Financial System Reform

The FDIC's Resolution Authority: How will it work and can it prevent 'too big to fail'?

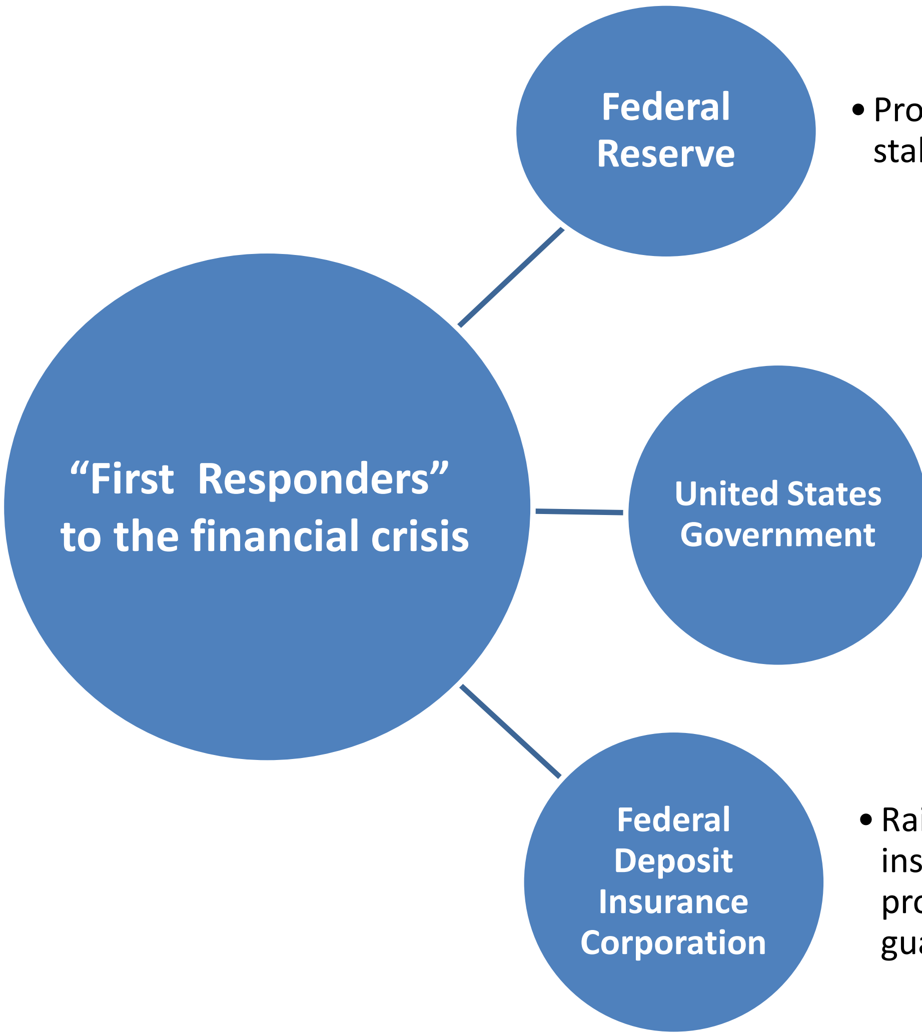
What led to financial system reform and the creation of a nonbank financial firm resolution mechanism?

"The financial crisis that gripped the United States last fall was unprecedented in type and magnitude. It began with an asset bubble in housing, expanded into the subprime mortgage crisis, escalated into a severe freeze-up of the interbank lending market, and culminated in intervention by the United States and other industrialized countries to rescue their banking systems. During a remarkable 19-day stretch, the federal government took over the two largest players in the mortgage market, allowed a large investment bank to go bankrupt, bailed out one of the world's largest insurance companies, and steered a major financial institution through the largest bank failure in U.S. history."*

Congressional Oversight Report on the Troubled Asset Relief Program, December 9, 2009

** Reference is to the fall of 2008*

The crisis required a massive response.



- Provided funds (liquidity) to stabilize financial markets
- Funded the Troubled Asset Relief Program, the $800 billion economic stimulus, Cash for Clunkers, Homebuyer Tax Credit, extended unemployment benefits.
- Raised bank deposit insurance limits and provided other bank debt guarantees.

The crisis made clear several weaknesses in the U.S. financial and regulatory systems.

The Weaknesses

- There was no mechanism to look across financial firms (bank and nonbank) to identify “systemic risk” implications.
- There had been an over-reliance on “functional” regulation in bank and financial holding companies and there was no safety/soundness regulator for large financial firms that were not bank or financial holding companies.
- **There was no mechanism to resolve a significant nonbank financial firm other than bankruptcy.**
- There was insufficient consumer protection.