## NEW APPROACH TO TOO BIG TO FAIL

When President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, he claimed the law would end bailouts for good. But nearly five years after its enactment, the problem of "too big to fail" has only gotten worse, as the five largest banks now hold 45 percent of Americans' financial assets, up from 30 percent 10 years ago, according to the Mercatus Center at George Mason University. Since the enactment of Dodd-Frank, 10 percent of small banks have either been acquired or closed. Innovations in consumer and business finance and payments systems are bubbling to the surface, but in many cases they remain stuck in regulatory limbo. That leaves consumers and small entrepreneurs with limited choices in saving, investing, and credit.

**Congress should:**

- End the Financial Stability Oversight Council's (FSOC) exemption from the Freedom of Information Act and mandate that it open its meetings to the public.
- Short of repealing the FSOC's designation of large banks as "systemically important financial institutions" (SIFI), give entities so designated more avenues to challenge the designation in court.
- Bar federal banking regulatory agencies from applying Basel III and other bank-centric rules to nonbanks, such as insurers.
- Repeal Dodd-Frank's Durbin Amendment, which sets price controls for what retailers pay banks and credit unions to process debit cards.
- Put the burden of proof on regulators at the Federal Deposit Insurance Corporation (FDIC), Federal Reserve, and Office of the Comptroller of the Currency when processing applications for new bank charters. Require bureaucrats to give specific reasons why such a charter would harm the safety and soundness of the financial system before denying a charter application for a new bank. Make a denial of a charter application challengeable in court.

Far from ending bailouts of big financial institutions, Dodd-Frank has enshrined them into law through the creation of the Financial Stability Oversight Council. Set up under Dodd-Frank, the FSOC has the power to designate a "systemically important financial institution." Dodd-Frank exempts this agency from open-meeting laws and the Freedom of Information Act, and the FSOC's secrecy rivals that of defense and intelligence agencies.

A SIFI designation means that a firm cannot be allowed to fail through normal bankruptcy or receivership, and gives the government the authority to make creditors of the financial institution whole. Large banks and financial firms with a SIFI designation have a competitive advantage over their smaller counterparts, as market participants are more likely to extend credit to SIFIs, given that government guarantee.

The SIFI designation has other market-distorting effects. Because the bailout of one SIFI is paid for by the others, the FSOC has an incentive to find healthy, stable companies to designate as a SIFI to pay the cost of bailing out a SIFI that engages in riskier activities. And when nonbank financial companies are designated as SIFIs, they may face bank-like capital rules, such as the much-criticized international Basel III standards (rules created by the Bank of International Settlements in Basel, Switzerland, that favor government securities over corporate bonds, and that are of questionable value for banks as well), which nearly all experts agree are inappropriate for insurance companies or asset managers, if they are even appropriate for banks.

That is why MetLife strenuously objected to being designated a SIFI in September 2014. It is also why in 2014 the House and Senate unanimously passed and President Obama signed into law the Insurance Capital Standards Clarification Act, which modifies Dodd-Frank to make it clear that the government need not force SIFIs or insurance companies with banking affiliates to adhere to bank-centric capital rules.

At the same time, innovations in consumer and business finance and payments systems are bubbling to the surface, but in many cases they remain stuck in regulatory limbo. Well-managed companies like Walmart and Apple can dip their toes into financial waters but cannot get bank charters because of a de facto FDIC ban on new charters for "industrial lending companies" affiliated with nonbank firms. In fact, the federal government has slowed to a halt approval of new bank charters in general. Fewer than 30 charters for new banks were approved from 2009 to 2012.

Big banks are effectively sheltered from competition from both smaller rivals and larger firms that cannot form banking units. That factor exacerbates the problem of too-big-to-fail by limiting alternatives when a giant bank falters. To permanently end bailouts, Congress needs to end subsidies and simultaneously open up avenues for competitors to the big banks.

Experts: John Berlau, Iain Murray, Todd Zywicki

### *For Further Reading*

John Berlau and Kyle Tassinari, "In Praise of Banking at Big Box Stores," *Wall Street Journal*, July 23, 2013, http://online.wsj.com/news/articles/SB10001424127887323309404578617483599112670.

Craig D. Miller, "Small Banks' Ranks Will Dwindle without New Charters," *American Banker*, March 20, 2012, http://www.americanbanker.com/bankthink/small-banks-ranks-will-dwindle-without-new-charters-1047701-1.html.

Hester Peirce, Ian Robinson, and Thomas Stratmann, "How Are Small Banks Faring under Dodd-Frank?" Working Paper No. 14-05, Mercatus Center, February 27, 2014, http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank.