it has assets.[67] But if the assets forming the overcollateralization are the same type of debt as is issued in the securitization, as is usual, those assets are also vulnerable to a sudden devaluation of the base debt.[68] When the actual value of the securitization becomes apparent, panic sets in and investors abandon ship, leaving lenders holding onto debt that turns out to be worth far less than they calculated, leading to bankruptcy.[69] Positive feedback loops can be created by investors who blindly trust credit ratings and rely on stable or increasing prices.[70]

This is exactly the situation which played out during the subprime crisis.[71] To almost every investor, the MBS market looked like solid investments, and the investors were egged on by glowing credit ratings from the big credit rating agencies.[72] As demand for

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[63] *Id.*

[64] GUGGENHEIM INVS., *supra* note 60, at 7.

[65] *Id.* ("Cheap debt increases hard asset values as firms enjoy a lower cost of funds and consequently have lower hurdle rates for investments, bidding up asset price.").

[66] *Id*. (explaining that higher hard asset values "point to additional over-collateralization, and extend more cheap debt, which increases appraisals further, and so on.").

[67] *Id*.

[68] *Id.*

[69] *Id.* (referring positive feedback loop an "inherently unstable condition").

[70] *Id.* (analyzing that overly relying on LTV and asset prices can "subject unwary investors to an unstable positive feedback loop").

[71] Kumar, *supra* note 22.

[72] Marc Joffe, *Unfinished Business: Despite Dodd-Frank, Credit Rating Agencies Remain the Financial System's Weakest Link*, REASON FOUND. (Feb. 27, 2018), https://reason.org/policy-study/dodd-frank-credit-rating-agencies-financial-system/ [perma.cc/25TA-ZNJR] ("The lenient ratings attracted

MBS increased, standards loosened to accommodate eager investors.[73] Lenders kept investing the money they received back into MBS again, in what seemed like a gift that kept on giving.[74] While many companies did retain assets in order to protect themselves, in reality they were only making themselves more vulnerable since those assets were decreasing in value like all the rest.[75] Once the market woke up as the housing bubble burst, panic set in as everyone collectively realized how little their assets were actually worth.[76] It is important to remember that overcollateralization is in a different (and preferably highly liquid) form than the debt being issued, it risks helping build the positive feedback loop rather than hedging against it.

B. SLABS Market Data

U.S. student debt has increased dramatically to 1.5 trillion dollars in 2018, and is now the largest share of consumer debt aside from mortgages, surpassing credit card debt and auto loans.[77] It is worth noting that tracking the exact amount of student loan debt is difficult enough that contemporary writers often differ appreciably on the amount, although that amount is always quite high.[78] While this

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excessive mortgage finance capital that exacerbated a home price bubble – and a wider asset price bubble.").

[73] Kumar, *supra* note 22.

[74] *Id.* ("Mortgage defaults would rise, but the bank could still sell the house on the market to recoup the investment.").

[75] Tim Worstall, *Another Problem with the Dodd Frank Regulations over MBS, that 5% Retention*, FORBES (Dec. 1, 2013, 11:55 AM), https://www.forbes.com/sites/timworstall/2013/12/01/another-problem-with-the-dodd-frank-regulations-over-mbs-that-5-retention/#7617609f7959 [https://perma.cc/R6JB-KNZM] ("[W]e ha[ve] a problem when all the banks started to fall over because they were stuffed to the gills with MBS segments which contained those dodgy mortgages.").

[76] Kumar, *supra* note 22.

[77] Zach Friedman, *Student Loan Debt Statistics in 2018: A $1.5 Trillion Crisis*, FORBES (June 13, 2018, 8:52 AM), https://www.forbes.com/sites/zackfriedman/2018/06/13/student-loan-debt-statistics-2018/#42c6dbc87310 [perma.cc/4TSR-VWUC].

[78] *See* Jillian Berman, *Cancelling $1.4 trillion in Student Loan Debt Could Have Major Benefits for the Economy*, MARKETWATCH (Feb. 8, 2018, 9:40 AM), https://www.marketwatch.com/story/canceling-14-trillion-in-student-debt-could-have-major-benefits-for-the-economy-2018-02-07 [perma.cc/7XBR-ZZSJ].

state of affairs is highly alarming to some, others in the financial industry see it as an opportunity.[79] Since student loan debt is delaying homeownership for Millennials, and thus keeping them from taking out mortgages, it makes sense to follow the money flow to where they are spending it: to repay their student loans.[80] Interestingly, Goldman Sachs recently suggested that SLABS issued from private student loans might offer better value than SLABS issued from public student loans, despite the public SLABS being essentially guaranteed by the government, and thus ostensibly bearing a far lower risk of default.[81] Their reason for this recommendation is that the student loans the private SLABS were issued from are considered "super-prime" and have a very low risk of defaulting on their loans, a profile that is starkly at odds with the student loan debt forming most public SLABS.[82]

The dollar amount of SLABS outstanding on the market is deceptively hard to identify, with Goldman Sachs putting the amount at $190 billion as of December 2017.[83] Sifma, which represents the U.S. securities industry and is often the go-to for securitization statistics, reports $176 billion, but qualifies this number by noting that this represents an undercount of true totals because they cannot properly distinguish SLABS in all cases from other ABS.[84] Sifma

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[79] Akin Oyedele, *Goldman Sachs: There's an Attractive Way to Profit from the $1.3 Trillion Student-Loan Bubble*, BUS. INSIDER (Dec. 9, 2017, 7:05 AM), http://www.businessinsider.com/student-loan-bubble-investment-is-private-abs-goldman-2017-12 [perma.cc/NY6B-355A].

