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BOOK REVIEW

DERIVATIVES TRADERS DO WHAT, AGAIN?

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Reviewing

COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS

Written by Annelise Riles

The financial crisis inspired unprecedented interest in what derivatives traders do. In the opinion of many lawmakers, lack of transparency and absence of regulation in derivatives markets contributed significantly to the crisis. The Dodd-Frank Wall Street Reform and Consumer Protection Act contains numerous provisions designed to eliminate opacity in derivatives trading, and many continue to debate the value of speculative (as opposed to hedging) derivatives contracts.[1]

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1. The new regulations include requirements that certain derivatives be cleared on a central clearing house, through a central counterparty. The clearing house nets out members' trades daily and requires that parties post collateral daily. It centralizes reporting and provides transparency post-trade to the derivatives market; members can see prices, and aggregate and individual counterparty information, for example. An exchange-trading requirement, in contrast, provides just pre-trade price transparency. Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 (2006 & Supp. 2011).

Critics of financial regulation sing a classic refrain, associated with Friedrich Hayek's theories: Regulation cannot match the temporality of capitalism, as it is based on analysis of what has already transpired in markets that are perpetually evolving.[2] Not everyone joins in this refrain. While some declare that our regulatory system fails to keep pace with changing financial practices,[3] others argue that the crisis resulted from specific changes in law that Congress could reverse, such as the Commodities Futures Modernization Act of 2000's removal of legal constraints on speculative, over-the-counter derivatives trading.[4]

In *Collateral Knowledge*, Annelise Riles disrupts the Hayekian critique of financial regulation in an entirely different way. She presents collateral in derivatives markets as a technique and an aesthetic practice and then contends that state actors also can deploy private actors' techniques in response to the temporal nature of markets. There is nothing inherently private about the methods of self-governance that private actors use to accommodate temporality.[5]

Riles contends that day-to-day technique is a viable site for regulatory innovation. This review has two main objectives. It offers a framework for vetting Riles's contentions about financial regulation by identifying two, U.S.-law examples of legal techniques from a context other than derivatives trading. In addition, it describes and critiques Riles's conception of swap collateral.

With respect to the first objective, the examples of techniques this review offers are from the context of securitization transactions. The first example—used by a handful of states—is the asset-backed securities facilitation statutes that deem certain assignments to be legal sales. The second example—used by private actors—is the third-party opinion letters that lawyers issue for the benefit of investors in asset-backed securities.

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2. *See* ANNELISE RILES, COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS 157 (2011) (referencing FRIEDRICH A. HAYEK, THE COUNTER-REVOLUTION OF SCIENCE: STUDIES ON THE ABUSE OF REASON (1952)).

3. For example, in testifying during discussion of the Restoring American Financial Stability Act of 2010, Comptroller of Currency Eugene Ludwig stated that "devastation [from the financial crisis] was made possible by a long-standing failure of our regulatory structure to keep pace with the changing financial system." S. REP. NO. 111-176, pt. III, at 40 (2010).

4. *See, e.g.*, Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1 (2011) (discussing the role of speculative trading of over-the-counter derivatives in the financial crisis).

5. Her turn to technique both substantiates and disrupts the Hayekian challenge to progressive regulation. *See* RILES, *supra* note 2, at 157–81, and discussion *infra* Part A.

This inquiry into Riles's assertion that we might find a wider range of more efficacious responses to systemic risk in the context of day-to-day practices is preliminary. With respect to opinion letters in structured finance, it is not clear that these letters—in their current iteration—could be a site for regulatory innovation. At the same time, given recent commentary on opinions practice, it is possible that third-party opinions could evolve to become part of the kind of day-to-day practices-based movement towards greater market stability that Riles imagines.

In other words, Riles's approach has potential despite the fact that one, prevalent technique (from a context apart from derivatives) does not currently bear out her contention. Riles offers an interesting and difficult interpretation of swap collateral that, with further exploration and action among private actors, could potentially incite stability-enhancing governance responses at the level of day-to-day practice rather than top-down regulation.

With respect to the second objective, Riles's conception of swap collateral—as a type of property interest—departs from conventional formalist and realist notions. Describing her description of collateral in derivatives trading is much of the work of this review.

