Press Release

Too Big To Fail Re-Examined In New AAF Research

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The American Action Forum (@AAF) released new research examining "too big to fail" (TBTF) and finding that TBTF expectations are a problem at the nexus of public policy and creditors. Creditors provide funds to companies without properly pricing for risk by incorporating the possibility of a rescue.

TBTF extends beyond a few large financial institutions and results not from bad management by a firm but from the creditors' beliefs that policymakers will undertake firm-specific policies to contain financial shocks, the AAF research found.

Additional findings include:

- TBTF can be traced back several decades, and there is no particular pattern to government intervention. There is also no clear line on who will benefit from an intervention as assistance has gone to commercial banks, a large insurer, a hedge fund, domestic automakers, Fannie Mae and Freddie Mac, and large and small banks.
- Dodd-Frank contains elements that reduce the likelihood of failure and contain the costs of any failures. However, the enhanced regulatory and supervisory requirements may have the perverse effect of exacerbating TBTF problems.
- Funding differences between so-called TBTF institutions and non-TBTF institutions are more likely the result of a complex and changing combinations of factors which determine risk, which change over time, and exists for almost all industries.

"The bottom line is bailouts are costly. As policymakers continue to highlight these problems and pursue corrective action, they should keep in mind that the heart of the problem (such as it is) is ultimately one of policymaker discretion. The more complicated the regulatory landscape becomes, and the more it changes, the more likely both policymakers

and markets will expect authorities to step in in times of crisis," concludes Satya Thallam, AAF's Director of Financial Services Policy.

Click here to read the research.