[80] Michele Lerner, *Report: Student Loan Debt Delays Homeownership by Seven Years*, WASH. POST (Oct. 19, 2017), https://www.washingtonpost.com/news/where-we-live/wp/2017/10/19/report-student-loan-debt-delays-homeownership-by-seven-years/?utm_term=.345256c393d2 ("Millennials include the age range when people typically marry, have children and buy a house, yet this study found that the burden of student loans is driving them to delay financial and personal decisions that could have a long-term impact on their wealth building and personal happiness.").

[81] Oyedele, *supra* note 79.

[82] *Id.* ("Recent marketplace student loan deals have featured borrower pools with average credit scores above 770 and average borrower incomes above $160k: a very different credit profile than the government guaranteed portfolios.").

[83] *Id.*

[84] *US ABS Issuance and Outstanding*, SEC. INDUSTRY & FIN. MKTS. ASS'N (Mar. 2018) (detailing a breakdown of the US securities market as of the first quarter of 2018).

records SLABS as comprising about twelve percent of the U.S. ABS market, but again, it is certain that the actual percentage is higher than that.[85] The good news is that SLABS issuance has "declined substantially" since the Great Recession.[86] Additionally, an encouraging data point is that the dollar amount of SLABS outstanding has actually decreased from 2008, when Sifma reported $244 billion outstanding.[87] Considering the recent and aggressive growth and success of Sofi, it remains to be seen whether the SLABS market is on the cusp of another precipitous increase.[88] If the current trend continues, demand for SLABS will remain high and the market will steadily increase.[89]

IV. Title IX, the Investor Protection and Securities Reform Act of 2010

Of the broad number of topics Title IX covers, those which most directly inform the discussion surrounding SLABS are enhancements in the regulation of credit agencies and changes to the ABS process.[90] The SEC was responsible for completing many studies and promulgating new rules, and it found itself overwhelmed and unable to meet the deadlines outlined in the Dodd-Frank Act.[91] The SEC

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[85] *Id.*

[86] Memorandum from Diamond Hill Capital Mgmt., Douglas Gimple, The Evolution of the Asset-Backed Securities Market (Nov. 2018), https://www.diamond-hill.com/the-evolution-of-the-asset-backed-securities-market/ [perma.cc/63ST-LB5A].

[87] SEC. INDUS. & FIN. MKTS. ASS'N, RESEARCH QUARTERLY 7 (Feb. 2008) (detailing outstanding ABS amounts by major credit type).

[88] Ainsley Harris, *SoFi Is Paying Top Dollar To Acquire Its Prime Customers*, FAST COMPANY (Mar. 8, 2018), https://www.fastcompany.com/40539348/sofi-pays-premium-prices-to-acquire-its-prime-customers [perma.cc/3246-ZMFS] ("Last year . . . SoFi originated $12.9 billion in loans, added 225,000 customers, and turned a profit.").

[89] Joseph Cioffi, *United States: Student Loans: 60-Second Market Review And Insights*, MONDAQ (June 26, 2018), http://www.mondaq.com/unitedstates/x/712852/securitization+structured+finance/Student+Loans+60Second+Market+Review+And+Insights [perma.cc/FYK2-ATBV] (forecasting a high demand and steady growth in SLABS issuance).

[90] *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of the U.S. Code).

[91] Memorandum from Shearman & Sterling LLP, Developments in Asset-Backed Securitization Since Dodd–Frank: An Assessment of the Regulatory Landscape (Aug. 2011), https://www.shearman.com/~/media/Files/News

claimed that it "would not sacrifice quality to achieve undue speed," but the time pressures placed on the agency should be kept in mind when discussing their efforts.[92] The SEC declared in 2015 that it had completed "virtually all" of the rulemaking mandates in the Dodd-Frank Act, but as of June 2018 their official website still listed a handful of rules that had not been promulgated.[93]

A. The Regulation of Credit Agencies

Another contributing factor to the last global financial crisis was the role of the credit rating agencies (CRAs), whose unwarranted positive ratings of what proved to be failing securitizations ushered many investors into financial peril.[94] A reasonable person might assume that having such a large hand in causing a global market crisis would put the CRAs out of business, but since the crisis it has largely been business as usual for them.[95] Recognizing this problem, the Dodd-Frank Act set out to strengthen the regulation of CRAs.[96] Most importantly, it imposed new standards on the process of issuing credit ratings; the CRAs were now required to reveal the data used to arrive

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Insights/Publications/2011/08/Developments-in-AssetBacked-Securitization-since__/Files/View-a-version-of-the-article-Developments-in-As__/FileAttachment/FIA083011DevelopmentsinAssetBackedSecuritization__.pdf [https://perma.cc/4FJZ-LV56] ("Across the board, financial agencies are experiencing difficulty meeting the ambitious rulemaking deadlines in Dodd-Frank.").

[92] *Id.* ("Moreover, she asserted that the SEC would not sacrifice quality simply to achieve undue speed.").

[93] Most notably, eight out of the twenty-nine total rules on security-based swaps still show as proposed, rather than adopted. *Implementing the Dodd-Frank Wall Street Reform and Protection Act*, SEC. & EXCHANGE COMMISSION (Nov. 14, 2016), https://www.sec.gov/spotlight/dodd-frank.shtml [perma.cc/M9F3-JLN6].

[94] Joffe, *supra* note 72 ("The lenient ratings attracted excessive mortgage finance capital that exacerbated a home price bubble—and a wider asset price bubble. It was the bursting of this bubble that triggered the Great Recession of 2007–2009.").

[95] Sid Verma, *The Great Escape: How Credit Raters Ducked Reform*, BLOOMBERG (Aug. 2, 2017, 5:03 PM), https://www.bloomberg.com/news/articles/2017-08-02/the-great-escape-how-the-big-three-credit-raters-ducked-reform.