Derivatives traders do what, again? Various commentators, expert and not, offer descriptions of bankers entering into contracts that specify conditions under which they make payments to one another, placing opposing bets on the future value of some asset. To secure performance, the banks or "swap counterparties" may assign collateral, creating a collateralized swap obligation.[6]

But typical descriptions of derivatives trading do not prepare a reader for the account of swap collateral that Riles makes. She presents collateral in derivatives markets as a motif and as central to strategies for private governance. Though they have differing scopes and connotations, the terms motif, technique, and aesthetic practice are largely interchangeable in Riles's narrative. Techniques are aesthetic practices; motif makes these concepts visual.

"As a motif," Riles writes, "collateral tells us much about what law is like in global markets."[7]

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6. Numerous sources explain this type of transaction. *See, e.g.*, Times Topics: *Derivatives*, N.Y. TIMES, *available at* http://topics.nytimes.com/top/reference/timestopics/subjects/d/derivatives/index.html (last updated Apr. 18, 2012) (explaining what derivatives are and referring readers to various recent articles about derivatives); Stout, *supra* note 4.

7. RILES, *supra* note 2, at 2. She refers to collateral as a motif in several instances.

> Motif: 1: a usually recurring salient thematic element (as in the arts); *especially*: a dominant idea or central theme; 2: a single or repeated design or color.[8]

Collateral as motif—a recurring pattern of technical requirements given effect through back-office conventions—functions as an "anti-network."[9]

The capacity of derivatives traders around the world to enter into obligations the cumulative effect of which is a market integral to financial systems depends not on actual, shared space or values. Rather, it runs on collateral—a property "ping" that settles the parties' relationship without them interacting at the level of community.[10]

Collateral makes it unnecessary for market participants to actually share norms. It permits swap counterparties to avoid normative contests by side-stepping domestic bankruptcy laws and contracts questions. As a central feature of derivatives markets, then, collateral implies that we can view law in global markets as an aesthetic practice in which form follows function and has agency of its own.[11]

Collateral Knowledge is an ethnographic study of derivatives traders in Japan with which Riles assesses the meaning of swap collateral. The book challenges the notion that global private law is a system of substantive commitments analogous to state law. By studying how Japanese bankers have accommodated ISDA[12] provisions embodying norms that do not mesh cleanly with local laws, Riles develops her thesis that collateral assignments are indicative of a global private law system rooted in technique and pattern, rather than in spaces where culturally diverse parties share values.

This review does not assess Riles's ethnography as such. Again, it focuses on two of the book's major themes: the idea that collateral is an aesthetic practice and the potential governance implications of this idea. Part A discusses how Riles presents legal technique and how this relates to the

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8. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1475 (2002).

9. *See* Annelise Riles, *The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State*, 56 AM. J. COMP. L. 605 (2008).

10. This notion of anti-network references a very current, cultural theme. Contemporary social networking creates communities in pluralist, unprecedented ways. Yet at the same time, the detachment of an internet-mediated culture calls into question the meaning of community.

11. Riles has related law and aesthetics before. *See, e.g.*, Annelise Riles, *A New Agenda for the Cultural Study of Law: Taking on the Technicalities*, 53 BUFF. L. REV. 973 (2005) (discussing that the agency of form, or aesthetics, makes legal technicalities—forms of argument, tools—central to law). She uses "aesthetic" to mean "the power of form to define the limits and possibilities of thought and social life," building on definitions of aesthetic sensibility as "empathy towards pattern." RILES, *supra* note 2, at 82 n.41.

12. International Swaps and Derivatives Association, Inc.

concept of an aesthetic practice and to Hayek. Part B considers Riles's description of collateral. Part C discusses Riles's sense of the implications of her approach for financial regulation.

A. TECHNIQUE AND HAYEK

Riles defines legal technique as "a constellation of material and aesthetic features, and forms of expertise that go with them."[13] These features include the ideology of instrumentalism, legal actors who view themselves as technicians, problem-solving paradigms, and stock forms of legal argumentation.

Collateral, in Riles's view, is an example of legal technique:

> Collateral is a set of material and procedural knowledge practices, a set of documentary and institutional tools and outputs that encourages certain forms of collaboration according to carefully scripted routines. Just as in science, where scientific truths emerge as universally accepted and legitimate by virtue of the way available scientific instruments, scientific theories, and institutional and social relations work together to reinforce one another, in the financial markets legitimacy emerges from these interlocking technical practices of communication.[14]

The elements of collateral—documentary tools, scripted exchanges, institutional structures, etc.—represent legal technique. As such, these elements, these recurring forms or practices that constitute collateral, have agency of their own. Just as conventions and available instruments of experimentation shape the scientific truth, knowledge practices that produce legal concepts shape law. Here, we are concerned with the legal concept of property rights assigned to secure contractual obligations: collateral.

