Ending Too Big To Fail "The Minneapolis Plan"

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FEDERAL RESERVE BANK *of* MINNEAPOLIS

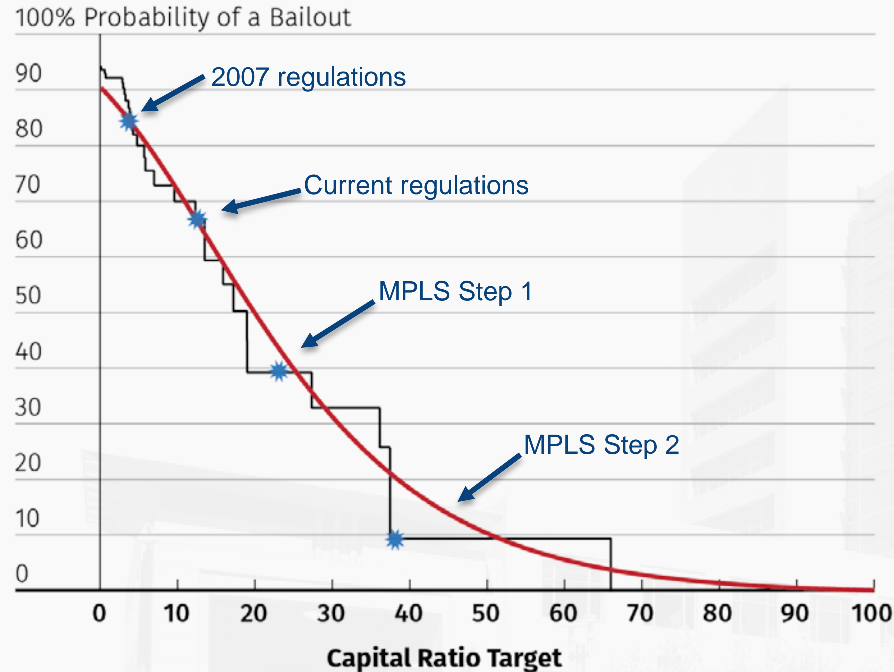
Evaluating the Minneapolis Plan

	Chance of Bailout (next 100 years)	Total Cost (% of GDP)	Net Benefit (% of GDP)
2007 Regulations	84%	0%	
Current Regulations	67%	11%	12%
Minneapolis Plan			
• Step 1	39%	24%	19%
• Step 2	≥ 9%	≤ 41%	15%
Typical Cost of a Banking Crisis		*158%*	

The Minneapolis Plan

	Minneapolis Plan	**Current Regulations**
Step 1: Increase equity capital for large banks	23.5%	13.0%
Step 2: Treasury to certify banks no longer TBTF or automatically increase capital requirements	Up to 38%	NA
Step 3: Shadow bank tax	1.2% - 2.2%	NA
Step 4: Reduce regulations on community banks	Yes	NA

Calculating Bailout Odds: IMF Data



Plan Protects Against Two Types of Systemic Risk

1. System-wide shock hits economy
    - 23.5% capital level will protect against vast majority of external shocks
2. Idiosyncratic shock hits systemically important bank
    - Higher capital levels of all large banks will make failure of one bank less likely to trigger contagion

Key Choices And Assumptions

- Long-term debt will not take losses/convert to equity
- Only 50% of cost of additional equity reduces GDP
- Follow IMF approach to estimating chance of a bailout
- Most banks will choose to restructure and become non-systemic rather than face dramatic increases in capital levels in Step 2
- Shadow bank tax equalizes funding costs across sectors

Primary Feedback Since Initial Release

- General agreement about tradeoffs between safety and costs
- Some argue we overestimate costs: more Modigliani-Miller
- Concern we underestimate arbitrage movement of activity overseas
- Provide more detail on new community bank regulatory regime
- Emphasize leverage ratio over risk weights

Recent Discussions Moving in Wrong Direction

- Some large bank CEOs claim they have too much capital – holding back lending
- Claim is demonstrably false
  - Borrowing costs near record lows
  - Bank credit has grown twice as fast as nominal GDP
  - Small businesses report having credit needs met
- CEOs' jobs are to boost stock prices (buybacks and dividends) not protect taxpayers
- Borrowing is difficult because of myriad regulations – not capital requirements