[96] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, §§ 932, 935, 939, 124 Stat. 1376 (mandating these stricter standards).

at their rating, and to disclose the effectiveness of their prior ratings.[97] Additionally, CRAs were required to consider "credible information" from other sources than the issuer of the security.[98] This was intended to curtail the practice of "ratings shopping" in which securities issuers would play the CRAs off against each other, attempting to get the highest possible grade for the lowest standards.[99]

The danger of over-inflated credit ratings is pertinent to SLABS. Recall what has already been discussed about how securitization can veer into an unstable positive feedback loop.[100] CRAs have in the past—and might in the future—play a significant part of this process.[101] The lure of a high credit rating paired with excellent returns may be enough to turn the heads of many unwary investors.[102] SLABS can contain hidden dangers, and even the CRAs reassess and downgrade their ratings as new risks present themselves.[103] So how effective are the Dodd-Frank reforms at improving the credit rating process? Can the investing public now trust the CRAs to issue solid ratings without worrying about inflated assessments?

The short answer is no. Most experts say the problem with the Dodd-Frank Act's reforms is that they do not really touch the heart of the matter: the fact that the business model of CRAs is to pander to the issuers who hire them.[104] The Dodd-Frank Act did attempt to directly address this problem by requiring the SEC and Government Accountability Office to study the CRAs' issuer-based business model

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[97] *Id.*
[98] *Id.*
[99] Joffe, *supra* note 72.
[100] *See* discussion, *supra* Section II.A.1.
[101] Joffe, *supra* note 72.
[102] GUGGENHEIM INVS., *supra* note 60 (warning investors to beware of the positive feedback loop and other misleading aspects of ABS).
[103] Press Release, Moody's Inv'rs Serv., Moody's Concludes Reviews of 12 Student Loan ABS Securitizations Following the Update of its Approach to Assessing Counterparty Risks in Structured Finance (Jan. 11, 2018), https://www.moodys.com/research/Moodys-concludes-reviews-of-12-student-loan-ABS-securitizations-following--PR_377893 (stating that Moody's downgraded the credit rating of 26 classes following their "approach update").
[104] Joffe, *supra* note 72 (describing how switching to a issuer-pays business model in the 1970s led to inflated and inaccurate credit ratings); Alice M. Rivlin & John B. Soroushian, *Credit Rating Agency Reform is Incomplete*, BROOKINGS INSTITUTION (Mar. 6, 2017), https://www.brookings.edu/research/credit-rating-agency-reform-is-incomplete/ [https://perma.cc/QZ6Z-MMEV].

and identify an alternative.[105] If no alternative could be agreed upon, the SEC was supposed to create a board that randomly assigned credit rating gigs to the Nationally Recognized Statistical Rating Organizations (NRSROs).[106] To date, neither an alternative business model nor the random assignment board has been created.[107] Meanwhile, SLABS issuers can still take advantage of ratings shopping, the process of hiring multiple CRAs to increase their ratings.[108] Gaming the credit rating system increases the danger that investors will overvalue securitizations to their and the market's detriment.[109] The subversion of the credit rating system is pervasive, overt, and unapologetic.[110]

So why did the SEC utterly fail to implement any solution to this problem? Given the clear and unequivocal mandate given by Dodd-Frank, the SEC's lack of action begins to look suspiciously like agency capture; though others say that the real problem is that the old, calcified CRAs have no competition, an issue the Dodd-Frank Act actually exacerbates.[111] Currently, there are only ten NRSROs, with the "Big Three"—Fitch, S&P, and Moody's—receiving the lion's share of credit rating assignments.[112] The Dodd-Frank Act increased the requirements for NRSRO registration and regulation, making it even harder for alternative credit rating sources to break into the

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[105] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 939C–D, 124 Stat. 1376, 1888 (codified in scattered sections of the U.S. Code) (directing the
SEC and the Government Accountability Office to study certain aspects of credit rating agencies, including compensation, independence, management, and more).
[106] Rivlin & Soroushian, *supra* note 104.
[107] *Id.* ("[T]he SEC took no further action since 2013 and has neither endorsed a business model for the NRSROs nor implemented the random assignment model.").
[108] Cezary Podkul, *How Bankers Manipulate Rating Agencies to Get Their Way*, PAC. STANDARD (Jan. 9, 2015), https://psmag.com/economics/bankers-manipulate-rating-agencies-get-way-97500 [perma.cc/CK8P-W92V].
[109] *See id.*
[110] *Id*.
[111] Joffe, *supra* note 72.
[112] Shankar Ramakrishnan & Philip Scipio, *Big Three in Credit Ratings Still Dominate Business*, REUTERS (May 4, 2016, 2:50 PM), https://www.reuters.com/article/uscorpbonds-ratings-idUSL2N17U1L4 [perma.cc/F5JM-W9HB] (describing how despite the presence of ten CRAs, the "Big Three" were responsible for 2.3 million of outstanding credit ratings out of a total of 2.42 million).

market and create real competition in a space where it has been sorely lacking for decades.[113] When brand name recognition is added in, it is clear that unless some sort of legislative action is taken to break up the effective CRA monopoly, the old CRA problems which contributed to the last global market crisis will continue to be an issue.[114] Such name recognition leads market participations to assert that "many investors remain wedded to the idea that a rating from the big three is an assurance of quality."[115] Consequently, the Dodd-Frank Act's attempt to clean up the ratings process will only give the CRAs new hurdles to overcome in their continuing competition to win the largesse of securities issuers.[116] And issuers for their part have known for a long time how best to rig the system to make their securities look optimal to CRAs, no matter the underlying value of the asset.[117]

This poses a serious, known risk to the SLABS process. Like MBS back before the last global financial crisis, SLABS look like a safe, high yield investment with low risk; in the words of one investment website: "The upshot is a financial vehicle viewed by many investors as highly reliable in a growing market, and as a result, SLAB[S] investment has been increasingly popular."[118] CRAs feed into this picture as they step up their credit ratings on these securities, increasing demand.[119] While the private SLABS market currently seems to have high standards regarding underlying assets,[120] the MBS

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[113] Joffe, *supra* note 72 ("On the downside, [the Dodd-Frank Act] stiffened NRSRO registration and reporting requirements, increasing the cost of entry for prospective entrants and thus limiting the prospects for new competition and much- needed industry disruption.").
[114] Ramakrishnan & Scipio, *supra* note 112.
[115] *Id.*
[116] Rivlin & Soroushian, *supra* note 104 ("[I]ssuers want higher ratings for their products, so they look safer and can be sold at a higher price. Since issuers pick and pay the CRAs that rate their securities, they have great influence on a CRA's market share and profit margins.").
[117] *Id.* ("[M]any CRA models were gamed and reverse engineered by issuers through tinkering with a security or hiring former CRA analysts to optimize their products to the models.").
[118] Reed, *supra* note 42.
[119] Press Release, CommonBond, Inc., CommonBond Closes $248 Million Securitization, Secures Inaugural S&P Rating of AA (Oct. 26, 2017), https://www.commonbond.co/press-releases/commonbond-closes-248-million-securitization-secures-inaugural-s-p-rating-of-aa [perma.cc/9FBK-CNJ3]).
[120] Announcement, Moody's Inv'rs Serv, Moody's: US Private Student Loan Refi Lenders' ABS Collateral Will Likely Continue to Perform Strongly

market before the 2007–08 financial crisis did as well, before increasing pressure caused issuers to cut corners and venture further into the sub-prime market.[121] In the period leading up to the crisis, lending standards slipped for student loans[122] as well as mortgages, and although standards have increased since the crisis, this demonstrates that SLABS face the same dangers to the assets from which they are formed during periods of lax financial standards. With demand for SLABS booming, and the same actors behaving in much the same ways as they did pre-crisis, it is only a matter of time before SLABS standards begin to slip under the pressure.[123] As it stands now, the Dodd-Frank Act will not be able to stop it.

B. Changes to the ABS Process

The Dodd-Frank Act recognizes that the ABS process is fallible, and attempts to remedy the process in a few different ways, including mandated risk retention on the part of the issuer, enhanced disclosure of asset-level data, and a requirement that issuers review the underlying assets of ABS they issue and disclose the results of that review.[124] These requirements seem to strike at the heart of the risks involved with securitizations. After all, if the issuer of the security has to hold a piece of their own product, and fully inform their customers about the product, should that not eliminate most of the risk involved? Unfortunately, this solution panders more to the viewpoint of blaming corporate greed for the subprime crisis than the reality of supposedly safe investments suddenly falling apart. The solution makes sense if one suspects that the security issuer is trying to take advantage of their customers. If instead one recognizes that neither the issuer nor the

(Nov. 16, 2017), https://www.moodys.com/research/Moodys-US-private-student-loan-refi-lenders-ABS-collateral-will--PR_375039 ("Refi lenders make loans mainly to borrowers with graduate degrees who wish to refinance their student debt to lower their interest rates or monthly payments . . . [t]hese borrowers have established payment histories and many have begun careers as high-earning professionals, lowering the chances that they will default.").

[121] Wallison, *supra* note 4, at 15–16.

[122] Kamenetz, *supra* note 49 ("The heyday of private student lending was in the run-up to the financial crisis, when credit standards were loose.").

[123] Reed, *supra* note 42.

[124] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 941–3, 124 Stat. 1376, 1888 (codified in scattered sections of the U.S. Code).

customer know where to look for danger, and both have equal good faith in a bad product, the solution suddenly seems far from perfect.

1. Risk Retention

Of these changes, the most relevant—and controversial—is mandated risk retention.[125] The Dodd-Frank Act requires federal banking agencies, together with the commission created by Dodd-Frank, to promulgate regulations requiring securitizers to retain part of the credit risk for any security issued.[126] The final rule, jointly issued by the Board of Governors of the Federal Reserve System, the Department of Housing and Urban Development, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of the Comptroller of the Currency, and the SEC, stated that issuers of ABS must retain not less than five percent of the credit risk associated with the underlying assets.[127] The final rule also includes a requirement intended to keep issuers from transferring or hedging the retained credit risk.[128]

The Dodd-Frank Act's requirement of credit risk retention was intended to ensure that securitizers had "skin in the game."[129] Congress was worried that security issuers were working off a model called "originate-to-distribute," in which risky assets were bought and securitized with the intent to be off-loaded onto investors, leaving the issuer with the profit and the investor holding the bag when the underlying instability of the securitization came due.[130] Forced credit retention was seen as a solution to this predatory behavior.[131] Since

[125] Worstall, *supra* note 75 (arguing that Dodd-Frank's requirements concerning risk retention are dangerous).
[126] Dodd-Frank Act § 941.
[127] Press Release, Sec. & Exch. Comm'n, Six Federal Agencies Jointly Approve Final Risk Retention Rule (Oct. 22, 2014), https://www.sec.gov/news/pressrelease/2014-236.html [perma.cc/7CPL-ZF7N]).
[128] *Id.*
[129] Public Statement, Sec. & Exch. Comm'n, Skin in the Game: Aligning the Interests of Sponsors and Investors (Oct. 22, 2014), https://www.sec.gov/news/public-statement/2014-spch102214laa [perma.cc/V8AY-DS4S]) ("At its core, today's risk retention rules are intended to align the incentives of sponsors and ABS investors by requiring sponsors to retain a financial interest and maintain skin in the game.").
[130] *Id.*
[131] Vishal M. Mahadkar, *Defending Skin-in-the-Game in the Market for Residential Mortgages*, FORDHAM J. CORP. & FIN. L. BLOG (Nov. 22, 2011),

issuers would now be forced to have a piece of the proceeds of their own securitizations, for better or worse, they would find it in their own best interests to ensure the underlying assets were sound.[132]

