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Pass or Fail? Grading the Effectiveness of Stress Tests a Decade After the Financial Crisis

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PASS OR FAIL? GRADING THE EFFECTIVENESS OF STRESS TESTS A DECADE AFTER THE FINANCIAL CRISIS

I. INTRODUCTION

It has been about a decade since the Financial Crisis of 2008—the worst financial downturn since the Great Depression—often termed the "great recession."[1] The American financial system was shaken to its core, unemployment rose rapidly,[2] and major banks neared insolvency.[3] While some institutions were bailed out, such as American International Group ("AIG") and Bear Stearns, others, most notably Lehman Brothers, were left to fend for themselves and ultimately ended up filing for bankruptcy.[4]

In the wake of the financial crisis, the Federal Reserve began subjecting larger banks to annual "stress tests" to determine whether they have enough capital to continue lending as normal when faced with stressful market conditions such as double digit unemployment, huge decreases in the housing market, and negative GDP growth over several quarters.[5] The Dodd-Frank Act ("Dodd-Frank"), enacted in 2010, made

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1. *See* Lawrence Mishel & Heidi Shierholz, *The Worst Downturn Since the Great Depression*, ECON. POL'Y INST. (June 2, 2009), https://www.epi.org/publication/jobspict_200906_preview/ (examining how the financial downturn of the late 2000s stacks up to the Great Depression and other recessions).

2. *See id.* (detailing the statistics behind the 2008 financial crisis).

3. *See* David Stout, *The Wall Street Bailout Plan, Explained*, N.Y. TIMES (Sept. 20, 2008), https://www.nytimes.com/2008/09/21/business/21qanda.html (reporting on how the government calculated a $700 billion bailout plan and why they chose to do so).

4. *See Lehman Brothers Bankruptcy*, HISTORY.COM (Jan. 19, 2018), https://www.history.com/this-day-in-history/lehman-brothers-collapses (detailing the collapse of Lehman Brothers – the largest bankruptcy in US history).

5. *See generally History of the Basel Committee*, BIS, https://www.bis.org/bcbs/history.htm (last updated Apr. 14, 2018) (explaining that before the financial recession banks largely conducted their own stress tests). In 2007, governmental regulatory bodies became more interested in supervising these tests or conducting the tests themselves. One such action was set out in the Basel Accords promulgated by the Basel Committee on Bank Supervision (BCBS), an international committee formed to develop standards for banking regulation. Until the enacting of Dodd-Frank, different regulatory bodies like the International Monetary Fund provided some level of oversight but Dodd-Frank gave more substantial control in the process. Ryan Tracy, *What Are the Fed's Stress Tests?*, WALL ST. J. (June 28, 2018, 12:06 PM), https://www.wsj.com/articles/what-are-the-feds-stress-tests-1529487001 (tracking differences in the 2018 stress tests versus previous years).

these annual tests mandatory for banks of a certain size.[6] As the ten year mark of the implementation of these stress tests approaches, it is an appropriate time to review how these tests have fared in both predicting the health of large banks and bolstering the banking industry.

In the coming years, the rigor of the stress tests may change if banks are successful in promoting deregulation.[7] The United States Treasury released a report to President Trump in response to Executive Order 13772, which the President signed in early 2017, that detailed inefficiencies and excess costs caused by the current regulatory scheme.[8] This Note examines how the stress tests have strengthened the banking sector over the past decade and the role and effectiveness the tests will have in the future if they are relaxed through legislation or otherwise. Specifically, this note examines the competing arguments surrounding the calls to relax the tests – are the banks sufficiently prepared at this point and no longer need to keep raising capital levels at the rate the Federal Reserve is requiring? Are the banks really being restrained from growing the economy further if they had more freedom? Or, rather, would loosening the stress tests put the banking industry at a substantial risk of plunging right back into another financial crisis?

Part II provides the background of Dodd-Frank that was enacted in response to the 2008 financial crisis.[9] Part III examines the impact the legislation has had on the banking landscape, specifically the capital position of the large banks and how their financial decisions in regards to dividends and stock buybacks are made in accordance with legislation.[10] Part III also considers the impact of recent roll backs of parts of Dodd-Frank. Finally, Part IV discusses the possibility of future changes in the law in the light of the Trump Administration's agenda.[11] The arguments

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6. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) § 1101, 12 U.S.C. § 5327 (2012) (setting asset threshold for banks to be subjected to submitting financial reports for use of regulations).

7. *See* Emily Flitter & Jim Tankersley, *Bank 'Stress Tests' Results Clear Way for Wall Street to Reward Investors*, N.Y. TIMES (June 28, 2018), https://www.nytimes.com/2018/06/28/business/bank-stress-tests-fed.html (reporting how the results of this year's second round of stress tests will be used by the banks to lobby for further deregulation given their relative success over the past decade).

8. Exec. Order No.13772, 82 Fed. Reg. 9965 (2017) (ordering the Secretary of the Treasury to report on Dodd-Frank's effectiveness); U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS (June 2017) [hereinafter ECONOMIC OPPORTUNITIES].

9. *See infra* Part II.

10. *See infra* Part III.

11. *See infra* Part IV.

of regulation proponents and opponents will be weighed to address where the banking industry might be heading, and where it should be heading.

II. THE DODD-FRANK ACT AND BANK STRESS TESTS

Dodd-Frank is the most significant banking legislation enacted since the Great Depression.[12] It was enacted in direct response to the financial crisis exposing the lack of preparedness of the nation's big banks and their regulators.[13] Due to this lack of preparedness, the federal government and the American citizens, by virtue of taxes, had to bail out some big banks while others failed, further compounding the adverse effects of the recession.[14] Essentially, the stress tests require big banks to hold enough capital to ensure a 2008–2009 bank crisis never happens again.[15]

Before the financial crisis of 2008, regulators and financial institutions were already conducting various forms of stress testing.[16] However, the origin of the current supervisory stress tests can be traced back to 2009 when, in the midst of the financial crisis, supervisors conducted the Supervisory Capital Assessment Program ("SCAP"), a series of stress tests of the nineteen largest bank holding companies ("BHC").[17] The SCAP sought to address the uncertainty that investors and the public had in these large BHCs concerning its solvency and ability to lend by

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12. *See Dodd-Frank Act*, HISTORY.COM (Jan. 26, 2018), https://www.history.com/topics/21st-century/dodd-frank-act (summarizing the sheer weight Dodd-Frank had on the financial industry).

13. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DODD-FRANK ACT STRESS TEST 2017: SUPERVISORY STRESS TEST METHODOLOGY AND RESULTS – JUNE 2017 (Sept. 7, 2017) [hereinafter BD. OF GOVERNORS 2017] https://www.federalreserve.gov/publications/2017-june-dodd-frank-act-stress-test-background-on-dodd-frank-act-stress-testing.htm (providing background on Congress' enactment of Dodd-Frank).

14. *See* Mike Collins, *The Big Bank Bailout*, FORBES (July 14, 2015), https://www.forbes.com/sites/mikecollins/2015/07/14/the-big-bank-bailout/#1ab762442d83 (examining the government's bailout plan and where the funding came from).

15. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) § 1101, 12 U.S.C. § 5301 (2012) ("To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end too big to fail, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.").

16. *See* TIM P. CLARK & LISA H. RYU, FED. RESERVE BD., CCAR AND STRESS TESTING AS COMPLIMENTARY SUPERVISORY TOOLS (2015) (providing historical context for current CCAR and Dodd-Frank stress tests).