The relationship between technique and aesthetics is that legal techniques manifest in recurring forms—forms of argument, of contract, of institutional structure. Aesthetics is the branch of philosophy that concerns the study of form (including beauty). To say that legal techniques have agency of their own, that form itself is at the heart of law and global governance, is to conceive of law as an aesthetic practice.[15]

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13. RILES, *supra* note 2, at 65.

14. *Id.*

15. For a summary of uses of aesthetics in legal scholarship, *see* Heather Hughes, *Aesthetics of Commercial Law—Domestic and International Implications*, 67 LA. L. REV. 689, 695–706 (2007) (building on recent work on law and aesthetics to assess aesthetic elements of finance and commercial law).

The implications of presenting collateral as technique emerge when Riles discusses ISDA's standard rehypothecation provisions in Chapter Four, which is titled *Placeholders: Engaging the Hayekian Critique of Financial Regulation*. Rehypothecation is when a secured party or pledgee assigns (i.e. hypothecates) its collateral to a third party.

Many financial transactions involve a semantic disconnection between contractual language and the parties' understandings of their respective rights. Again, the term "rehypothecation" indicates assignment of collateral (by a secured party) to a third party to secure an obligation. The original swap counterparties assign or hypothecate collateral to one another, and then they can each re-assign or re-hypothecate that collateral.

But the ISDA rehypothecation provisions permit the original assignee to sell the collateral before default. This suggests that the conveyance is not an assignment of collateral per se, but rather a sale subject to repurchase or substitution obligations.[16] Which of these characterizations is accurate we cannot know in the abstract.[17] That a contract creates a sale and then re-purchase or substitution, rather than assignment and then release of a lien, just reflects how the parties have structured and priced their swap.

Riles describes collateral in this context as involving entangled rights in the "near future," in that both counterparties have rights with respect to property assigned to secure an obligation.[18] The ISDA rehypothecation provisions, in Riles's view, are a "placeholder" that determines rights in the meantime so that the property can be put to best use during the life of the swap. These provisions, she states, indicate an assumption that "all we can really know at the moment is this near future. We will leave final outcomes to unfold as they may."[19]

She also describes these provisions as a "legal fiction." The notion that rehypothecation is a placeholder—a market response to a temporal challenge (the dedication of property for a period of time)—makes sense. But in what

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16. *See, e.g.*, INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., USER'S GUIDE TO THE 2001 ISDA MARGIN PROVISIONS 37 (2001) (observing that the term "rehypothecation" can cause confusion).

17. *See* INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., 2001 ISDA MARGIN PROVISIONS X (2001) (permitting the collateral taker, notwithstanding U.C.C. § 9-207, to use or dispose of collateral). Though use and disposition of collateral is not necessarily inconsistent with characterization of the assignment as creating a security interest, whether any given assignment effectuates a sale or assignment of collateral security is, again, a function of the intent of the parties and substance of their actual contract.

18. RILES, *supra* note 2, at 175.

19. *Id.* at 169.

sense it is a legal fiction is less clear. With respect to collateral itself, she writes: "So, what is collateral? It is simply a legal fiction—a fiction that the rights of the parties are well defined—nothing more and nothing less."[20]

Riles says that rehypothecation provisions deem the rights of the parties with respect to collateral to be certain when in fact they are not certain. But unless we are just positing that all property rights are fictions, in order to know if the rights of the parties are certain or not, we would need to know more about the swap transactions at issue.

Readers, here, may find themselves wavering between indeterminacy theories through which we may view all property rights as fictional (and powerful as such), and varying versions of swap transactions themselves, some of which involve a disconnection between the contract's language and the parties' positions and others that do not. It is unclear whether Riles is calling out collateral in particular, or whether she means that property rights generally are fictions. This distinction is important to her discussion of rehypothecation.

The purchaser of rehypothecated collateral is not acquiring a fiction (again, except in the sense that all property is fictional). It is acquiring whatever property rights the original pledgee has the power to convey. If the pledgee is a purchaser with full rights of disposition and a contractual obligation to re-convey equivalent value at a future date, the swap parties may have a conveyance that is a sale, with a repurchase or substitute sale at the close of their deal.

Again, a given contract may create a sale and then re-purchase or substitution obligation, or it may require assignment and then release of a lien; the difference just reflects the parties' preferences. It does not indicate a fiction, necessarily. Below is a discussion of a U.S. law that more clearly functions as legal fiction: asset-backed securities statutes deeming all transfers in the context of securitization to be sales (regardless of recourse).