Unfortunately, skin-in-the-game is widely regarded as next to useless or even worse, although critics have several different perspectives on why. One problem is that, even if the rule would have otherwise worked as intended, issuers quickly found ways around it.[133] Investment banks worked around the rule by pooling retained credit risk in a majority-owned affiliate fund, a practice allowed by the rule.[134] The issuer need only retain a majority interest—usually fifty-one percent—meaning that issuer exposure to credit retention is effectively halved.[135] Some companies even considered pushing the envelope further, since "majority-owned" is not defined, and owning only twenty percent of the affiliate fund could be argued as having a "controlling financial interest," which would meet rule requirements.[136] Since there is no limit to the amount of risk that can be held by such an affiliate, securitization issuers can use this tactic to effectively reduce the risk retention imposed by the Dodd-Frank Act to meaningless amounts.[137]

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https://news.law.fordham.edu/jcfl/2011/11/22/defending-skin-in-the-game-in-the-market-for-residential-mortgages [perma.cc/AH4T-BE4N].

[132] *Id*.

[133] Sam Knight, *Wall Street Preparing Dodd-Frank "Skin-in-the-Game" Workaround*, DISTRICT SENTINEL (Oct. 17, 2016), https://www.districtsentinel.com/wall-streeet-preparing-dodd-frank-skin-game-rule-workaround/ [perma.cc/G9E9-B5WL].

[134] Gilbert K. S. Liu & Kevin P. Scanlan, *Risk Retention Regulations Prompt Rise of Majority-Owned Affiliate Funds*, KRAMER LEVIN NAFTALIS & FRANKEL LLP (June 8, 2016), https://www.kramerlevin.com/en/perspectives-search/risk-retention-regulations-prompt-rise-of-majority-owned-affiliate-funds.html [https://perma.cc/P4JS-GM5J].

[135] Sam Goldfarb & Serena Ng, *Financial Engineers Take On New Rule with More Engineering*, WALL ST. J. (Oct. 17, 2016, 8:27 AM), https://www.wsj.com/articles/financial-engineers-take-on-new-rule-with-more-engineering-1476696600 ("Firms including J.P. Morgan Chase & Co. spinoff HPS Investment Partners LLC have moved instead to set up affiliated companies that would buy the stakes. HPS and some others would own roughly 51% of the new firms, and outside investors would own the rest, according to market participants. That means their effective exposure would be halved.").

[136] *Id*.

[137] *See id*.

Another objection to mandated credit risk retention is that it actually may be dangerous for the issuers.[138] The recession, goes the argument, was not the problem; rather, it was financial institution failure and the threat of failure that nearly caused the U.S. economy to implode.[139] Although it is often repeated that the "originate-to-distribute" model left all the risk in the hands of the investors, the events of the 2007–08 financial crisis showed that rather than unloading all the faulty assets, issuers had been holding on to some portion of them, and the resulting drop in capital when the bottom fell out of the MBS market sent them into a tailspin of financial ruin.[140] Accordingly, if anyone should hold asset risk, it should be the investors, since that would spread risk, as opposed to mandating a concentration of retained credit risk by issuers—a recipe for another financial disaster.[141]

This leads to another question: if issuers were already voluntarily retaining credit risk prior to the crisis, why mandate it afterwards on the supposition that it would change anything?[142] As it turns out, sponsors were retaining roughly five percent of the risk of their issuance before the crisis for a simple reason: they were able to sell their securities for better prices when they retained a reasonable amount of interest in them.[143] The fact that many of these issuers maintained a large balance of what turned out to be terrible assets points to the conclusion that they themselves did not understand the danger or consider the assets to be worthless. Considered from this perspective, a credit risk is worthless: it is forcing behavior that was already being voluntarily engaged in, and it cannot act to deter issuers

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[138] Worstall, *supra* note 75 ("So, the way that I look at this is that it was because the banks were retaining slices of those MBS deals that they all got into problems.").
[139] *Id.*
[140] *Id.*
[141] *Id.* ("So, the way that I look at this is that it was *because* the banks were retaining slices of those MBS deals that they all got into problems. Which means, in turn, that of course I regard a rule that banks *must* retain a slice of any future MBS deals as entirely insane.").
[142] Mark A. Calabria, *Title IX Subtitle D and Title XIV: Likely to Increase Cost of Mortgage Credit and Increase Foreclosures*, *in* THE CASE AGAINST DODD-FRANK 186 (Norbert J. Michel ed., 2016).
[143] *Id.* ("Investors had access to the size of the risk retention and priced accordingly. Researchers have found that, all else equal, higher risk retention (larger equity tranche) yielded a better price for the non-equity tranches.").

from selling shoddy securitizations that they genuinely believe are good investments.

SLABS fall under the risk retention rule of the Dodd-Frank Act along with all other securitizations.[144] Although the risk retention rule is touted as the most important protective measure in the entirety of the Dodd-Frank Act,[145] it is clear from the facts discussed above that it does nothing to prevent either blind good-faith propagation of sub-par SLABS that the issuer thinks are profitable, or a more predatory approach by a bad faith issuer who sells what they know to be junk SLABS and then shifts almost all of the risk retention onto an affiliated fund. Further, an associated specter arises which is unique to public SLABS offerings, a large category of which are almost completely guaranteed by the government.[146] As of 2015, $200–$250 billion of those loans have been securitized.[147] If the underlying assets in these cases turn out to be over-valued, the risk does not hit the investor, and instead it would all be concentrated directly in the government, which would likely cause negative economic effects. In the last financial crisis, the government stepped in with Troubled Asset Relief Program bailouts which some credit with preventing the total collapse of the economy.[148] But in the event of a collapse of government-backed student loans, the market effects of the government trying to bail itself out might be even more serious than the financial crisis of 2008–09, since the government would take a direct economic hit instead of choosing how and whether to bail out financial institutions.

