TOO BIG TO FAIL:
HEADS WE WIN, TAILS YOU LOSE

Edward J. O'Boyle, PhD
Senior Research Associate
Mayo Research Institute
www.mayoresearch.org
edoboyle737@gmail.com

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“Something for nothing. It never loses its charm.” Michael Lewis 2011.

Bank insolvency and bank failure are not one and the same. Failure means that a bank is unable to generate sufficient revenue to cover its expenses and for that reason the government forces it to cease operations.

Insolvency means that as a result of adverse economic incidents a bank is unable to meet its obligations to pay its debts as they become due. Insolvency can occur even when a bank has been known for good decision-making. This problem can be resolved by restructuring the bank’s debt through a formal process that may allow it to continue operating. It follows that insolvency does not necessarily result in bank failure.

Current public policy in the United States regarding an insolvent bank is based principally on two factors: size of the bank and depth of its insolvency. An insolvent bank that is small in size and depth of insolvency can be restructured or forced to cease operations. Failure is an option because forcing it to stop operating does not have potentially catastrophic system-wide consequences.

A big bank[1] that is insolvent may be handled differently because forcing it into failure may have ruinous systemic effects. To prevent systemic failure, public decision-makers have settled on bailing out big banks with public funds explicitly authorized and appropriated by Congress even though taxpayers were not a party to the decision-making that pushed those banks into insolvency. Bankers get to keep their jobs because authorities fear the financial and economic consequences of confronting their insolvency. The too-big-to-fail safety net incentivizes a megabank to risk its own ruin for the additional financial gains possible. The taxpayer is the fall guy when a TBTF bank is rescued.

At the end of WWII in Europe many war criminals served short sentences or none at all because their help was needed for post-war recovery. Expediency trumped justice. Similarly, in the absence of personal accountability on the part of culpable banking decision-makers too-big-to-fail means that macro-economic stabilization justifies holding the taxpayer accountable for the bank’s losses instead of the banking parties directly responsible for those losses.

I am most grateful to Professor Edward J. Kane for insightful comments on an earlier draft. Any and all errors remaining in the text are entirely my own doing.

[1] More later on how big is too big.

Kane condemns this practice on grounds that it violates Kant's second categorical imperative which forbids one person from using another for strictly personal gain. The safety net created by TBTF allows insolvent megabanks to dismiss this imperative and coerce the taxpayer to clean up their financial mess (Kane 2018, pp.211-226).

In the following we add to Kane's argument by appealing to Aristotle's four types of causes/explanations, three principles of economic justice, the principle of the double effect, and to due diligence and the principle of subsidiarity.

Our central concern in this article is whether TBTF is justified in terms of commutative, distributive, and contributive justice, or is permissible under the conditions of the principle of the double effect. For those reasons we make no attempt herein to review and cite the vast theoretical and empirical literature on the moral hazard of TBTF.

THE FOUR CAUSES OF TOO BIG TO FAIL

How did TBTF come about? We address that question based on the insights embedded in Aristotle's four types of causes or explanations of change: the material, the formal, the efficient, and the final (Cohen 2000).[2] We express the four as follows:

> **the material cause is the thing or condition that calls for change;**
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> **the formal cause is a vision as to what that change should look like;**
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> **the efficient cause is the means by which that change takes place;**
>
> **the final cause is the end for which that change is undertaken.**

It is our intent to scrutinize the TBTF in terms of those four causes. For our purposes it is necessary to begin with the Savings and Loan (S&L) crisis of the 1980s.

***MATERIAL CAUSE: fundamental instability in the financial sector in the late 1980s.* The General Accounting Office estimated the direct and indirect cost of this crisis at $160.1 billion of which the taxpayer provided $132.1 billion (GAO 1996, p.13).[3]**

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[2] We are NOT trying to look further into the causes of the underlying economic conditions.

[3] The total cost was much higher because these estimates did not include the known and estimated interest expense amounting to $209 billion that is linked to carrying Federal Savings and Loan Insurance Corporation (FSLIC)'s accumulated debt over the years until it is included in the federal budget and paid off (GAO 1996, p.19). In addition, it does not include the opportunity cost of FSLIC forbearance that for 1985-1989 increased on average about $8 billion per year (Kane and Yu 1994).