17. *See id.* (discussing how the current stress tests and CCAR originated from 2009 stress testing done in an immediate response to the current financial crisis).

requiring the BHCs to raise their capital levels.[18] SCAP assessed whether a BHC had sufficient capital to incur losses and continue operating as a financial intermediary and, if it did not, required that bank to raise their capital levels within six months.[19] A unique feature of SCAP is that the U.S. Treasury provided a capital backstop in the event that the nineteen BHCs failed to raise their respective capital levels in the six month period.[20] Additionally, SCAP was the first time that supervisors released individual results of each bank's tests to the public.[21] This public disclosure, coupled with the perceived credibility of the SCAP stress tests, significantly contributed to restoring the confidence in the country's banking system.[22]

Taking lessons learned from the SCAP, the stress tests that are in place today were rolled out the following year in 2010.[23] These stress tests—the Dodd-Frank stress tests and the Comprehensive Capital Analysis and Review (CCAR) stress tests—originally applied to banks with more than $50 billion in total assets, which was the asset threshold for a BHC to be considered "systematically important" (the "SIFI threshold") and be subjected to the Federal Reserve's "enhanced prudential standards" (essentially the most stringent of regulation standards) in its assessment.[24] Together the Dodd-Frank and CCAR tests include both a quantitative and qualitative portion and are used conjunctively by the Federal Reserve to determine whether a financial institution has sufficient capital to continue operating through different measures of economic stress.[25] While complimentary to one another in use by the Federal Reserve, the

18. *See id.* (detailing the goals of SCAP and the process designed to achieve those goals).

19. *See id.* (providing the requirements of SCAP used by the Federal Reserve in an attempt to stabilize the financial system).

20. *See id.* (detailing the capital backstop created by the U.S. Treasury in an effort to ensure the banks stabilization efforts would not fail).

21. *See id.* (discussing how the release of bank-by-bank results helped improve confidence in the banking system).

22. *See id.* (complimenting the overall progress that SCAP had towards stabilizing the financial system).

23. *See id.* (citing the influence of SCAP on the provisions of Dodd-Frank and the Comprehensive Capital Analysis and Review).

24. *See* SULLIVAN & CROMWELL LLP, FINANCIAL SERVICES REGULATORY REFORM LEGISLATION (2018), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Financial_Services_Regulatory_Reform_Legislation_05_24_18.pdf (providing the standard of regulations banks were subjected to by Dodd-Frank).

25. *See* ECONOMIC OPPORTUNITIES, *supra* note 8 (detailing the complementary nature of the Dodd-Frank stress tests and CCAR stress tests).

two tests are distinct.[26] The Dodd-Frank stress test is a forward-looking, quantitative evaluation of the impact of poor financial market conditions and stressful economic pressures on a firm's capital.[27] The enhanced prudential standards applied to all BHCs with $50 billion or more in total assets and required stress tests to be conducted by both the Federal Reserve (supervisory-run tests) and the BHCs themselves (i.e., company-run tests).[28] Additionally, the enhanced prudential standards require BHCs to establish risk committees and to meet various capital and leverage ratios.[29] As a whole, Dodd-Frank stress tests serve to "inform the Federal Reserve, firms, and the general public of how institutions' capital ratios might change under a hypothetical set of stressful economic conditions."[30] In particular, the quantitative portion of the test evaluates a firm's capital adequacy after subjecting the bank to three stress scenarios: baseline, adverse, and severely adverse.[31]

The second assessment conducted by the Federal Reserve, CCAR, contains both a quantitative and qualitative portion.[32] The quantitative portion of the CCAR assessment is largely the same as the supervisory-run Dodd-Frank stress tests, except that CCAR takes into account a financial institution's planned capital distributions when conducting the test, whereas the Dodd-Frank stress test assumes a firm's capital distributions will be consistent with prior distributions.[33] The qualitative portion of the test involves the Federal Reserve making evaluations about a firm's capital adequacy after taking into consideration the firm's planned capital distributions, such as stock buybacks or dividend payments.[34] The

26. *See* ECONOMIC OPPORTUNITIES, *supra* note 8 (distinguishing Dodd-Frank and CCAR as two separate exercise although used complimentary).

27. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DODD-FRANK ACT STRESS TEST 2018: SUPERVISORY STRESS TEST METHODOLOGY AND RESULTS – JUNE 2018 (2018) [hereinafter BD. OF GOVERNORS 2018], https://www.federalreserve.gov/publications/files/2018-dfast-methodology-results-20180621.pdf.

28. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) §165(i), 12 U.S.C § 5365(b)(1)(A)(i) (2012).

29. *See* BD. OF GOVERNORS 2018, *supra* note 27 (showing all the various calculations each BHC are tested with to determine several ratios such as the Tier 1 capital ratio, Tier 1 leverage ratio, and the supplementary leverage ratio).

30. BD. OF GOVERNORS 2018, *supra* note 27.

31. BD. OF GOVERNORS 2018, *supra* note 27.

32. *See* ECONOMIC OPPORTUNITIES, *supra* note 8 (summarizing the assessment procedure of CCAR).

33. See ECONOMIC OPPORTUNITIES, *supra* note 8 (distinguishing the quantitative methodologies, data, and processes used in the supervisory-run Dodd-Frank stress tests from the CCAR).

34. BD. OF GOVERNORS 2018, *supra* note 27.

qualitative portion also gives the Federal Reserve broad discretion to make subjective evaluations about a bank's capital planning, including the bank's governance, risk identification, risk management, internal audit, and all-around control of those practices.[35] The Federal Reserve assesses whether the banks have enough capital to continue lending as normal through stressful economic conditions, "even after making all planned capital distributions."[36] As of May 2018, legislation makes the CCAR only applicable to banks with more than $250 billion in assets and the Dodd-Frank stress tests apply only to banks with more than $100 billion in assets.[37]

At the conclusion of the CCAR, the Federal Reserve either objects to a firm's capital plan or does not object.[38] Colloquially, the Federal Reserve's decision means that the bank either "passed" or "failed" their test.[39] If the Federal Reserve "objects" to a firm's capital plan, the firm's capital distribution plan[40] is limited to whatever amount the Federal Reserve permits in writing.[41] Sometimes, a bank will be given a "conditional pass" of a stress test.[42] This either means that a bank came quite close to failing the stress test or the Federal Reserve found its decision to object or not was being affected by an outside influence. Such was the case with Goldman Sachs and Morgan Stanley's "conditional pass" in 2018, in which the banks technically failed but for a reason that

35. BD. OF GOVERNORS 2018, *supra* note 27; *see also* CCAR AND DFAST: REACHING THE SUMMIT, DELOITTE (July 2017), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/regulatory/us-reg-ccar-dfast-reaching-the-summit.pdf (detailing some major areas that the Fed typically finds issues with during the qualitative portion of the stress tests).

36. BD. OF GOVERNORS 2018, *supra* note 27.

37. Economic Growth, Regulatory Relief, and Consumer Protection Act §2155, 12 U.S.C. §401 (2012); 82 Fed. Reg. 9308 (Mar. 6, 2017).

38. BD. OF GOVERNORS 2018, *supra* note 27.

39. *See* Tracy, *supra* note 5 (examining the Federal Reserve's movement toward eliminating the 'pass' or 'fail' grades from stress tests in 2019 while referring to the test results by the colloquial term).

40. A firm's capital distribution plan refers to the value of dividends the firm planned to pay out or to the number of stock shares it planned to buy back. SULLIVAN & CROMWELL, *supra* note 24.

41. BD. OF GOVERNORS 2018, *supra* note 27.

42. *See* Peter Eavis, *Wells Fargo Sailed Through Its Stress Test. Goldman Sachs and Morgan Stanley, Not So Much.*, N.Y. TIMES (June 29, 2018), https://www.nytimes.com/2018/06/29/business/dealbook/fed-stress-tests.html?rref=collection%2Ftimestopic%2FBanking%20Industry (reporting on the "conditional passes" of Morgan Stanley and Goldman Sachs in latest round of stress tests).

was deemed outside their control.[43] Typically, banks that pass on a conditional basis have to resubmit their capital plan of action for review to the Federal Reserve.[44] In the case of Morgan Stanley and Goldman Sachs, both had their failures attributed to the recent tax bill enacted by Congress.[45] Specifically, the lower tax rate resulted in each firm's deferred tax assets being worth less in the future which subsequently reduced the firm's current capital.[46] Additionally, the new tax bill was implemented right before the Federal Reserve collected the data for the tests, which left the banks without adequate time to make necessary changes.[47] Considering these unconventional circumstances, the Federal Reserve concluded that the tax bill would deplete their capital in the short-term but bolster earnings over time.[48] Accordingly, the Federal Reserve decided to allow Goldman Sachs and Morgan Stanley to make dividend payments on the condition that their payouts remained at the same level as the previous year.[49] While Morgan Stanley and Goldman Sachs did technically fall below the minimum capital requirements, the two firms fell below only on the most severe stress tests and only after accounting for the amount of stock buybacks and dividend payments the firms wanted to make.[50] That is, they passed the quantitative portion of the test

43. *See id.* (reporting that Morgan Stanley and Goldman Sachs passed the quantitative portion of the test and their "conditional pass" of the qualitative test was due solely to adverse effects from the new tax bill).