By asserting that the fiction is that "the rights of the parties are well defined," Riles implies that they are not in fact so well defined. For example, there could be uncertainty as to enforceability in Japan of a New York choice of law clause. The choice of law question, of course, introduces uncertainty given the potentially different approaches to re-assignment of collateral under Japan's and New York's laws.[21]

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20. *Id.* at 172.
21. For discussion of these differences, *see* RILES, *supra* note 2, at 168–71.

Perhaps Riles intends her discussion to extend only to the context of Japanese parties to swaps with foreign counterparties—the subject of her ethnography. But it seems not, given how her discussion resonates with thinking about collateral, derivatives markets, and governance generally. In any event, apart from the effects of the choice of law issue, Riles does not fully explain how and in what sense rehypothecation is a legal fiction.

In terms of her argument as a whole, the need for clarification on this point does not detract from her discussion of legal placeholders. In fact, it seems she does not need both concepts—legal fiction and legal placeholder. Riles presents the legal fiction as a placeholder.[22] But it is not clear how the fictional or non-fictional quality of the technique is dependent on it being a placeholder. And it is the placeholder quality that is most relevant to the chapter's goal of engaging the Hayekian critique of financial regulation.

Riles's point about the relationship between legal techniques and Hayekian thinking is a provocative one. She contends that private governance and the problem of time, and public governance and the problem of time, can be functionally equivalent. This equivalence "give[s] substance to Hayek's impressionistic arguments on behalf of the temporality of the private."[23]

Friedrich Hayek's theories inform much conventional wisdom about regulation. In public discourse, we frequently hear versions of the notion that economic planning and regulation are always temporally behind the market such that effective financial regulation seems impossible.

Riles contends that "the ideological dimension of Hayek's argument lies not in his attention to the limitations of technocratic reasoning per se but rather in the way he slips from observations that public legal reasoning has certain temporal weaknesses to a simple assumption that private reasoning must have equivalent temporal strengths."[24] What market techniques evidence private actors' temporal strength, and is this strength unique to market actors, or might the state utilize private techniques just as well?

Rehypothecation is the example Riles uses to show that private actors use technique to bridge temporal problems. The property assigned to secure swap obligations would not be put to best use if, pending satisfaction of the obligation, it could not be re-assigned. In order to re-assign it at the highest possible value, the pledgee should act as an outright owner or buyer, with

22. *Id.* at 172–75.
23. *Id.* at 177.
24. *Id.* at 158.

rights of disposition. The pledgee's only obligation is to return equivalent securities at the close of the swap.

This example corroborates Hayek's assumption that private reasoning has temporal strengths. But what interests Riles—and what is at the heart of the nexus she presents between technique and possibilities for financial regulation—is that there is nothing inherently or exclusively private about private law or private ordering techniques. "The fallacy of the Hayekian argument," she states, "is the assumption that these 'private' technologies can only be deployed by private actors."[25]

Her ultimate point is that we should explore at greater depth how private law techniques like rehypothecation clauses function because in such technique there is "far more epistemological complexity, far more political imaginativeness . . . than the existing ways of thinking about financial regulation are even willing to entertain, let alone address."[26]

To illustrate how the state can deploy techniques typically associated with market actors, Riles discusses the Japanese Payments and Settlements Division's real time gross settlement system.[27] As another example, from a different context, consider the asset-backed securities statutes.

Beginning in 2003, a handful of U.S. states passed asset-backed securities facilitation acts or "ABS statutes" in response to (pre-financial crisis) concern about the legal foundations of the multi-trillion dollar securitization industry.[28] The concern is that the securitization market could collapse if courts were to find that assets assigned to collateralize securities are not the property of the issuer because the level of recourse the issuer has against the assets' originator is inconsistent with treatment of the transfer as a sale (rather than an assignment of security for a loan).

Legislators in Delaware, for example, enacted that "any property, assets or rights purported to be transferred, in whole or in part, in . . . securitization transactions shall be deemed to no longer be the property, assets or rights of

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25. *Id.* at 178.

26. *Id.* at 177.

27. Specifically, she notes how the RTGS functions by having the Division head deem before the fact that after the fact all transactions occurred sequentially (A paid B who then paid C) when in fact real time settlement creates liquidity problems when A cannot pay B before C pays it, for example. (Daily settlement avoided this problem by clearing all transactions at the same, designated time.) *See id.* at 179.

