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Excerpts from

The Squam Lake Report: Fixing the Financial System*

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† This article reprints most of Chapter 1 (Introduction) and Chapter 11 (Conclusions) of *The Squam Lake Report: Fixing the Financial System* (Princeton: Princeton University Press, 2010). It is reprinted here with the permission of Princeton University Press.

Abstract

In these excerpts from *The Squam Lake Report*, fifteen distinguished economists analyze where the global financial system failed, and how such failures might be prevented (or at least their damage better contained) in the future. Although there were many contributing factors to the crisis—including "agency" problems throughout the financial system and a bankruptcy code poorly suited for reorganizing financial firms—at the core of the problem is a potential conflict between the risk-taking proclivity of financial institutions and the interests of the economy at large that must be managed at least in part through more effective regulation. *The Squam Lake Report* provides a nonpartisan plan to transform the regulation of financial markets in ways designed to limit systemic risk while preserving—to the extent possible and prudent—the economies of scale and scope that justify the existence of today's large financial institutions.

To reduce the risks that large banks will fail, the authors call for higher capital requirements based on more effective assessments of the risks of bank assets and liabilities, as well as a new systemic regulator that should be part of the central bank. To reduce the costs of failure when it occurs, the authors propose that banks be required to create "living wills" laying out their plan to sell assets or shut down operations in the event of financial trouble. As part of that plan, regulators are urged to "aggressively encourage" banks to issue "contingent" debt capital securities that convert into equity.