44. *See Bank Stress Test*, INVESTOPEDIA, https://www.investopedia.com/terms/b/bank-stress-test.asp (last visited Feb. 5, 2019) (providing general overview of the Federal Reserve's stress tests and how they operate in practice when a bank receives a conditional pass).

45. *See* Joseph Lawler, *Tax Cuts Trip Up Goldman Sachs, Morgan Stanley, State Street in Stress Tests*, WASH. EXAM'R (June 28, 2018), https://www.washingtonexaminer.com/policy/economy/tax-cuts-trip-up-goldman-sachs-morgan-stanley-state-street-in-stress-tests (discussing how Goldman Sachs and Morgan Stanley's low capital levels were negatively affected by the GOP's 2018 tax bill).

46. *See id.* (detailing how the tax bill results in only a one time hit for Morgan Stanley and Goldman Sachs).

47. *See id.* (explaining how the short notice of the new tax bill also played a part in banks, such as Morgan Stanley and Goldman Sachs, being unable to adjust before the Federal Reserve conducted the tests).

48. Eavis, *supra* note 42.

49. Eavis, *supra* note 42.

50. *See* Hugh Son, *Goldman Sachs, Morgan Stanley Left Out of the Rally in Bank Stocks After Fed Stress Test Blunder,* CNBC (June 28, 2018, 4:30 PM), https://www.cnbc.com/2018/06/28/goldman-sachs-morgan-stanley-keep-dividends-andbuy-backs-unchanged-af.html (discussing how Morgan Stanley and Goldman Sachs narrowly missed on their leverage requirements but were still given a conditional pass).

and only narrowly missed the mark on the qualitative portion.[51] The minimum required tier 1 leverage ratio was set at 4.5% this past year—Goldman Sachs' ratio was 4.4% and Morgan Stanley's ratio was 4.3%.[52] Considering the firms narrowly missed the mark under only the severely adverse scenario and the fact that the firms experienced a one-time loss due to the recent tax bill, it seems highly unlikely, if a financial crisis had actually occurred last year, that either firm would have actually failed.[53] When a bank receives a "conditional pass," the public is made aware of the near failure, which can carry a stigma and have repercussions of its own.[54] On the morning the Federal Reserve released the results of the 2018 stress tests, banks that easily cleared the tests, such as Wells Fargo, saw stock increase 5.4%.[55] Morgan Stanley and Goldman Sachs, on the other hand, suffering from the negative public perception of a "conditional pass," saw their stocks go up less than 0.3% during that same time.[56]

III. THE IMPACT OF STRESS TESTS, CCAR, AND RECENT DEREGULATION

Where has the mandatory stress testing embedded in the staggering 2300 pages of legislation that is the Dodd-Frank Act gotten us?[57] The passing of Dodd-Frank undoubtedly kick-started wide spread changes throughout the banking sector.[58] In designing the stress tests pursuant to

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51. *See id.* (discussing how Morgan Stanley and Goldman Sachs narrowly missed on their leverage requirements under the qualitative portion of the test but were still given a conditional pass and did indeed pass the quantitative portion as well).

52. BD. OF GOVERNORS 2018, *supra* note 27.

53. *See* Son, *supra* note 50 (detailing how regulators gave the two firms conditional non objections in light of all these factors).

54. *See* N.Y.S.E, *Historical Quote June 21, 2018*, MKT. WATCH, https://www.marketwatch.com/investing/stock/ms/historical (last visited Feb. 4, 2019) (showing that Goldman Sachs's and Morgan Stanley's stock price dropped near the lowest value of the entire year the week surrounding the Federal Reserve's announcement of their "conditional pass"); Steve Goldstein, *Fed Limits Payouts at Goldman Sachs, Morgan Stanley, Again Faults Deutsche Bank*, MKT. WATCH (June 28, 2018, 4:51 PM), https://www.marketwatch.com/story/fed-limits-payouts-at-goldman-sachs-morgan-stanley-again-faults-deutsche-bank-2018-06-28 (recapping how Morgan Stanley and Goldman Sachs's stock price reacted when the Fed released the news of a "conditional pass").

55. *See* Son, *supra* note 50 (listing the different stock market reactions to the Fed's release of the stress tests results).

56. *See* Son, *supra* note 50 (discussing Morgan Stanley's and Goldman Sachs's poor stock increase in light of the news of a conditional pass to the public).

57. *See* FIN. SERV. COMM., OVERSIGHT OF DODD-FRANK ACT IMPLEMENTATION (2017), https://financialservices.house.gov/dodd-frank/ (providing background on Dodd-Frank's path through legislation).

58. *Id.*

Dodd-Frank, the Federal Reserve wants to see banks stay afloat amid potential economic downturns and be able to continue operating and lending as if the economy was steady or growing.[59] The ability to continue lending as usual in an economic downturn requires massive amounts of capital, and this high expectation have led the thirty-five largest banks to add a collective $800 billion of the highest quality of capital to their balance sheets since 2009.[60]

The sheer amount of capital raised in less than ten years is even more impressive in light of just how stressful the Federal Reserve's tests are.[61] The most stressful hypothetical scenario posed by the Federal Reserve, the "severely adverse scenario,"[62] envisions a situation in which those same thirty-five largest banks would lose a whopping $578 billion from a recession and still continue lending.[63] According to Randal K. Quarles, the Federal Reserve's vice chairman for supervision, after applying the severely adverse scenario the firms' capital levels "are higher than the actual capital levels of large banks in the years leading up to the most recent recession."[64] This suggests that the largest banks would fare much better and be able to continue operating through the downturn if faced with another crisis of the magnitude of the 2008 recession.

Taking a bird's eye view of the banking industry, the consensus opinion is that Dodd-Frank has clearly been successful in making banks much safer today than they were ten years ago.[65] Since the start of the annual stress tests, fewer banks are "failing" the tests, with only one (Deutsche Bank) falling short in 2018.[66] In 2017, for example, every single bank passed their stress tests for the first time.[67] Even when banks do fail, the penalties imposed by the Federal Reserve typically result in

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59. *See* Matt Phillips & Jim Tankersley, *Biggest Banks Pass Fed's Stress Tests*, N.Y. TIMES (June 21, 2018), https://www.nytimes.com/2018/06/21/business/fed-stress-tests-banks.html?rref=collection%2Ftimestopic%2FBanking%20Industry (reporting on results of this year's first round of stress tests).

60. *See* BD. OF GOVERNORS 2017, *supra* note 13 (detailing the impact and success Dodd-Frank has had since 2009).

61. BD. OF GOVERNORS 2017, *supra* note 13.

62. BD. OF GOVERNORS 2018, *supra* note 27.

63. *See* Phillips & Tankersley, *supra* note 59 (detailing the progress banks have made in their capital structures since the passing of Dodd-Frank).

64. Phillips & Tankersley, *supra* note 59.

65. *See* Phillips & Tankersley, *supra* note 59 (containing quotes from various financial experts who all agree that the banking system is safer, regardless if they agree with the Dodd-Frank Act or not).