28. *See* ALA. CODE § 35-10A-2(a)(1) (2003); DEL. CODE ANN. tit. 6, §§ 2701A–2703A (2003); LA. REV. STAT. ANN. § 10:9-109(e) (2003); OHIO REV. CODE ANN. § 1109.75 (2003); N.C. GEN. STAT. §§ 53-425, 53-426 (2004); S.D. CODIFIED LAWS § 54-1-10 (2003); TEX. BUS. & COM. CODE ANN. § 9-109(e) (2004).

the transferor."[29] This is the equivalent of passing a law stating that all cars are blue. Not all cars are blue, but for legal purposes in a specific context, all cars are now blue as a matter of law.

This is a legal fiction. Everyone knows it to be false, but the act serves a purpose. It settles the question of whether the level of recourse the issuer has to the originator might warrant re-characterization of the original sale to the issuer as a loan. If such re-characterization were a risk, investors would not have the extent of rights in the assets backing their asset-backed securities that they expect.

This legislative move seems to be an example of the kind of state deployment of private law technique that Riles is talking about. These laws are a type of financial regulation—they are a statutory response to a market problem. State actors can deem transfers to be sales and not loans as a matter of law in order to avoid thorny judicial interpretations of levels recourse among parties. Or, states might enact such regulations just to lower transaction costs—either cutting out or greatly simplifying the "true sale" opinion letter from originator's counsel that investors typically require in this type of deal.

In any event, we have a problem. The market has evolved to the multi-trillion dollar level, yet the true sale status of the transaction by which the assets are isolated from originators' liabilities can be unsettled and expensive to establish. The state can settle the uncertainty with a legal fiction—a deeming of all transfers in the securitization context to be sales.

The correlative private actor technique is contract provisions that function "notwithstanding anything herein to the contrary." This typical formulation in commercial contracts enables stipulations that openly contradict other contract terms. We might construe the ABS statutes as the equivalent of contract provisions stating that "notwithstanding anything herein to the contrary, the transfer of assets pursuant to this purchase and sale agreement shall for all purposes be treated as a sale and not an assignment of security." The provisions "to the contrary" would be the various obligations of the seller that may amount to a level of recourse from purchaser to seller that makes the deal inconsistent with sale treatment as a matter of law.

Thinking through this example, it seems true that the state can deploy private law techniques. Yet the power of this technique when used by the state exceeds what contracting parties can do privately. The state can override the common law true sale doctrine and make transfers sales as a matter of law. Private parties, on the other hand, can express intentions to have a transfer

29. DEL. CODE ANN. tit. 6, § 2703A(1) (2005).

treated as a sale, but ultimately only effectuate a sale as a matter of law if their transaction is not one that a court would find creates a security interest.[30]

But Riles is not saying that public and private governance techniques are in all ways the same. She is saying that there is nothing inherently private about private law techniques, such that public governance and private governance can both be responsive to the temporality of markets.

Her example of real time gross settlement systems in derivatives markets deals explicitly with time and liquidity challenges. The ABS statutes are not primarily about time or liquidity. They both show, however, that the state can perceive market problems and respond, during ascendance of market practices, to facilitate commercial activity. The question of whether the way in which the state does this is good or bad, aggravates or ameliorates systemic risk, is another matter.

B. Form and Formalism

Riles's description of collateral builds upon critical approaches to property law that present property as complex and contextual. For example, she endorses well-known critiques of Hernando de Soto's titling project—in a nutshell, that it treats property rights as clear and discrete building blocks for wealth, whereas in fact they are contested and contingent, their efficacy as wealth-building tools incomplete.[31]

But despite this bent, her position is not necessarily at odds with a formalist explanation of the value of collateral in derivatives markets. Riles characterizes legal formalism as the "view that private law doctrines and techniques can stand as a bulwark against the complexity and indeterminacy of the market."[32] She implies that it is not the salience of property rights themselves that gives collateral its legitimacy, but rather the repetition and regularity of the technical effectuation of collateralized swap obligations.

She is examining the technicalities of derivatives trading—the market conventions that effectuate collateral assignments. In other words, she is exploring the construction of the legal practices that stand as bulwark against the complexity of markets. The notion that private law doctrines are perpetually constructed by performance and technique, rather than constituted

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30. *See generally* U.C.C. §§ 9-109, 1-201(35), 1-203 (2011).

