

Addressing TBTF:

The Advantage of Premiums Over Capital

Ron Feldman

April 6, 2010

# Disclaimer

- The Views Expressed Here Are the Presenter's and Not Necessarily Those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System

# The TBTF Problem

- Expected Government Support Distorts Debtor/Counterparty Behavior
  - Reduces Cost to Bank
    - Cheaper Funding
    - More Funding
    - Nature of Contracts
- Banks Become Riskier

# Two Options for Addressing TBTF

- “Tougher” Capital Requirements for Systemically Important Financial Institutions
  - Higher Requirement, More Common Equity
  - Leverage, Risk-Based, etc.
- Pigouvian Premium Correcting Market Distortions
- Will Compare Under Two Scenarios
  - Capital Set “Equivalent” to Premium
  - Capital Set Based on Historical Approach

# Premium and “Equivalent” Capital

Attribute	Premium	Capital
Calculation	Difficult	Difficult

# Premium and “Historically” Set Capital

Attribute	Premiums	Capital
Calculation	Difficult, Perhaps Addressed Through Market Signal	Difficult