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[144] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 941, 124 Stat. 1376, 1888 (codified in scattered sections of the U.S. Code).
[145] Goldfarb & Ng, *supra* note 135.
[146] Timothy Bernstein, *The Trouble with FFELP ABS: An Explainer*, NEWOAK CAP. LLC, https://newoak.com/trouble-ffelp-abs-explainer/ [perma.cc/NB44-86CS].
[147] *Id.*
[148] Robert J. Samuelson, *Why TARP has been a Success Story*, WASH. POST (Mar. 27, 2011), https://www.washingtonpost.com/opinions/why-tarp-has-been-a-success-story/2011/03/25/AFEe6jkB_story.html?utm_term=.8099c4bad07f ("When the entire financial system succumbs to panic, only the government is powerful enough to prevent a complete collapse.").

2. *Increased Asset-Level Transparency*

The Dodd-Frank Act also attempted to prevent predatory securitization by mandating increased disclosures of asset information.[149] It calls for regulations that enable consumers to easily compare securities against each other to determine quality.[150] It also requires the release of information on the compensation of both the originator and the securitizer of the underlying assets, and the amount of their risk retention in the same.[151] The SEC promulgated rules enforcing these standards, which became effective in the spring of 2011.[152] How effective these measures are in preventing investors from buying into subpar securitizations remains to be seen. However, it is clear that in the case of an underlying strategy or asset that builds systemic risk in unforeseen ways, transparency is sadly little help in preventing consumers from investing. In that case, it is not knowledge of what the product is that matters, but instead the product's actual value, which can be masked by a positive feedback loop as previously discussed.[153]

Postulating that standards for SLABS start to slip as the pressure to invest in them rises; their short-term performance may do much to mask their underlying value. In a rising economic tide, every boat is lifted: and if less than prime student loan securities make good returns initially, many might be lulled into investing where caution would dictate otherwise. For example, "junk" subprime auto loan securitizations have been performing particularly well as of late, and consequently the demand has increased, despite the "deeply subordinated" tranches having little credit protection.[154] Analysts observed that "this emerging trend highlights just how much risk some investors are willing to take in the current environment."[155] If that outlook indicates a market more willing to take risks on subprime securities as

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[149] Dodd-Frank Act § 942.
[150] *Id.*
[151] *Id.*
[152] Press Release, Sec. & Exch. Comm'n, SEC Approves New Rules Regulating Asset-Backed Securities (Jan. 20, 2011), https://www.sec.gov/news/press/2011/2011-18.htm [perma.cc/PKR6-XBKJ].
[153] *See* discussion *supra* Section II.A.1 (discussing the inherent risks of securitization).
[154] Adam Tempkin, *Riskiest Subprime Auto Debt Buyers Shrug Off Lending Worries*, BLOOMBERG (July 16, 2018, 11:18 AM), https://www.bloomberg.com/news/articles/2018-07-16/riskiest-subprime-auto-bonds-shrug-off-consumer-lending-worries.
[155] *Id.*

long as the outlay looks good, past experience would indicate that trouble lies ahead.

Other investors could fall into the same trap as investors did before the subprime crisis of 2008–09, thinking that properly structured securitization diversifies away risk to a manageable level despite the risk of the base assets. In neither of these cases would transparency help, especially if offset by the oft-incestuous relationship between bank and CRA. Investors nervous about the subprime assets might well gain a false sense of security from inflated credit ratings, and the continued abuse of that system, as previously discussed, raises a concern that this scenario may occur.

3. *Review of Underlying Assets*

The Dodd-Frank Act also attempted to illuminate the activity between issuers and NRSROs by directing the SEC to create regulations requiring NSRSOs to include additional information in their credit ratings; and that securitizers must disclose purchase requests.[156] The SEC was given a fairly short window of 180 days to enact such regulation.[157] The SEC ignored the Dodd-Frank Act's directives—as they have done with other matters involving the NRSROs—and only finalized the rules for disclosure of this information on August 27, 2014, 1,318 days delinquent.[158] In directing the CRAs and the securitizers to make these additional disclosures, the Dodd-Frank Act is again attempting to make it easy for consumers to compare securities against each other to better identify deficient offerings.[159]

As discussed in the previous section, a comparison between securities means little when a majority of the market is engaging in collective bad action. An informed consumer pre-subprime crisis might have shrugged off the shoddy underpinnings of MBS securities since so many were utilizing them and they seemed stable and profitable. A concerned consumer before Black Monday would not

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[156] Dodd-Frank Act § 943.
[157] *Id.*
[158] *August 2014 Amendments to Existing Rules and New Rules that Apply to Nationally Recognized Statistical Rating Organizations, Providers of Due Diligence Services for Asset-Backed Securities, and Issuers and Underwriters of Asset-Backed Securities in Accord*, U.S. SEC. & EXCHANGE COMMISSION (June 13, 2015), https://www.sec.gov/info/smallbus/secg/nrsro-amendements-small-entity-compliance-guide.htm [perma.cc/SF5L-RXVT].
[159] Dodd-Frank Act § 943.

have known the potentially devastating effects, both personally and market-wide, of portfolio insurance because no one did. Disclosures are useful in highlighting normative differences, but when the norm itself is corrupted, they quickly become fairly meaningless. Consequently, transparency, while perhaps a noble and worthwhile goal in and of itself, plays little role in reducing systemic risk and preventing financial crises.

