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**PROPOSED REFORMS MAY NOT REDUCE SYSTEMIC RISKS OF LARGE
FINANCIAL INSTITUTIONS, NEW LEVY STUDY SAYS**

ANNANDALE-ON-HUDSON, N.Y.—As the global economy continues to struggle in the aftermath of the financial crisis, policymakers and regulators are exploring policies to both stabilize the financial system and enact reforms to prevent future crises from occurring. In a new study from the Levy Economics Institute of Bard College, Senior Scholar Jan Kregel maintains that the current approach to the financial crisis—resolving small- and medium-size banks through the Federal Deposit Insurance Corporation while giving direct government support to larger institutions—has created even bigger banks, further aggravating the problem of “too big to fail.” Kregel argues that the current thrust of regulatory reform, which aims—through increased capital and liquidity requirements, and further legislation—to make these large banks as safe as possible or to allow dissolution through insolvency without creating system disruption, may not reduce the system risks of large financial institutions that contributed to the crisis.

In his policy note *Observations on the Problem of “Too Big to Fail/Save/Resolve,”* Kregel says that there are at least three separate problems associated with bank size that present challenges to current regulation efforts. The first, which he calls multifunctional banking, refers to the inherent conflicts of interest that result from institutions being allowed to combine multiple functions, such as commercial banking, trusts and insurance, corporate underwriting, and brokering. “Past experience suggests that multifunctional banking is the leading source of financial crisis, while large size contributes to contagion and systemic risk,” he writes. “This suggests that resolving large banks will not solve the problems associated with multifunctional banking. This conclusion has been reached following every financial crisis, and it should apply to the present crisis as well.”

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Kregel contends that two problems further complicating the regulation process are market concentration and interconnectedness. The former reduces the ability of market competition to ensure efficiency in providing banking services and allocating credit, suggesting that new antitrust legislation is needed. The latter is a problem that “has to do with the ability of the regulatory agency to rapidly resolve an institution that is exposed to a wide range of unrelated financial institutions operating in different financial markets,” Kregel writes.

Kregel concludes by asserting that any regulatory reform must address the current context of financial institutions and the regulatory reforms that allowed for, and failed to keep up with, the rapid integration of diverse banking functions. “It is important to recognize that past solutions may not be appropriate for present conditions,” writes Kregel. “This means that it will not be sufficient to apply prior solutions, such as those proposed in the 1933 Banking Act, to reform the current financial system. Rather, the challenge is to provide solutions to the problems of multifunctional banking given the financial innovations and changes in banking practices since the beginning of deregulation in the 1970s.”

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Policy Note 2009/11: *Observations on the Problem of “Too Big to Fail/Save/Resolve”*

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