FEDERAL RESERVE BANK OF RICHMOND

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Richmond Fed eBrief

TBTF Special Issue

The Richmond Fed has been studying the problem of "too big to fail" since at least the 1980s. When market participants expect that the government will protect firms thought to be "too big to fail," firms may take greater risks, increasing the frequency and severity of financial crises and bailouts.

This special issue of the Richmond Fed eBrief shares our latest work on the "too big to fail" problem and its potential solutions.

Speeches

Lacker on Solving "Too Big to Fail"
Richmond Fed President Jeffrey Lacker spoke on May 26 about the "too big to fail" problem. Decisions initially intended to protect small banks have resulted in an estimated 60 percent of the financial system's liabilities being protected by the government. Solving the fundamental problem at the heart of "too big to fail" requires restoring market discipline by removing the expectation of government intervention to rescue failing firms.

Research

Bailout Barometer: Updated Research From the Richmond Fed
Richmond Fed researchers estimate that 60 percent of the liabilities of the financial system were either explicitly or implicitly protected from losses by the federal government as of the end of 2013. This is problematic because creditors who expect to be protected from losses will overfund risky activities, making future crises and bailouts more likely.

Living Wills as a Tool for Curbing "Too Big to Fail"
The Richmond Fed's 2014 Annual Report explores "living wills" as a tool for curbing bailouts of large financial firms that are considered "too big to fail." Through living wills, large and complex financial firms would provide regulators with a roadmap for resolving them via the bankruptcy process without disrupting the financial system or resorting to bailouts.

The Fed's Discount Window and Moral Hazard
The latest *Economic Brief* examines the New York Fed's $22.6 billion emergency discount window loan to the Bank of New York in 1985. The authors note that without counteracting incentives to encourage prudence, such rescues may induce firms to take greater risks, increasing the rate of failures requiring bailouts.

[Understanding the Fed’s Role as “Lender of Last Resort”]
During the financial crisis of 2007–08, the Fed was credited with acting as a “lender of last resort” for troubled institutions, a role originally described by 19th century scholars Henry Thornton and Walter Bagehot. But Thornton and Bagehot also stressed the need for rules governing such lending to curb the incentive it provides for firms to take greater risks and create more crises in the future.

[Our Perspective: Too Big To Fail]
Need background on the “too big to fail” problem? This nontechnical resource shares the Richmond Fed’s long-standing research on this subject, as well as explores possible solutions to produce a more stable financial system.