Additionally, the belated additional reporting requirements do not seem to have dampened the influence or operating methods of the CRAs, which are continuing business as usual.[160] Securitizers still play CRAs against each other to improve their ratings, and employ former CRA employees familiar with the rating system to ensure their offerings were optimized for the CRAs review.[161] In other words, the credit rating system is still a game of mutual profit and understanding between issuers and CRAs, rather than a system which really reveals useful data to consumers. This is not surprising, since the basic dynamics of the toxic relationships between issuers and CRAs saw no essential changes. Putting additional reporting requirements on bad actors who have the market locked down will not stop their actions. The CRAs have already demonstrated they know how to game the system, and faced little to no accountability for their actions even after the subprime crisis.[162] The reasonable conclusion is that the new disclosure standards simply add a few new wrinkles in an old game, to be ironed out with all the rest.

V. The Potential Dangers of SLABS

So far, one can see that the protections of the Dodd-Frank Act do not do much against the securitization risks highlighted by the subprime crisis. Credit retention requirements are too easy to get around, the credit rating agencies carry on with business as usual, and additional transparency by itself does not solve or address the underlying systemic problems. But what about dangers which are inherent to SLABS? Are potential areas of concern addressed by Dodd-Frank, or does the Act's myopic focus on MBS miss them entirely? Unfortunately, the latter scenario most often turns out to be

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[160] Rivlin & Soroshian, *supra* note 104.

[161] *Id.* (explaining the inherent conflict of interest present when a CRA has an incentive to appease customers).

[162] Verma, *supra* note 95 (characterizing CRAs' lack of consequences as "the great escape of the post-crisis era.").

true, casting even more doubt on the ability of the Dodd-Frank Act to prevent a SLABS created financial crisis.

A. The Dischargeability of SLABS Obligations

Perhaps the greatest difference between a mortgage and a student loan is that a mortgage is based off a tangible product—real estate—while student loan is based off an intangible service—education. With a mortgage, there is property to repossess in the event of a default, providing a means to recoup systemic losses if the mortgage fails. Student loans, however, have no such inherent stability: when failed or forgiven, there is nothing left upon which one can recover losses.[163] Thus, any talk of forgiving student loans en masse should make SLABS investors apprehensive.[164] Because the SLABS market is stable and growing, potential investors are not worried about this scenario. [165] While the current administration is unlikely to take any such action, a recent major presidential candidate made massive student loan reform a popular part of his platform and thus, mass student loan forgiveness is not an occurrence which should be written off as impossible, especially as a maturing population heavily saddled with student loan debt continues to vote their interests.[166] The Dodd-Frank Act does not address this possibility, and indeed there is not much that can be done to prevent systemic instability brought about by a major legislative change.

Another significant issue with some SLABS is that their student loan assets are less immune to dischargeability in bankruptcy than many think.[167] A federal, non-profit, or qualified private education student loan is indeed non-dischargeable in bankruptcy, but that leaves a wide swath of student loans unaccounted for, much of which has been securitized.[168] As of the end of 2018, an estimated $30–50

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[163] Reed, *supra* note 42 (explaining the basic characteristics of SLABS).
[164] Berman, *supra* note 78 (arguing that the SLABS market could face a crisis similar to the one in the mortgage-backed securities market).
[165] Cioffi, *supra* note 89.
[166] Andrew Josuweit, *Where the Candidates Stand on Student-Loan Debt*, CNBC (Apr. 4, 2016, 2:08 PM), https://www.cnbc.com/2016/04/04/where-the-candidates-stand-on-student-loan-debt-commentary.html [perma.cc/6L6N-JES3] (detailing Senator Bernie Sanders' proposal to lower student loan interest rates and allow borrowers to refinance at those lower rates).
[167] Smith, *supra* note 43 (correcting the "common misconception" that student loans are never dischargeable in bankruptcy).
[168] *Id*.

billion in student debt might be dischargeable in bankruptcy.[169] When combined with forecasts that forty percent of borrowers may default on their student loans by 2023[170] this fact raises the concern that a large portion of the SLABS market has the potential to fail suddenly and swiftly. If the failure of some portions of the SLABS market touches off a market panic, past experience tells us that the effects will likely spread to the rest of the SLABS market, and on to the greater financial markets, potentially wreaking havoc on the global economy.

B. The Growing Student Loan Debt Bubble

The impact on the U.S. economy of the $1.5 trillion in student loan debt only continues to grow.[171] Ironically, the more student loan debt grows, the more attractive it looks for investors,[172] but conversely, the more likely it is that the debt will never be repaid.[173] As Millennials saddled with crushing student loan debt send their children to higher education, they will likely function as a less effective backstop for their offspring's loans than their parents did.[174] This is another potential trend that is hard to quantify or predict with accuracy. However, the negative effects of student loan debt on the economy, however, are well documented.[175]

In addition, there is still the issue of the Federal Family Education Loan Program (FFELP) hanging over the heads of the American public.[176] Although the program halted guarantees on privately financed student loans in 2010, $281.8 billion remains on the

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[169] *Id.*
[170] Annie Nova, *More than 1 Million People Default on their Student Loans Each Year*, CNBC (Aug. 13, 2018, 1:51 PM), https://www.cnbc.com/2018/08/13/twenty-two-percent-of-student-loan-borrowers-fall-into-default.html [perma.cc/A579-XN73].
[171] *Id.*
[172] David Taylor, *How US Student Loans Could Cause the Next Share Market Crash*, ABC (Oct. 7, 2017, 6:25 AM), http://www.abc.net.au/news/2017-10-06/how-us-student-loans-could-cause-the-next-share-market-crash/9019818 [perma.cc/8Q2Y-LXAY].
[173] *See* Nova, *supra* note 170.
[174] Hazel Christie & Moira Munro, *The Logic of Loans: Students' Perceptions of the Costs and Benefits of the Student Loan*, 24 BRIT. J. SOC. EDUC. 621, 633.
[175] Lerner, *supra* note 80.
[176] *See* Bernstein, *supra* note 146.

