Any Regulation of Risk Increases Risk

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We show that any objective risk measurement algorithm mandated by central banks for regulated financial entities will result in more risk being taken on by those financial entities than would otherwise be the case. Furthermore, the risks taken on by the regulated financial entities are far more systemically concentrated than they would have been otherwise, making the entire financial system more fragile. This result leaves three directions for the future of financial regulation: continue regulating by enforcing risk measurement algorithms at the cost of occasional severe crises, regulate more severely and subjectively by fully nationalizing all financial entities, or abolish all central banking regulations including deposit insurance to let risk be determined by the entities themselves and, ultimately, by their depositors through voluntary market transactions rather than by the taxpayers through enforced government participation.

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