66. Eavis, *supra* note 42.

67. *See* BD. OF GOVERNORS 2017, *supra* note 13 (reporting results of 2017 stress tests in which no banks received a "failing" grade).

giving them a running start to pass the following year.[68] When a bank is forced to decrease its planned dividends payouts or stocks buybacks, that money is instead rerouted and added to their capital base, putting the bank in a position to reach the capital requirements the next time around.[69] In the case of Morgan Stanley and Goldman Sachs in 2018, the two banks were forced to decrease their dividend payouts and stock buybacks and hold those amounts as capital so that they could meet the leverage ratio requirements.[70]

What is not so clear is whether Dodd-Frank has successfully made the banking industry inherently safer or if it has only achieved success to the extent that banks are only taking actions necessary to "pass" the annual tests.[71] Most of the "failures" over the years have stemmed from the Federal Reserve objecting to a bank's proposed capital distribution plan, not its actual, current capital ratios.[72] Take, for example, Citigroup's failures in 2012 and 2014.[73] Both years, Citigroup's capital ratio "passed the test easily" and its Tier 1 capital ratio was higher than the Tier 1 ratios for JPMorgan, Goldman Sachs, and Bank of America – all three of which passed the Federal Reserve's test.[74] Nevertheless, Citigroup failed both years because its proposed capital distribution plan was essentially too aggressive in the Federal Reserve's eyes.[75] Without making any substantive changes to its current capital levels and simply submitting a different, less aggressive capital plan (i.e., cutting back on planned stock buybacks and dividend payments) the following year, Citigroup not only passed but "got the cleanest approval from the Federal

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68. *See* Tracy, *supra* note 5 (stating CitiGroup failed stress test one year and passed the next); Eavis, *supra* note 42 (covering Wells Fargo's ability to pass the stress tests despite "stringent regulatory action" imposed by the Fed the previous year).

69. *See* Michael Corkery, *Citigroup Fails Federal Reserve's Stress Tests for 2nd Time in 3 Years*, N.Y. TIMES (Mar. 26, 2014), https://dealbook.nytimes.com/2014/03/26/fed-rebuffs-citigroup-on-capital-plans/ (discussing how Citigroup's failure in 2012 helped usher in a new leadership era which resulted in good test results in 2013).

70. *See* Son, *supra* note 50 (detailing Morgan Stanley and Goldman Sachs's requirement to put some of the money they desired to expend on buybacks and dividends back into savings to increase their capital).

71. *See* James Pethokoukis, *So What Exactly did Dodd-Frank Really Accomplish?*, AEIDEAS (Feb. 14, 2017), http://www.aei.org/publication/so-what-exactly-did-dodd-frank-really-accomplish/ (looking into the long-term beneficial effects of Dodd-Frank and drawbacks that took some time to surface).

72. *See* Corkery, *supra* note 69 (stating Citigroup failed due to its capital plan not their capital ratio); *see also* Eavis, *supra* note 42 (reporting that Deutsche Bank's 2018 failure was due to a rejection in their capital plan rather than their capital ratio).

73. Corkery, *supra* note 69.

74. Corkery, *supra* note 69.

75. Corkery, *supra* note 69.

Reserve among top Wall Street banks."[76] Was Citigroup actually "safer" that year or did it only conform its behavior to ace the test? Citigroup was safer in the sense that the regulations "did their job" and adjusted the behavior of Citigroup to account for safety before growth.[77] However, Citigroup's behavior was essentially forced and its rejected capital distribution proposal suggested its own internal risk and reward policies still favored aggressive, capitalistic growth over safety.[78] This same type of disregard for safety contributed to the banking industry's trouble in 2008 and that influenced the passing of Dodd-Frank to eradicate such issues.

Questions of that nature, and a general feeling by some that the Federal Reserve's regulations have gone too far and are now choking banks,[79] have served as a basis for legislative changes geared toward loosening Dodd-Frank in the last couple years.[80] The Trump Administration sought to address these questions in February of 2017, when President Trump, less than one month after taking office, issued an executive order directing the Secretary of Treasury to meet with members of the Financial Stability Oversight Council[81] and provide a report on the effectiveness of Dodd-Frank.[82] Shortly thereafter, two bills were introduced before Congress to repeal Dodd-Frank to varying degrees. The first bill, the Financial CHOICE Act,[83] ultimately did not pass, but the second bill, the

76. *See* Dakin Campbell, Michael J. Moore & Hugh Son, *Citigroup Has Cleanest Fed-Test Pass of Wall Street Rivals*, BLOOMBERG (Mar. 11, 2015), https://www.bloomberg.com/news/articles/2015-03-11/citigroup-has-cleanest-stress-test-pass-of-top-wall-street-banks (reporting on Citigroup's comeback from a failure the previous year to passing with flying colors the next year).

77. Corkery, *supra* note 69.

78. Corkery, *supra* note 69.

79. *See* Campbell, Moore & Son, *supra* note 76 (reporting on how some banking heads feel Dodd-Frank has imposed too much regulation).

80. Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") § 2155, 12 U.S.C. § 401 (2012); 82 Fed. Reg. 9308 (Mar. 6, 2017) (exempting twenty-one firms from complying with the qualitative requirements of CCAR).

81. The Federal Stability Oversight Council was created by Dodd-Frank. BD. OF GOVERNORS 2017, *supra* note 13.

82. Exec. Order No. 13772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (directing the Secretary of the Treasury to consult with members of the Financial Stability Oversight Council and report their findings of the effectiveness of Dodd Frank).

83. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017) ("To create hope and opportunity for investors, consumers, and entrepreneurs by ending bailouts and Too Big to Fail, holding Washington and Wall Street accountable, eliminating red tape to increase access to capital and credit, and repealing the provisions of the Dodd-Frank Act that make America less prosperous, less stable, and less free, and for other purposes.").

Economic Growth, Regulatory Relief, and Consumer Protection Act,[84] was passed.

The Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Reform Law") signed by President Trump on May 24, 2018 represents the "largest legal change to financial regulation since passage of the Dodd-Frank."[85] Most notably, the Reform Law changed the pool of banks subjected to the stress tests.[86] The Reform Law provided an increase, in two stages, of the minimum asset threshold from $50 billion to $250 billion for the Federal Reserve's requirement of company-run stress tests and more broadly for finding that a BHC is systematically significant.[87] This change freed banks such as SunTrust and BB&T[88] from conducting company-run stress tests and being subjected to the enhanced prudential regulation associated with being a systematically significant BHC.[89] The increase in the SIFI threshold will take effect eighteen months after the date of enactment for BHCs with total assets of $100 billion or more but less than $250 billion.[90] The Reform Law contains an important caveat that the Federal Reserve retains the authority to apply the enhanced prudential standards to any specific BHC with total assets more than $100 billion, if the Federal Reserve feels it is warranted.[91] The other stage of the increase raised the asset threshold for a BHC to be

84. Economic Growth Act § 2155, 12 U.S.C. §401 (2012).

85. *See* Aaron Klein, *No, Dodd-Frank Was Neither Repealed nor Gutted. Here's What Really Happened*, BROOKINGS (May 25, 2018), https://www.brookings.edu/research/no-dodd-frank-was-neither-repealed-nor-gutted-heres-what-really-happened/ (summarizing the changes to Dodd-Frank made by the Reform Law).

86. *See* Economic Growth Act § 2155, 12 U.S.C. §401 (modifying the threshold of the minimum number of assets of a bank required to comply with Dodd-Frank stress tests).

87. *Id.; see* Matthew Frankel, *The Senate Just Passed a Bill to Ease Bank Regulations – Here's What You Need To Know*, THE MOTLEY FOOL (Mar. 15, 2018), https://www.fool.com/investing/2018/03/15/the-senate-just-passed-a-bill-to-ease-bank-regulat.aspx (detailing how particular banks have been effected by the new Reform Law).

88. As this note went to the press, SunTrust and BB&T announced initial plans to combine in a roughly $66 billion all-stock merger. This would easily be the largest bank merger since the financial crisis in 2008. The merged entity would become the sixth largest bank in the U.S. and would then once again be subjected to the enhanced prudential regulations. Jacob Passy, *SunTrust and BB&T are Merging – Here's What Customers Need to Know*, MKT. WATCH (Feb. 9, 2019, 12:19 PM), https://www.marketwatch.com/story/suntrust-and-bbt-are-merging-heres-what-customers-need-to-know-2019-02-09.

89. Economic Growth Act §2155, 12 U.S.C. § 401*; see* Frankel, *supra* note 87 (detailing how particular banks have been effected by the new Reform Law).