31. *See, e.g.*, RILES, *supra* note 2, at 4–7, 166–67.

32. *Id.* at 164.

by abstract principles, does not undermine their functionality as ordering devices in a complex and indeterminate world.

If various, disjointed swap counterparties each believe that the techniques Riles describes effectuate a property conveyance with a certain, substantive scope, does it matter that the substance each party imagines differs, such that the rights are indeterminate? Well, yes, once there is a dispute.

But one wonders how relevant the dispute context is to the day-to-day practices on which Riles focuses. In Chapter One, we read:

> So in place of . . . ideas that create coherent standards, . . . I suggest that we understand the ensemble of legal techniques that make up the private governance of the global derivatives markets as an assemblage of glitches . . . . We have a flurry of activity that creates distinctions, sets limits, cuts . . . one line of analysis from another, . . . that does not "add up" to . . . a new source of epistemological or juridical authority.[33]

This description would seem fundamentally at odds with formalist conceptions of law. It asserts a lack of coherence and of epistemological and juridical authority, whereas formalism is a theory of legal justification in which coherence of relations among legal actors enables non-instrumental determination of legal outcomes.[34]

This description of "legal techniques that make up the private governance of the global derivatives markets" is not a realist conception either. Realism, too, is a theory of legal justification—one in which factual relations and real-world impacts explain legal outcomes. There is no reference in Riles's description of derivatives markets to any shared social context in which dynamics among the parties generate standards. Quite to the contrary, again, she sees an "anti-network."

The way she locates law in technique rather than in shared principles invokes a nexus of critical, theoretical understandings of law and formalist elements of law. Her position is distinct from either (i) critical theorists who explain legal systems in reference to distributional outcomes,[35] or (ii) formalists who assert a coherence of abstract principles sufficient to sustain non-instrumental modes of lawmaking.[36]

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33. *Id.* at 63–64.

34. *See generally* Ernest J. Weinrib, *Legal Formalism: On the Immanent Rationality of Law*, 97 YALE L.J. 949 (1988); Ernest J. Weinrib, *Legal Formalism*, *in* A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY 332 (Dennis Patterson ed., 1996).

35. *See, e.g.*, DUNCAN KENNEDY, CRITIQUE OF ADJUDICATION (1997); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

36. *See, e.g.*, Weinrib, *supra* note 34.

Yet, she draws on elements of critical theory in her assertions of a lack of coherent norms among market actors. The idea that technique itself is at the heart of global private law references theories of law rooted in Continental philosophy. These include the assertion of a lack of external referent or abstract justificatory principle on which to base legal relations.[37]

At the same time, the idea that technique is a site of governance draws on the formalist concept that abstract formulations of rights can mediate relations among diverse legal actors. The mode of coherence in Riles's description of global private law in derivatives markets is not a function of shared norms in the way that traditional formalists imagine. But the notion that the system inheres in a set of practices detached from shared norms suggests a formalism—one in which technique, rather than shared principles, bridges difference.[38]

C. Expanding Approaches to Financial Regulation

Riles's conception of law as an aesthetic practice (in which form has agency of its own) casts collateral as a kind of property that we can understand in reference to, but apart from, conventional realist and formalist concepts. This approach could have interesting implications for regulation of financial markets.

Dodd-Frank includes requirements that certain derivatives be cleared on a central clearing house that nets out members' trades daily and requires that parties post collateral daily.[39] These provisions are designed to provide transparency in the derivatives market to reduce risk associated with over-the-counter, speculative derivatives contracts.

The regulations contained in Dodd-Frank emerged from a "remarkably narrow" range of policy proposals, in Riles's view.[40] Financial regulation seems to be captured by a discourse that pits new architecture against intransigence.

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37. *See, e.g.*, Jean Baudrillard, *Simulacra and Simulations*, *in* JEAN BAUDRILLARD, SELECTED WRITINGS 166 (Mark Poster ed., 1988).

38. In *Taking on the Technicalities*, she writes that "if we define formalism not as an epistemological or political position, but as an aesthetic propensity, a genre of self-presentation . . . it is easy to see that this technical aesthetic is by no means the exclusive province of legal formalism." Riles, *supra* note 11, at 1027.

39. Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5301 (2006 & Supp. 2011).

