Addressing TBTF:
The Advantage of Premiums Over Capital

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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

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Premium</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calculation</td>
<td>Difficult</td>
<td>Difficult</td>
</tr>
</tbody>
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- Transparency is relatively straightforward, high information content to public and policymakers (e.g., budget).
- Relatively opaque.
## Premium and “Historically” Set Capital

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