90. *See* SULLIVAN & CROMWELL, *supra* note 24 (discussing the eighteen month "off-ramp" that will be applied for those banks that fall in between $100 and $250 billion).

91. *See* SULLIVAN & CROMWELL, *supra* note 24 (detailing how the Federal Reserve still has the discretion to apply the enhanced prudential standards to the BHCs that were just freed of that burden in the same law).

subjected to supervisory-run stress tests from $50 billion to $100 billion, exempting three banks—CIT Group, Comerica, and Zions Bancorp—from the 2018 round of supervisory-run tests.[92] The asset threshold for being subjected to the qualitative portion of CCAR had already been raised to $250 billion, leaving only about half of the thirty-five banks to face the qualitative assessment.[93] Some of the mid-size banks now exempt from the tests are allowed to conduct all stress tests internally, rather than being supervised by the Federal Reserve's tests.[94] This opens the door for these banks to lower their capital cushions in order to increase return on equity or pursue more aggressive capital distributions, potentially undoing the safety mechanisms put in place by Dodd-Frank.[95]

As the dust settled from the new legislation, it is important to point out that the banking landscape did not make a drastic departure from the status quo, and Dodd-Frank is still far from dead.[96] While there are currently only eleven U.S. banks that have greater than $250 billion in assets that will be subjected to stress tests, those eleven banks make up over half of all the banking industry's assets and deposits.[97] The Reform Law also permits the Federal Reserve to apply any of the regulations previously in place under Dodd-Frank to the banks that were just made exempt from the stress tests if the Federal Reserve feels that is warranted.[98]

Public misconception that this new regulation dismantled Dodd-Frank is not unfounded.[99] The Financial CHOICE Act of 2017[100] was

92. *See* Phillips & Tankersley, *supra* note 59 (detailing that the new rules that raised the threshold has freed a few banks from being subject to the oversight of Dodd-Frank).

93. *See* Exec. Order No. 13772, 82 Fed. Reg. 9308 (Mar. 6, 2017) (exempting firms with less than $250 billion in assets from complying with CCAR); Tracy, *supra* note 5 (tracking differences in the 2018 stress tests versus previous years).

94. *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 13 (discussing how banks with $100 billion or less in total assets no longer have to submit to supervisory stress tests by the Fed).

95. The new bill also provides some de-regulation for smaller banks, exempts banks with less than $10 billion in assets from the Volcker Rule, and legally requires credit bureaus – such as Equifax, Experian, and TransUnion – to provide free credit freezes to consumers.

96. *See* Klein, *supra* note 85 (dismissing the notion that the Reform Law was any sort of complete repeal of Dodd-Frank).

97. *See* Jeff Cox, *5 Biggest Banks Now Own Almost Half of the Industry*, CNBC (Apr. 15, 2015), https://www.cnbc.com/2015/04/15/5-biggest-banks-now-own-almost-half-the-industry.html (detailing how top heavy the bank industry is).

98. *See* Klein, *supra* note 85 (discussing that many safeguards of Dodd-Frank are still in place and arguing the law is not as big of a reform as the public is conceiving it to be).

99. Klein, *supra* note 85.

100. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017) ("To create hope and opportunity for investors, consumers, and entrepreneurs by ending bailouts and Too Big to Fail, holding Washington and Wall Street accountable, eliminating red tape to increase access

intended to "do a number"[101] on Dodd-Frank and passed the House by a sizeable margin but ultimately stalled out in the Senate.[102] As a result, the Reform Law is a much more modest attempt at amending of Dodd-Frank.[103] In fact, symbolic of the Reform Law's lack of monumental changes, it received wide bipartisan support and even Rep. Barney Frank, who helped craft Dodd-Frank, said that "90% of the Wall Street Reform bill would be unchanged" by the new legislation.[104] Republicans hope the Reform Law is merely the start, not the end, of further Dodd-Frank legislative rollbacks.[105] Now that at least the first step has been taken, the debate for further rollbacks has begun.[106]

IV. COMPETING ARGUMENTS ABOUT ROLLBACKS OF DODD-FRANK AND THE FUTURE OF BANKING REGULATIONS

There is little, if any disagreement that the banks subjected to the stress tests are in a much better position today than they were before the passage of Dodd-Frank.[107] Instead, the debate is over whether the stress tests and enhanced prudential standards are still needed to protect the

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to capital and credit, and repealing the provisions of the Dodd-Frank Act that make America less prosperous, less stable, and less free, and for other purposes.").

101. Ryan Tracy & Andrew Ackerman, *How Congress Rolled Back Banking Rules in a Rare Bipartisan Deal*, WALL ST. J. (May 23, 2018, 1:20 AM), https://www.wsj.com/articles/how-congress-rolled-back-banking-rules-in-a-rare-bipartisan-deal-1527030512 (quoting President Trump's promise made ten days after his inauguration to make legislation to repeal Dodd-Frank).

102. Frankel, *supra* note 87.

103. Michael F. Bennet, *No, Congress isn't Gutting Dodd-Frank*, WASH. POST (Mar. 16, 2018), https://www.washingtonpost.com/opinions/no-congress-isnt-gutting-dodd-frank/2018/03/16/f221c4a6-289b-11e8-bc72-077aa4dab9ef_story.html?utm_term=.efde443ac3de.

104. *See* Barney Frank, *I Have Two Serious Objections to Senate's Plan to Reform Dodd-Frank*, CNBC (Nov. 27, 2017, 2:15 PM), https://www.cnbc.com/2017/11/27/barney-franks-serious-objections-to-senate-dodd-frank-reform-commentray.html (writing his reaction, pros, and cons, to the new Reform bill).

105. *See* Thomas Kaplan, *Congress Approves First Big Dodd-Frank Rollback*, N.Y. TIMES (May 22, 2018), https://www.nytimes.com/2018/05/22/business/congress-passes-dodd-frank-rollback-for-smaller-banks.html (reporting on republican and democratic policy makers' views toward the Dodd-Frank rollback and its future implications).

106. *See* Leandra Bernstein, *Trump to Sign Partial Dodd-Frank Repeal: A Financial Win or the Start of a New Crisis?*, WJLA (May 23, 2018), https://wjla.com/news/nation-world/trump-to-sign-partial-dodd-frank-repeal ("The bill is only the beginning of a more vigorous effort to loosen some of the post-crisis restraints on the financial services sector.").

107. *See* Ian McKendry, *B of A's Moynihan: Big Banks are 'Fine' with Dodd-Frank*, AM. BANKER, Feb. 15, 2018, https://www.americanbanker.com/news/b-of-as-moynihan-big-banks-are-fine-with-dodd-frank (detailing how Bank of America's CEO believes that Dodd-Frank has indeed made banks safer but was a bit of an overreaction in terms of how much regulation was included).

industry, or whether the regulations have already done their job and are now unnecessarily hampering banks from growing themselves – and subsequently the economy.[108]

Opinions about regulating the banking industry have been a dividing political point for years, and recent legislation is no exception.[109] On one end of the spectrum, Dodd-Frank was a Democratic-led proposal that passed with only the support of three republicans in the Senate.[110] On the other end, the Financial CHOICE Act, which essentially proposed a total repeal of Dodd-Frank, passed the House without a single Democrat vote before being shut down in the Senate.[111] Both bills took what would be considered as an extreme stance by the opposing party, and because each bill received no support from the opposing party, both either passed or failed due to the demographics of Congress at the time.[112] The Reform Law was a slight concession to Republicans but further legislation seems imminent as both sides are far from laying down their torch.[113]

A. Maintaining Regulations

At a high level, the pro-regulation argument is essentially that the citizens at large are the winners of the stress tests and strict regulations of banks.[114] Whether banks pass or fail, citizens still benefit from being able to get a look into a bank's health and protection from having to fund future bailouts with their taxes.[115] The pro-regulation side considers Dodd-Frank to have been a "clear win" in some areas such as increasing both

108. *See* Phillips & Tankersley, *supra* note 59 (quoting pro-regulator Marcus Stanley on the continued need for regulation to keep our financial system safe from another crisis); Michael Tremoglie, *Dodd-Frank's Unintended Consequences – Wall Street Reaps Benefits of D.C. Regulation*, THE STREET (Feb. 26, 2015, 7:15 AM), https://www.thestreet.com/story/13048752/1/dodd-franks-unintended-consequences—wall-street-reaps-benefits-of-dc-regulation.html (quoting long time critics of Dodd-Frank on the consequences that Democrat supporters did not realize at the time).

109. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, INV. BUS. DAILY (May 25, 2018), https://www.investors.com/politics/editorials/dodd-frank-refrom/.

110. H.R. REP. NO. 111-4173 (2ND SESS. 2010) (tallying votes for the Dodd-Frank Wall Street Reform and Consumer Protection Act).

111. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017).

112. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

113. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

114. Eavis, *supra* note 42.

115. *See* Martin Neil Bailey, Aaron Klein & Justin Schardin, *The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth*, RUSSEL SAGE FOUND. J. (Jan. 2017), at 20–47 (assessing key benefits and costs of the Dodd-Frank Act's attempt to provide needed stability in wake of the financial crisis).

financial stability and increasing economic growth.[116] Now that the economy has recovered from the financial crisis, Dodd-Frank's job is still far from over.

The pro-regulation position is that banks routinely passing the stress tests should not be taken as a symbol that they are safe and incapable of falling victim to another crisis like in 2008.[117] Rather, passing the tests only says that banks have sufficient capital.[118] Further, because some models also said banks had sufficient capital before the financial crisis, the banks passing the tests now should not be taken as a sign that the industry no longer "need[s] to be vigilant."[119]

The Reform Law did draw some bipartisan support,[120] but ardent pro-regulators see the loosened regulations as a threat to financial stability.[121] Taking special exception to the raise in the threshold from $50 billion under the original Dodd-Frank provision to the current $250 billion threshold, the pro-regulation camp argue a rollback of that size is "irresponsible."[122] They emphasize that banks in the asset bracket between $50 billion and $250 billion still play an important role in the country's financial well-being.[123] Pointing to the financial crisis that took place just a decade ago, they highlight specific defunct banks, like Countrywide Financial, that were at the epicenter of the crisis but would now be exempt from stress tests.[124]

Even some pro-regulators that were more open to some small legislative changes to Dodd-Frank echo the sentiment that the threshold was

116. *Id.*

117. *See* Phillips & Tankersley, *supra* note 59 (interviewing pro-regulators for their take on banks passing the last round of stress tests).

118. *See* Phillips & Tankersley, *supra* note 59 (quoting pro-regulator Marcus Stanley on the continued need for regulation to keep our financial system safe from another crisis).

119. Phillips & Tankersley, *supra* note 59.

120. The law only drew bipartisan support after the Financial CHOICE Act was rejected in the Senate and essentially watered-down and reworked to arrive at the Reform Law that did actually pass. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

121. *See* Kaplan, *supra* note 105 (reporting on republican and democratic policy makers' views toward the Dodd-Frank rollback and its future implications).

122. *See* Bernstein, *supra* note 106 (quoting Carter Dougherty, a spokesman for Americans for Financial Reform, on the threshold being raised too high).

123. *See* Bernstein, *supra* note 106 (pointing out that the banks in the $50 billion to $250 billion bracket still received nearly $50 billion in support funds during the bailout).

124. *See* Bernstein, *supra* note 106 (arguing that banks like Countrywide Financial are living proof that there is still substantial risk to be accounted for in the $50 billion to $250 billion bracket).

raised too high.[125] Barney Frank, in reflecting on the influence his namesake legislation has had, admitted "the mistake was the $50 billion limit."[126] However, Frank and some others in the pro-regulation camp agree that raising the limit to $250 billion would be an even greater mistake.[127] Frank envisions a threshold of $125 billion as the sweet spot and accordingly argues that the new threshold is at a level that is "twice as high as prudent."[128] He and fellow pro-regulators warn that the failure of two or three institutions in the $125–$250 billion bracket would "put us in Lehman Brothers territory."[129]

Broadly speaking, the pro-regulation side does agree that Dodd-Frank unintentionally imposed hardship on smaller and community banks.[130] This middle ground was a primary reason some Democrats were able to come to a consensus with Republicans in passing the bipartisan Reform Law.[131] However, for others who couldn't get on-board with the new legislation, the loosening of regulations is a slippery slope that could unwind the past ten years of work geared toward strengthening the financial system.[132] With the Republicans wanting a complete, or at least substantial, repeal of Dodd-Frank and having to dilute their reform

125. *Dodd-Frank Author: Current SIFI Threshold is 'Mistake'*, A.B.A. BANKING J. (Nov. 21, 2016), https://bankingjournal.aba.com/2016/11/dodd-frank-author-current-sifi-threshold-is-mistake/.

126. *See* Barney Frank, *Why I Would Vote 'No' on Senate Bill to Amend Dodd-Frank*, CNBC (Mar. 1, 2018), https://www.cnbc.com/2018/03/01/barney-frank-why-i-would-vote-no-on-senate-bill-to-amend-dodd-frank-commentary.html (discussing what he would do now if he was still a member of Congress in regards to banking legislation).

127. *See id.* (discussing that he thinks the new threshold of $250 billion is too high); *see also* Chris Dodd, *Dodd: Sen. Crapo's Bank Reform Bill has One Fatal Flaw*, THE HILL (Mar. 14, 2018), https://thehill.com/opinion/finance/378211-dodd-sen-crapos-bank-reform-bill-has-one-fatal-flaw?amp (arguing that the major problem with the new Reform Law is that the threshold was raised too high); Kevin Freking, *Senate Poised to Change "Too Big To Fail" Bank Rules, Other Measures of Dodd-Frank*, DENVER POST (Mar. 5, 2018), https://www.denverpost.com/2018/03/05/senate-ease-dodd-frank-bank-rules/ (quoting Senator Elizabeth Warren's disproval of raising the threshold amount to this amount).

128. *See* Frank, *supra* note 126 (reasoning that a raise in the threshold was needed but the new bill surpasses the mark that would be adequate).

129. *See* Frank, *supra* note 104 (quoting former Senator Frank on the consequences he envisions from raising the threshold to $250 billion).

130. *See* Tremoglie, *supra* note 108 (quoting long time critics of Dodd-Frank on the consequences that Democrat supporters did not realize at the time).

131. *See* Frank, *supra* note 104 (speaking on why fellow Democrats supported the new law).

132. *See* Phillips & Tankersley, *supra* note 59 (discussing the general consensus among Senators who voted against the reform of Dodd-Frank).

bill in order to pass it earlier this year, future proposed legislation is poised to be heading down that slope.[133]

B. Deregulating

At a high level, the de-regulators' argument centers on the regulations being overly burdensome.[134] The regulations are simply too strict and are hindering banks from activities that will further grow the economy, such as partaking in types of proprietary trading and structuring their own dividend payout and stock buyback plans.[135] As it stands, the de-regulators argue that the stress tests are too stringent because the hypothetical stressful scenarios that the Federal Reserve puts the banks through are essentially doomsday type situations that are very unlikely to happen in real life.[136] What's more, the Federal Reserve increases the difficulty of the tests as the overall economic environment improves.[137] Take, for example, the unemployment rate stress measure. This past year the Federal Reserve subjected the banks to a hypothetical 10% unemployment rate.[138] While the actual unemployment rate did peak around 10% during the Great Recession, the baseline unemployment rate was much higher too.[139] The Federal Reserve's hypothetical unemployment rate of 10% from the current baseline[140] is thus substantially more severe than the stressful impacts of the Great Recession.[141] This is not a matter of

133. *See* Bernstein, *supra* note 106 (discussing how the Reform Law is not the end game for the Trump Administration and fellow de-regulators).

134. Hester Pierce, *10 Ways Dodd-Frank Will Hurt The Economy in 2013*, U.S. NEWS (Jan. 7, 2013, 9:30 AM), https://www.usnews.com/opinion/blogs/economic-intelligence/2013/01/07/10-ways-dodd-frank-will-hurt-the-economy-in-2013.