40. RILES, *supra* note 2, at 225.

To be a reformer "is to be an architect and a designer, someone who creates something bold and new."[41] "So ubiquitous is the call for new architecture that it often seems that there are only two positions in the current regulatory debate—either you are an architect or you are an apologist for the financial industry."[42]

Riles suggests that turning to technique can break us free of this discourse. Techniques implemented day-to-day can provide a new site for regulation via small changes and better use of existing structures. She asks:

> What would market reform look like if, instead of investing all our political energies in a policy-driven search for the perfectly calibrated regulatory architecture, we focused more attention on developing and redirecting the practical legal techniques that are already contributing in practical, day-to-day ways to market stability?[43]

Consider again the example of securitization. The third-party legal opinion letters required in these transactions are a day-to-day practice with which to think through Riles's approach.

First of all, these letters do seem to exemplify what Riles calls a technique. They are a routine closing requirement in financial transactions and they tend to take standardized forms. Scholarship on opinions practice identifies both economic and non-economic reasons for the practice. In economic terms, scholars discuss how these letters can reduce information asymmetries or can function as a kind of deal insurance, shifting liability to lawyers. In non-economic terms, scholars discuss path dependency and conceptions of lawyers' professional roles in transactions.[44] Regardless of the forces driving opinions practice, these letters reflect "a set of material and procedural knowledge practices, a set of documentary and institutional tools" that require recurring forms of collaboration that follow scripted routines.[45]

Securitization transactions typically require third-party opinion letters from counsel to the originator for the benefit of investors.[46] These opinions

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41. *Id.*

42. *Id.*

43. *Id.* at 244.

44. *See* Jonathan Macey, *The Limits of Legal Analysis: Using Externalities to Explain Legal Opinions in Structured Finance*, 84 TEX. L. REV. 75 (2005) (responding to Schwarcz); Jonathan Lipson, *Price, Path & Pride: Third-Party Closing Opinion Practice Among U.S. Lawyers (A Preliminary Investigation)*, 3 BERKELEY BUS. L.J. 59 (2005).

45. RILES, *supra* note 2, at 65.

46. Many types of transactions call for opinions of counsel as a condition precedent to closing. The forms that these opinions take and the liability associated with them are subjects of the literature on transactional representation. *See generally* Thomas L. Ambro & Arthur Norman Field, *The Legal Opinion*

assure investors, among other things, that assets transferred to a special purpose vehicle (SPV) are bankruptcy remote—meaning, they are conveyed in a sale (not assigned to secure debt) and the SPV is a distinct legal entity that would not be consolidated with the originator in bankruptcy. Attorneys issue opinion letters to investors, but accountants and rating agents often look to the letters as well in the securitization context.

Since the recent financial crisis, many scholars have discussed investors' due diligence failures, over-estimation of the value of collateral for asset-backed securities, and the like. Third-party opinion letters may appear to be a technical requirement for closing, relevant only to the legal status of the transaction. But perhaps they are a technique with potential for enhancing market stability. Decent vetting of this contention would require more thorough treatment than there is room for here. The following discussion merely frames a more complete inquiry.

Third-party opinion letters are a legal technique operating at the heart of structured finance. Commercial law scholar Steven Schwarcz has stated that "significant controversy" surrounds these legal opinions. "Reflecting at its core the unresolved boundaries between public and private in financial transactions," he writes "this controversy raises important issues of first impression: To what extent, for example, should lawyers be able to issue legal opinions that create negative externalities?"[47]

Schwarcz has observed that opinion letters can create negative externalities by potentially misleading investors in originators' securities.[48] But, Schwarcz argues, this potential is not the fault of lawyers rendering third-party opinions. It is a function of an information problem—namely, that these opinions are given to assure the bankruptcy remoteness of assets assigned to an SPV, as a legal matter, but then are used for purposes of accounting for transactions as off-balance sheet sales.[49] Schwarcz contends that investors could learn about contingent recourse in these transactions if they more closely read disclosure statements.[50]

The externalities with which Schwarcz is concerned are effects of off-balance-sheet financing on investors, given investors' capacities to access and

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Risk Seminar Papers, 62 BUS. LAW. 397 (2007). Here, the discussion is limited to true sale and non-consolidation opinions in structured finance transactions.

47. Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 1 (2005).

48. *Id.* at 7.

49. *Id.* at 2, 7 n.33.

50. *Id.* at 4.

understand information. He concludes that unless lawyers suspect that a transaction is fraudulent, for example, by seeing that it has no business purpose, lawyers should not be forced to decide whether to render an opinion as to the legal structure of the deal. Rather, the government should address the underlying harm—here, opacity to investors of off-balance sheet financing.[51]

Riles's contention about technique references systemic risk. Schwarcz's discussion of third-party opinion letters could be, ultimately, about systemic risk, but it is most proximately about the particular externalities created by legal opinions about assignments for purposes of securitization.

