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The catastrophic failure of 2008 shows where Kevin Warsh should start

di John H. Cochrane e Amit Seru

John H. Cochrane, an adjunct scholar at the Cato Institute, and Amit Seru, a finance professor at Stanford University, are senior fellows at the Hoover Institution.

New Federal Reserve chair Kevin Warsh [wants to make](#) fundamental reforms to the central bank. Fixing financial regulation should be high on his list.

The U.S. financial regulatory regime [failed catastrophically](#) in 2008. The financial crisis was, at its heart, a classic bank run. Financial institutions lost some money on their assets. People ran to pull their deposits and other short-term investments, leading to a wave of failures. Only a [\\$475 billion bailout](#) from the Treasury Department kept the biggest banks from failing and avoided complete financial collapse.

In the wake of this disaster, leaders had the decency to admit that regulation failed and reforms were needed. But the resulting changes — the Dodd-Frank law and the Fed's subsidiary regulation — simply piled on the previous approach that focused on managing asset riskiness.

The focus should instead have been on run-prone liabilities. Corporate assets such as data centers and rockets are far riskier than bank assets such as loans and debt securities. Why are the safer assets so much more heavily regulated? Because tech companies are financed by equity. When shareholders lose money, it is not a systemic crisis. Banks are financed with short-term debt (deposits) that can suffer contagious runs and invite government rescues.

The Dodd-Frank reforms were supposed to end bailouts. But in the turmoil of 2020, skeptics were proved right when the Fed and Treasury undertook a second bailout.

The [central bank intervened](#) in Treasury markets, bailed out money market funds, lent directly to cities and states, and put a floor on corporate debt prices.

In 2023, Silicon Valley Bank collapsed, leading to another bailout. The bank issued large uninsured deposits and invested in long-term Treasuries. When interest rates rose, the value of those Treasuries fell and depositors ran. To stop the run, the Fed and Federal Deposit Insurance Corp. [guaranteed uninsured deposits](#). That guarantee implicitly extends across the banking system — nearly \$9 trillion.

Absent that support, many more banks [might have gone under](#). The post-2008 supervisory apparatus — stress tests, liquidity rules, supervisory teams and model-based oversight — missed an elephant in the room: simple interest-rate risk matched to uninsured deposits. It has failed.

The SVB affair was fueled by earlier Fed errors. In the 2010s, banks [tried to create](#) segregated accounts and narrow banks. Both innovations back deposits entirely with reserves, eliminating runs and the need for deposit insurance and bailouts. By giving large depositors a risk-free place to park money, they would have forestalled the SVB fiasco. But the Fed has not allowed either innovation, in part to protect the profitable deposit franchise of big banks. Stablecoins — cryptocurrencies tied to tangible assets — are now entering to try to provide the same service, but so far are hobbled because they are not allowed to pay interest.

In the face of onerous regulation, banks [retreated from making loans](#). Fintech companies and private credit stepped in. These unregulated non-banks voluntarily fund themselves with stable [long-term financing](#) and substantially more equity. Fintech companies quickly sell off their loans and hold little risk.

Instead of embracing these crisis-insulated institutions, the Fed is [considering a reduction](#) in already low bank capital requirements, to help banks recover lost market share. At the Fed, deregulation has come to mean less capital, not fewer rules.

The Fed cannot rewrite Dodd-Frank by itself — only Congress can do that. But the central bank can revise the subsidiary regulations and review its discretionary implementations. Periodically sunseting and reviewing each rule would be a good start.

Warsh need not reform the big banks. He can instead allow new and innovative competitors to emerge that provide financial services without run-prone funding. He should focus on simple truths: A crisis is a run and only a run is a crisis. Somebody losing money on a risky investment is not a crisis.

[Detailed plans](#) to transition to a safe, deregulated and innovative financial system are sitting on the shelf. Risky investments should be funded by equity and long-term debt. Deposits and other runnable liabilities should be backed by safe, liquid assets or much larger capital cushions. Such plans can end private sector financial crises forever. They just need a visionary leader who is willing to put the plans into place.