135. *See id.* (listing expected harmful economic effects of Dodd-Frank that will stem from the stifling of small banks and replacing market monitoring with more regulatory monitoring).

136. *See* Frankel, *supra* note 87 (providing a high-level overview of the aim of Dodd-Frank).

137. *See* Michelle Price & David Henry, *America's Biggest Banks All Clear the Fed's Stress Test*, REUTERS (Jun. 21, 2018, 4:43 PM), https://www.businessinsider.com/americas-biggest-banks-all-clear-the-feds-stress-test-2018-6 (detailing how stress tests change from year to year).

138. *See id.* (detailing how stress tests change from year to year).

139. U.S. BUREAU OF LABOR STATISTICS, THE RECESSION OF 2007–2009, at 2 (2012), https://www.bls.gov/spotlight/2012/recession/pdf/recession_bls_spotlight.pdf (summarizing unemployment rates during the Great Recession).

140. The current unemployment rate in America, as of April 2018, is 3.9%. U.S. BUREAU OF LABOR STATISTICS, LABOR FORCE STATISTICS FROM THE CURRENT POPULATION SURVEY (2019), https://data.bls.gov/timeseries/lns14000000.

141. At the start of the Great Recession the baseline unemployment rate was already at 5% so when it peaked around 10%, it only rose half that from the baseline level. U.S. BUREAU OF LABOR STATISTICS, *supra* note 139.

"rather be safe than sorry," de-regulators argue, but instead an overboard safety precaution that requires banks to face unemployment numbers that haven't been seen since the 1930s Great Depression in the tests.[142] De-regulators make similar arguments over other portions of the test too, such as the negative GDP growth.[143]

While proponents of deregulation have their gripes about the stringent testing, the cardinal sin of Dodd-Frank is that it stifles the little guy.[144] Small and community banks have been harmed the most, and Dodd-Frank's provisions have given Wall Street an advantage over Main Street, something that the most fervent pro-regulator and de-regulator can agree was never the goal.[145]

Dodd-Frank's overly complex labyrinth of requirements, meshed together in 2300 pages, treats large banks the same as community banks in a lot of ways.[146] The resulting damage to the smaller community banks is twofold: first, larger banks and their team of lawyers are more adept at dissecting the web of regulations; second, Dodd-Frank imposes disproportionate and immense compliance and regulatory costs on community banks.[147] These mandatory compliance programs are unnecessary and yet another drain on the bank's resources—a drain felt most by community banks with less resources to begin with.[148] Alarmingly, since the second quarter of 2010 and the passage of Dodd Frank, community banks have seen their share of U.S. commercial banking assets decrease at nearly double the rate that their assets decreased from 2006 until 2010.[149] The number of community banks, defined as smaller than $200 million for this purpose, has also declined by more than 50% over the last eleven

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142. *See* Frankel, *supra* note 87 (detailing the extent of the stress test's adverse scenarios).

143. Like the unemployment rate, the negative GDP rate that was included in the last stress test was actually reached during the Great Recession, but when taking the baseline GDP point into consideration as well, the Fed's stressful scenario is again worse than the actual recession ever was. U.S. BUREAU OF LABOR STATISTICS, *supra* note 139.

144. Tremoglie, *supra* note 108.

145. *See* Tremoglie, *supra* note 108 (detailing how Dodd-Frank's requirements have effected smaller community banks).

146. FIN. SERVS. COMM., OVERSIGHT OF DODD-FRANK ACT IMPLEMENTATION, *supra* note 57.

147. *See* Tremoglie, *supra* note 108 (detailing how Dodd-Frank's requirements have effected smaller community banks the most).

148. *See* Douglas J. Elliott, *The Volcker Rule Is Still a Bad Idea*, BROOKINGS (Mar. 19, 2012), https://www.brookings.edu/opinions/the-volcker-rule-is-still-a-bad-idea/ (summarizing the core problems the Volcker Rule imposes from the perspective of a strong supporter of Dodd Frank.)

149. Marshall Lux & Robert Greene, *The State and Fate of Community Banking* (M-RCBG Associate Working Paper No. 37, 2015).

years.[150] There were almost 6000 banks in 2006 with less than $200 million in assets.[151] Now, there are only about 2500.[152]

Taken as a whole, Dodd-Frank unintentionally caused the lion's share of economic harm to be shouldered by small and community banks.[153] The banks that played no part in the financial crisis have been punished the most.[154] As a sign of the community banks' plight, some have even looked to the courts for help and made constitutional challenges to Dodd-Frank.[155] The Reform Law provides some relief, chiefly in the exemption from the Volker Rule for banks with $10 billion or less in assets,[156] but their accelerating loss in market share since Dodd-Frank has community banks pushing for further rollbacks.[157]

C. *Future of Banking Regulations*

The future of banking regulations is largely dependent on politics, but the current trend suggests there will be more rollbacks to Dodd-Frank.[158] How much of a rollback and how long it will take are questions that are even more uncertain. The Financial CHOICE Act's failure to garner any bipartisan support highlighted the wide divide between pro and de-regulators and seriously dampened the outlook on any significant legislative reform.[159] The Economic Growth, Regulatory Relief, and Consumer Protection Act restored some of that faith, but the significant departure from the Financial CHOICE Act's proposals shows that

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150. *See* Tom Bengtson, *M&A Expert Notes 'Endgame' Underway for Community Banks*, BANK BEAT (Jan. 29, 2018), https://bankbeat.biz/ma-expert-notes-endgame-underway-community-banks/ (discussing the decline of community banks over the last decade).

151. *Id.*

152. *Id.*

153. Tremoglie, *supra* note 108.

154. *See* Tremoglie, *supra* note 108 (detailing how Dodd-Frank's requirements have effected smaller community banks).

155. *See* Tremoglie, *supra* note 108 (reporting on the State National Bank of Big Spring (Texas) joining as co-plaintiff in a constitutional challenge of Dodd-Frank).

156. *See* Jerry Comizio, Jessica Forbes & Nathan Brownback, *How Dodd-Frank Rollback Changes The Volcker Rule*, LAW 360 (May 25, 2018, 3:49 PM), http://www.friedfrank.com/siteFiles/Publications/How%20Dodd-Frank%20Rollback%20Changes%20The%20Volcker%20Rule.pdf (assessing the impact the newest legislation will have in its changing of the Volker Rule).

157. *See* Tremoglie, *supra* note 108 (reporting on an assessment from the FDIC that details community bank loss in market share in several "key segments of the commercial bank lending market").

158. Bernstein, *supra* note 106.

159. *See* Klein, *supra* note 85 (reporting on the Reform Law that passed after the Financial CHOICE Act failed to garner a single bipartisan supporter).

Republicans and Democrats are still not on the same page on many issues, which could hamper the trend of further rollbacks.[160]

The most likely, and perhaps best, solution is to take an "everything in moderation" approach to the rollbacks. To make a significant, or even total, repeal of Dodd-Frank would not give fair deference to the positives of Dodd-Frank. At the same time, however, smaller and incremental rollbacks that cut away at some of the breadth of Dodd-Frank will provide relief from exacting regulations while keeping safeguards in place. For example, eliminating the Federal Reserve's control of dividend payouts and stock buybacks for banks so long as the banks pass the quantitative test.[161] Indeed, a larger consensus is growing that Dodd-Frank was a bit of a knee-jerk reaction.[162] Dodd-Frank's sweeping stance is evidenced by Congressional Democrats' show of bipartisan support for the Reform Law,[163] and by Barney Frank admitting to some of his bill's deficiencies.[164] It certainly is possible that if Congress becomes even more right-leaning in upcoming elections, then a bill like the Financial CHOICE Act could pass with essentially no bipartisan support in the same manner Dodd-Frank did.[165] However, given the push by the Trump administration and the current demographic of Congress being in Republicans' favor, it seems that the timing of the Financial CHOICE Act's proposal was as good of a chance as any.[166] That leaves incremental legislative rollbacks that chip away at Dodd-Frank as the likely path.

