



## Research Working Papers

# Risk-Shifting, Regulation, and Government Assistance

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November 25, 2019

The elimination of bailouts during the savings and loan crisis in 1989 led thrift institutions to increase their composition of safe assets.

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*RWP 19-10, November 2019; updated August 2022*

This paper examines an episode when policy response to a financial crisis effectively incentivized financial institutions to reallocate their portfolios toward safe assets. Following a shift to a regime of enhanced regulation and scaled-down public assistance during the savings and loan crisis in 1989, I find that thrifts with a high probability of failure increased their composition of safe assets relative to thrifts with a low probability of failure. The findings also show a shift to safe assets among stock thrifts relative to mutual thrifts, thereby providing evidence of risk-shifting from equity-holders to debt-holders of stock thrifts prior to the regulatory reforms. These findings suggest that for recent policies aimed at reducing moral hazard to succeed (such as the Orderly Liquidation Authority under Title II of the Dodd-Frank Act), credible signals around government assistance should be provided to shareholders of financial institutions. To identify the effect of the policy change I develop a new Bayesian estimation method for causal studies.

JEL Classification: C11, C31, C33, G21, G33, G38

## Article Citations

- Sharma, Padma. 2019. "Risk-Shifting, Regulation, and Government Assistance." Federal Reserve Bank of Kansas City, Research Working Paper no. 19-10, October. Available at <https://doi.org/10.18651/RWP2019-10>

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