But as a thought experiment, we could posit that these externalities are inextricably linked to systemic risk and then consider possibilities for reform of opinions practice that mitigates this risk. Two examples of such possibilities follow.

First, for example: What if an investment group decided to purchase asset-backed securities only from issuers that acquire assets in transactions that are clearly legal sales in the sense that any contingent recourse is limited and the nature of the assignment is transparent to originators' investors? As a pre-requisite to funding, the form of "true sale" opinion letter from counsel must contain only certain qualifications and exceptions.

Would the potentially more modest recourse the issuer has to the originator in this scenario just reduce the amount of capital that the parties might otherwise raise against the same pool of assets? If so, would this turn to technique just writ small the same tension between maximizing access to capital and ensuring sound foundations that concerns the architects and intransigents?

Perhaps, but not for sure. Riles imagines a market movement involving diverse actors, each reconsidering the impacts of what they do day-to-day.[52] She writes that professional doubts about whether to "encourage or discourage a certain form of risk-taking on the part of clients are not only inevitable, they are actually the engine of such a movement."[53] We might imagine a group of lawyers getting together and re-formulating standard contracts and opinion letters with the health of the market in mind. But this is hypothetical. Maximizing the profits of individual clients may always take priority over the kinds of collective considerations that concern regulation.

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51. *See* Steven L. Schwarcz, *We Are All Saying Much the Same Thing: A Rejoinder to the Comments of Professors Coffee, Macey, and Simon*, 84 TEX. L. REV. 93 (2005).

52. RILES, *supra* note 2, at 245.

53. *Id.*

Second, for example: What if lawyers themselves, via bar associations or otherwise, agreed to best practices in which they assumed greater duties to the public in transactional representation than current professional responsibility standards require? In other words, attorneys could, in theory, generate a market for a different kind of opinions practice.[54]

Historically, opinions practice has resisted centralized best-practices or regulation, but this may be changing. Practitioners involved with the American Bar Association Opinion Committee observe that "business law practice has become more national and even international in the years since Silverado"—the 1989 conference where the ABA Section of Business Law attempted (without success) to garner institutional support for opinions standards.[55] Therefore, "the consensus that malpractice insurers, financial institutions, opinion recipient interests and rating agencies needed to agree as to customary practice is relatively recent."[56]

In an empirical analysis of third-party opinions practice, Jonathan Lipson observes that "[c]losing opinions are likely to become more, not less, controversial" as lawyers become "increasingly attractive litigation targets when transactions fail[] . . . ."[57] In addition, "pressure to create increasingly complex transaction structures will likely demand that lawyers issue more, perhaps riskier, closing opinions," potentially leaving lawyers with "far greater exposure than they are prepared to absorb."[58] In light of these observations, Riles's vision of a day-to-day practices-based movement to mitigate systemic risk seems plausible.

It is beyond the scope of this review to articulate what greater transactional lawyers' duties to third parties might look like. The purpose here is to consider Riles's contention that technique is an under-explored site for regulatory innovation. As such, the discussion here merely identifies an example of something that Riles would call a technique and the potential relationship of this technique to her view of financial regulation.

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54. In his qualitative empirical study, Jonathan Lipson finds that opinions practice appears to resist market-based change, and that the main forces behind changing practices are bar associations. *See* Lipson, *supra* note 44, at 64. Even bar associations, though, have not necessarily succeeded in establishing centrally-articulated standards. *See* Ambro & Field, *supra* note 46, at 397.

55. Ambro & Field, *supra* note 46, at 398.

56. *Id.*

57. Lipson, *supra* note 44, at 65.

58. *Id.*

D. CONCLUSION

There is something highly compelling about these two, central points that Riles makes. Break out of Hayekian conventional wisdom—the state can also deploy so-called private techniques. Break out of conventional discourse on regulation—small-scale, technical practices have transformative potential.

Each of these two points is a function of Riles's focus on legal techniques and knowledge practices. But they suggest different forms of action and are not necessarily interdependent. The call to craft state-level regulation that uses private law techniques is different from the call to revisit techniques to see how they might enhance market stability.

Collateral Knowledge surely inspires difficult thinking about private law and financial regulation, using collateral in derivatives markets as a complex and interesting context. This, it seems at base, is what Riles set out to do.