> **… much of this cost could have been avoided if the government had had the political will to recognize its obligation to depositors in the early 1980s, rather than viewing the situation as an industry bailout. Believing that the marketplace would provide its own discipline, the government used rapid deregulation and forbearance instead of taking steps to protect depositors. The government guarantee of insured deposits nonetheless exposed U.S. taxpayers to the risk of loss -- while profits made possible by deregulation and forbearance would accrue to the owners and managers of the savings and loans (FDIC 2018, p.187).**

FORMAL CAUSE: what is missing and should be in place for financial and economic stability.

> **… It is the sense of the Congress that – (1) immediate and carefully coordinated action should be taken by the Congress and the President to arrest the credit crisis … and provide a healthy and efficient marketplace that works for owners, lenders, and investigators; and (2) that efforts should be undertaken to explore measures that --- (A) modernize and simplify the rules that apply to private investment real estate … (B) strengthen the secondary market for real estate debt and equity … (C) restore balance in the regulatory environment … (D) rationalize the tax system for real estate owners and operators … (FDIC 1991, Subtitle J).**

EFFICIENT CAUSE: action taken by Congress and the president. **In this instance it is the Federal Deposit Insurance Act of 1991 that created an exception from the ordinary regulations applying to banking institutions in order to avoid risks to the entire banking sector.**

> **If … the Secretary of the Treasury … determines that -- (I) the Corporation's [FDIC] compliance with subparagraphs (A) and (E) with respect to an insured depository institution would have serious adverse effects on economic conditions or financial stability; and (II) any action or assistance under this subparagraph the Corporation may take other action or provide other assistance under this section as necessary to avoid or mitigate such effects (FDIC 1991, Section 141).**

FINAL CAUSE: Treasury Secretary in 2008 used the systemic risk exception for the first time. **With net assets of $639 billion and net debt of $613 billion, Lehman Brothers in September 2008 filed for bankruptcy. At that time, the Treasury Secretary formed an opinion that Lehman Brothers had not reached the threshold of TBTF.**

Two weeks later and with enormous financial assistance from the federal government, the Treasury Department allowed Citigroup to acquire the financial holding company Wachovia that reported second quarter 2008 losses amounting to $8.9 billion, justifying its action on the basis of the systemic risk exception. At that time, Wachovia was the fourth largest banking institution in the United States (FDIC 2017, p.69).[4] Simply put, the final cause was the Treasury Secretary's decision to employ the systemic risk exception and bailout Citigroup instead of letting it fail like Lehman Brothers.

HOW BIG IS TOO BIG?

At the start of the financial meltdown in 2007-2008, no knew for sure how to answer that question. The FDIC Improvement Act of 1991 had established the norm of too big to fail but did not propose critical values (criteria) that would put that norm into measurable form which then could be applied to current conditions in the financial sector. By empowering the Secretary of the Treasury to decide how and when to use the systemic risk exception, Congress in effect expected the Secretary to know the answer.

The Lehman Brothers filing, which at that time was the largest financial bankruptcy in U.S. history (FDIC 2011, online), and the Citigroup/Wells Fargo/Wachovia experience no doubt informed the Secretary's judgment that the financial sector was spirally downward. Even so, it did not lead him to set a hard-and-fast threshold for TBTF. Decision-making both before and during the meltdown was strictly *ad hoc* (Labonte 2017, p.38).

Title I of the *Dodd-Frank Wall Street Reform and Consumer Protection Act,* also known as the *Financial Stability Act of 2010*, established the Financial Stability Oversight Council which included among its members the Secretary of the Treasury, the Chair of the Federal Reserve System, and the Comptroller of the Currency (Section 111). This Council was mandated to (1) identify risks to financial stability, (2) promote market discipline, and (3) respond to emerging threats to stability (Financial Stability Oversight Council 2011, online).

The question as to whether there are critical values that put the norm of too big to fail in measurable form has been widely discussed over the years by the Oversight Council and others without clear resolution. A 2017 report prepared by the Congressional Research Service on TBTF was inconclusive as to whether systemic risk should be drawn at $1

[4] Shortly after the announcement that Citigroup would acquire Wachovia, Wells Fargo entered the bidding war and eventually took control of Wachovia away from Citigroup. Subsequently, Wells Fargo was sued by Citigroup with the two sides eventually agreeing to a relatively small settlement for Citigroup (Barr 2010, online).

trillion, $100 billion, or $50 billion in assets (Labonte 2017, p.13). In part the problem is that TBTF is not just a matter of size. It involves interconnectedness.[5]

The bigger problem is that "too big" is a normative concept and its meaning depends very much on the values of the persons who use the term. Even so, the research and studies that have been and are being conducted, along with the associated discourse, offer promise of shedding more light on the effects of rescuing megabanks and leading us in the direction of a more explicit social commitment on how big is too big.[6]

Once we know more about the impact of TBTF in the past we will be in a better position to know when to call upon the systemic risk exception in the future. And as we continue to know even more, and find ourselves in a new and different financial crisis, we might even change our judgment as to when to apply this exception. For the foreseeable future, policy might be stated as follows: "We will know what to do when we see what is happening."

