

Introduction

A stable, well-functioning financial system is a precondition for a healthy economy. In recent years, America has seen what happens when turmoil engulfs the banks and other institutions that handle our money and provide credit to fuel economic expansion. We now confront slow growth, high unemployment and flat incomes. Policymakers appear flustered.

The country won't return to prosperity until the persistent fog surrounding our nation's financial system lifts. This will require not only rebuilding healthy balance sheets, but also addressing the public's diminished confidence in banks as reliable conduits of credit for the practice of American capitalism.

We believe the old and familiar virtues of traditional banking provide the framework. Financial stability rests on a level playing field that rewards sound judgment and integrity and penalizes excessive risk and complexity financed by taxpayer dollars. Government must retain its role as the financial system's watchdog, but it should render no institution immune to market discipline.

In recent years, a small number of globe-spanning behemoths have come to dominate the banking industry. Their size, complexity and risky behavior played a decisive role in the financial crisis and now weigh on the lackluster economic recovery. New laws strive to end "too big to fail" banks but come up short, violating our capitalist principles by interfering with market discipline and perpetuating a threat to the country's financial stability.

When it comes to our financial sector, we've seemingly stumbled into a place where we never wanted to be. Just as disturbing, we don't know how to get out. Do we simply accept that big banks will get bigger? Do we try to rein in their excesses through all-encompassing regulation, even if it risks burdening small and medium-sized banks that had little to do with the financial crisis? Or do we dedicate ourselves to creating a diverse financial system in which no bank is too big to fail?

This report presents five online essays, written by Dallas Fed financial experts, on the theme of rethinking America's banking system:

- "Community Banks Withstand the Storm" examines the inherent stability of smaller, customer-focused institutions.
- "A Lender for Tough Times" shows how smaller institutions support their customers during recessions.
- "Small Banks Squeezed" discusses these institutions' uphill struggle for market share.
- "Regulatory Burden Rising" illustrates the growing burden smaller banks face because of regulations aimed at policing the activities of the big institutions.
- "Leveling the Playing Field" analyzes how market discipline and public policy reform can influence bank size and contain the risk of too big to fail.

The stakes are too high to simply sit back and hope challenges to our system resolve themselves. Only by actively working toward a solution based on market discipline can we expect economic growth to accelerate and the United States to reach its dynamic potential.



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