The biggest selling point of the de-regulators thus far is leaving the enhanced prudential standards and stress tests on the nation's biggest

160. *See* Klein*, supra* note 85 (reporting on the Reform Law being a significant departure from the core principles of the Financial CHOICE Act).

161. *See* Charles Calomiris, *Top 10 Fixes For Dodd-Frank*, COLUM. BUS. SCH.: IDEAS & INSIGHTS (May 17, 2018), https://www8.gsb.columbia.edu/articles/ideas-work/top-10-fixes-dodd-frank (arguing for the most needed changes to Dodd-Frank as Congress was gearing up to release the Reform Law).

162. *See* Tremoglie, *supra* note 108 ("Many Democrats and Republicans recognize that Dodd-Frank has had unforeseen negative consequences . . . .").

163. The Reform bill had an exactly even mix of bipartisan cosponsors: 12 Democrats, 12 Republicans, and one independent. Ezra Klein, *Republicans Are About to Deregulate Banks—with Democratic Support*, VOX (Mar. 6, 2018), https://www.vox.com/explainers/2018/3/6/17081532/republicans-dodd-frank-financial-regulations.

164. *See* Frank, *supra* note 104 (writing his reaction, pros, and cons, to the new Reform bill).

165. *See* H.R. REP. NO.111-4173 (2d Sess. 2010) (tallying votes for the Dodd-Frank Wall Street Reform and Consumer Protection Act).

166. *See* U.S. H.R. PRESS GALLERY: PARTY BREAKDOWN, https://pressgallery.house.gov/member-data/party-breakdown (providing current numbers in House by party affiliation); U.S. S.: PARTY DIVISION, https://www.senate.gov/history/partydiv.htm (providing current numbers in the Senate by party affiliation).

banks intact.[167] Despite lobbying from the behemoth banks, if they meet the $250 billion threshold, then regulations still have not been loosened one bit.[168] Considering the fact that the banks that meet that $250 billion mark now hold over half of the entire banking industry's assets and deposits, which was actually an unintentional product of Dodd-Frank,[169] the security blanket Dodd-Frank created is still largely in place.[170] After all, the biggest fear following the financial crisis was a big bank failure that could threaten the whole financial system again, and the Reform Law maintained the protections that reduce the likelihood of such a failure.[171]

In February of 2017, President Trump issued an executive order directing the Secretary of Treasury to meet with members of the Financial Stability Oversight Counsel and provide a report on the effectiveness of Dodd-Frank.[172] The Trump administration released the 149-page report in the summer of 2017 and the deficiencies pointed out were echoed in the provisions proposed in the amended Financial CHOICE Act that passed the House and the Reform Law.[173] Thus, that report is one of the best sources for providing insight into the direction future laws might lead. Key recommendations of the report include providing more regulatory relief to smaller banks, specifically to loosen restrictions with respect to mortgage lending, reducing the role of the Consumer Financial Protection Bureau, and lessening or eliminating altogether the requirement that firms that pool and securitize mortgages, retain a portion of the loans to protect against loan failure.[174] Making these changes, it is argued, will

167. *See* Frankel, *supra* note 87 (emphasizing what the Reform Law will not do is just as important as what it will do).

168. Frankel*, supra* note 87.

169. Due to Dodd-Frank having unintentional consequences of harming the smaller banks, the larger banks have grown substantially since the passage of Dodd-Frank as several small banks closed shop.

170. *See* Cox, *supra* note 97 (detailing how top heavy the bank industry is and how that means Dodd-Frank is still largely in place since the largest banks hold such a large percentage of the total banking industry's assets).

171. *See* Frankel, *supra* note 87 (emphasizing what the Reform Law will not do is just as important as what it will do).

172. Exec. Order No. 13772, 82 Fed. Reg. 9965 (Feb. 3, 2017) (directing the Secretary of the Treasury to consult with members of the Financial Stability Oversight Counsel and report their findings of the effectiveness of Dodd Frank).

173. *See* KAREN Y. BITAR, SEYFARTH SHAW LLP, CLIENT ALERT: THE FUTURE OF DODD FRANK: WHERE IS IT GOING? (2017), https://www.seyfarth.com/publications/OMM062617-LE (summarizing the Trump Administrations report on the banking industry).

174. *Id.*

reduce the cost of loans, bolster the housing market, and result in overall economic growth as the market is able to expand naturally.[175]

As the years continue to pass since Dodd-Frank's implementation, the more original supporters of the Act realize that some rollback is in the country's best interest.[176] As data of the housing market is compiled since Dodd-Frank, the argument for the need of further changes to mortgage lending is getting stronger.[177] Also noteworthy, Senator Heidi Heitkamp, a Democrat who joined Republicans in voting for the Reform Law, said that she voted to pass the bill because it puts community banks back in the mortgage lending business.[178] Heitkamp, speaking on behalf of her fellow Democrats who voted against the Reform Law, stated that they did not oppose it because of the community banking policies but because of the restrictions lifted on mid-sized institutions.[179]

With all this in mind, legislation geared toward repealing most of the restrictions on community banks is both an appropriate and a probable next step in Dodd-Frank reformation. Any material changes in regulations or stress tests for the bracket of the largest banks are unlikely and would only harm de-regulators' attempts to pass legislation if included in the same bill.[180] Some tweaks to the stress tests are possible—like eliminating the pass/fail aspect—but the tweaks would be minor.[181] Relaxing the regulations concerning mid-size firms further appears to be the middle ground where garnering any bipartisan support will be tough to come by.[182] In time, as the economy improves in relation to recent rollbacks, the de-regulators will be in a better position to argue for looser restrictions for those mid-size firms. For now, de-regulators will continue to chip

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175. *Id.*

176. *See* Tremoglie, *supra* note 108 ("Many Democrats and Republicans recognize that Dodd-Frank has had unforeseen negative consequences . . . .").

177. *See* BITAR, *supra* note 173 (detailing a recent report in the Wall Street Journal about three million first-time home buyers were shut out of the market due to credit tightening in the last decade).

178. Jacob Pramuk, *Trump Signs the Biggest Rollback of Bank Rules Since the Financial Crisis*, CNBC (May 24, 2018, 7:45 PM), https://www.cnbc.com/2018/05/24/trump-signs-bank-bill-rolling-back-some-dodd-frank-regulations.html (quoting Democratic Senator Heitkamp on why she supported the Reform Law).

179. *Id.*

180. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

181. *See* Tracy, *supra* note 5 (examining the Federal Reserve's movement toward eliminating the 'pass' or 'fail' grades from stress tests in 2019 while noting that the delegation of a pass/fail grade does more harm than good because it causes shareholders to have negative reactions and the banks would not suffer safety simply because their pass or fail is not labeled with those exact words or not).

182. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

away with smaller legislation changes while the pro-regulation camp keeps them from taking up too much ground, all in a delicate balancing act.[183]

V. CONCLUSION

Dodd-Frank was enacted in response to a very serious financial crisis.[184] The legislation may have been an overreaction to a desperate, unfamiliar situation that begot such an overreaction. It was, however, an overreaction that still succeeded in making banks safer.[185] Stress testing the largest banks and keeping their risk exposure in check have made the financial system safer.[186] The Reform Act recognized that banks with $50–$250 billion in assets did not pose the same risks and appropriately freed those institutions from the stress test regulatory regime.[187] Unintended consequences of Dodd-Frank that do little to make the financial system safer invite some additional reform.[188] Community banks need relief from the restrictions imposed on them due largely to the shortcomings of larger banks. Dodd-Frank was intended to protect against crisis but heavily burdening the banks not responsible for the crisis does no good. Dodd-Frank took too tight a grip on the banking industry. Now, it needs to loosen that grip in order to allow the industry to operate and grow naturally, to work out its own kinks, and do some of the regulation itself.

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183. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109
184. Stout, *supra* note 3.
185. Pethokoukis, *supra* note 71.
186. BD. OF GOVERNORS 2017, *supra* note 13.
187. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.
188. *Partial Dodd-Frank Reform is Good, Total Repeal is Better*, *supra* note 109.

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