books,[177] and that liability will likely be shrinking more and more slowly as students enter forbearance or reduced payment plans at increasing rates.[178] The maturity of most FFELP loans has now extended to anything from a few months up to eight years longer than anticipated, which creates problems for SLABS built off of them.[179] It is also reasonable to conclude that those borrowers taking heavy advantage of forbearance and repayment plans might very well fall into that group of people who ultimately default on their student loan obligations.[180] If this occurs, these FEELP loans are guaranteed by the government, but the burden of meeting these obligations might worsen an already bad situation if a SLABS related crisis is already rocking financial markets.

C. SLABS-Related Litigation

A final consideration regarding SLABS is the effect that litigation against loan servicing companies might have on their underlying assets. As with MBS before the subprime crisis, underwriting standards in student loans reduced to such an extent that a great deal of essential paperwork was lost or never filled out, leading to law suits against the companies trying to exact loan payments without the paperwork to back up their demands.[181] In highest profile case, the Consumer Financial Protection Bureau (CFPB) sued the National Collegiate Student Loan Trusts over what it alleged are improper collection practices concerning billions of dollars in student

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[177] U.S. DEP'T OF EDUC., FEDERAL STUDENT AID PORTFOLIO SUMMARY, https://studentaid.ed.gov/sa/about/data-center/student/portfolio (last visited Mar. 8, 2019) (select "Federal Student Aid Portfolio Summary").

[178] John Dizard, Opinion, *The US Has a Festering Student Loan Problem, Bigger Even Than the Soon-to-be-Nationalised Puerto Rican Problem*, FIN. TIMES (May 29, 2015), https://www.ft.com/content/47b82c94-05fd-11e5-b676-00144feabdc0 ("The only real problem for lenders is that those students keep needing extensions and forbearance and restructurings, which are getting more complex and frequent. That makes it difficult, if not impossible, to know what the maturity of underlying loans will be.").

[179] *Id.*

[180] Nova, *supra* note 170.

[181] Stacy Cowley, *Student Loan Creditor, Fined for "False" Lawsuits, Must Halt Collections*, N.Y. TIMES: DEALBOOK (Sept. 18, 2017), https://www.nytimes.com/2017/09/18/business/dealbook/student-loan-national-collegiate-trusts.html.

loans.[182] The CFPB reached a deal that would have included a thorough audit of over 800,000 loans to determine which could be lawfully pursued through collections, and which had insufficient paperwork, most likely leading to a cancellation of the debt.[183] Perhaps unsurprisingly, investors holding over $1.4 billion in this debt have challenged the settlement deal in court, since it not only stood a good chance of wiping out a massive portion of the SLABS they hold, but could also end up costing even more if the audit uncovered systemic wrongdoing.[184]

This reveals another threat against SLABS: litigation leading to the reduction or cancellation of the debt underlying the security. Judging by reports, shoddy paperwork and questionable decisions were just as prevalent in the student loan industry as in the mortgage industry before the subprime crisis.[185] Depending on the outcome of the various cases surrounding the CFPB/National Collegiate Student Loan Trusts struggle, the viability of many of these subpar loans might be called sharply into question.[186] As shown by the settlement, the resolution of these issues could lead to entire SLABS either being wiped out or devalued to the point of worthlessness.[187] A major legal win against the collection agencies and investors could— depending on the stability of the SLABS market and how far the pressure to create SLABS has caused contemporary SLABS standards to slip— touch off a panic as investors try to unload their suddenly-questionable SLABS assets as quickly as possible. It is interesting to note, however, that the current administration's Department of Education has ceased cooperating with the CFPB on its student loan policing activities.[188] Of course, the Department of Education's current uncooperative stance could change with a new administration.

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[182] Shahien Nasiripour, *Wall Street Is Fighting A CFPB Deal Over Billions In Defaulted Student Loans*, BLOOMBERG (Nov. 8, 2017 5:00 AM), https://www.bloomberg.com/news/articles/2017-11-08/wall-street-is-fighting-a-cfpb-deal-over-billions-in-defaulted-student-loans.
[183] *Id*.
[184] *Id.* ("All told, investors holding some $1.4 billion in NCSLT notes asked U.S. District Judge Gregory Sleet in Wilmington, Delaware, to reject the accord, saying Vantage doesn't have the power to negotiate on their behalf.").
[185] Cowley, *supra* note 181.
[186] *See* Nasiripour, *supra* note 182.
[187] *Id*.
[188] Anya Kamenetz, *The Department of Education Cuts Off a Student Loan Watchdog*, WAMC (Sept. 20, 2017, 4:49 PM), https://www.wamc.org/post/department-education-cuts-student-loan-watchdog [perma.cc/PXD9-L9AU].

VI. Conclusion

The Dodd-Frank Act is often held up as a great improvement of financial market regulation, or at least a good step in the right direction towards preventing another serious financial crisis. When broken down and examined piece by piece, a more disturbing narrative forms: one of standards not enforced, problems not addressed, and massive loopholes. A grim picture emerges when one also considers that the next financial crisis might incorporate aspects of risk which we do not yet know to guard against. The rising push for investment in SLABS could lead to dark times for the financial markets, as the same group of usual suspects are taking similar actions to those that led to the Great Recession. If worse comes to worst, it is clear that the Dodd-Frank Act will not protect against such a threat without adjustment and reform.