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The Politics of Dodd Frank

By Madisson Goorman J.D. Candidate 2017 | February 22, 2015

The debate around breaking up big banks has become a focal point of the 2016 Presidential Election. With Wall Street facing growing market pressures there is uncertainty over whether reforms that have been put in place will be able to help withstand these challenges. One of the major reforms at question is the Dodd-Frank Wall Street Reform and Consumer Protection Act. The act was created to address the causes of the 2008 financial crisis, one of which was high leverage. Dodd Frank has been successful in reducing the leverage of large banks as seen by Citigroup whose “leverage peaked at 33 to one, [but] today it stands at less than 10 to one.”

Another important feature of the act is the annual stress test. Last year, many of the 31 banks that were tested under a “severely adverse” economic scenario passed. The test helps ensure that banks are meeting the minimum capital requirement established by Dodd Frank. In addition to the stress test, each bank must produce a ‘living will’ that outlines what will happen if their company goes bankrupt. These requirements are not easily met; some banks have not only failed the stress test, but have also had to resubmit their living wills because the Fed and FDIC considered their plans to be flawed. If they are not able to create a living will that garners the Fed or FDIC’s approval they will face sanctions such as higher capital requirements. As a result, the annual stress test and living will requirements have helped these financial institutions become healthier.

Viewing the work done by Dodd Frank as an overall positive, Steve Eisman, a money manager depicted in the motion picture “The Big Short”, diverges from the opinion that big banks need to be broken up. While he values the progress Dodd Frank has accomplished, he believes that the access to credit is currently too restricted. He believes that “if we want a stronger economy, improving the distribution and growth of personal income should be our focus.” The plans that have been suggested for breaking up big banks also ignore that this concept is “incredibly difficult, long and disruptive, and the banks might have to freeze loan growth during the process, slowing our economy even further.” Ultimately, the next financial crisis will determine whether or not the Dodd Frank reforms are enough to protect the economy from a systemic financial collapse or if one these alternatives needs to be implemented.