PRINCIPLES OF ECONOMIC JUSTICE

Is TBTF essentially unjust? To provide an answer requires us to explore the duties under justice in economic affairs that are grounded in the three, and only three, kinds of human relationships: person to person, superior to subordinates, member to group.

***Superior to Subordinates.* Distributive justice demands that the regulator (superior party) distribute the benefits and burdens among those who are regulated (subordinate parties, banking institutions) in some equal fashion. Discrimination is one side of the coin of a failure in distributive justice. Favoritism is the other. Regulators fail in their duties under distributive justice whenever they do not fully and properly apply their regulatory powers in a timely manner.**

Accommodations, however, are permitted for good reason. The systemic risk that inheres in big banks and not in small ones means that big banks may be treated differently. Considered separate and apart from compelling the taxpayer to absorb the losses of TBTF, the systemic risk exception *per se* is not a failure in distributive justice. We must look to commutative justice and contributive justice to see how and why TBTF is unjust.

***Person to Person.* Commutative justice relates to the interactions between economic agents. In financial affairs those interactions at times are face-to-face, but increasingly are driven by today's technology that makes exchange less a personal experience and more an electronic routine. Commutative justice is grounded in the presumption that both parties**

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[5] For more on banking interconnectedness, see Yellen 2013.

[6] We are indebted to Becker (1961, p.15) for his insight as to how to define and measure an entirely different normative concept -- the adequacy of benefits under state unemployment insurance laws.

are free to act, act transparently, and have done their due diligence, thereby promoting positive-sum outcomes for both.

In the exchange process two types of valuation come into play: use value and exchange value. Use value refers to what a product or service is worth uniquely to the person who possesses it. Exchange value refers to price of the thing to anyone interested in buying or selling it, subject of course to whatever price finally emerges as the parties bargain back and forth. In terms of use value, exchange between the parties involved does not take place unless and until for both parties what is gotten is more highly valued than what is given up. In terms of exchange value, commutative justice demands that the two parties are to exchange things of equal value (they must have agreed on the price) and impose equal burdens on one another.

The burdens are not equal whenever a banking partner knowingly sells a product or service the consumer cannot afford, or misinforms another financial institution about the risk involved, or hasn't bothered to find out what that risk might be. TBTF is fundamentally unjust because megabanks are not required to make restitution for the losses they impose on their counterparties from the ill-gotten gains they have taken opaquely or seized coercively. That burden instead is shifted to the taxpayer. TBTF is a failure in commutative justice.

Member to Group. **Contributive justice demands that to the extent that a person/organization is interconnected to others in a group and receives benefits from belonging to that group, that person/organization has a duty to maintain and support the group. To illustrate, the benefits of citizenship (such as the protections confirmed in the Constitution) require the citizen to pay taxes and to serve in the armed forces when the nation is attacked. For our purposes, banks are members of a group through correspondent relationships, the Federal Reserve System that sets interest rates, and the FDIC that maintains a pool of funds paid into by many banks to cover some of the losses when one of the members becomes insolvent.**

TBTF sets up a citizenship class within the group wherein small banks are required to account for their losses and loss exposures but big banks are not. Worse yet, even though they are not part of the financial circle, taxpayers are left holding the bag for the faulty decision-making of the big-bank members. TBTF is a failure in contributive justice.

JUSTICE IN TERMS OF ACTUATING AND LIMITING PRINCIPLES

In the following, each one of the three principles of justice is constructed and applied to the financial sector in ways that link the various parties involved to certain actuating and limiting principles.

For traders of financial instruments under commutative justice …

- **the actuating principle is the duty to exchange things of equal value;**

- **the limiting principle is the duty to impose equal burdens on one another.**

A simple example as to how these two principles apply is the purchase of a house. When a buyer pays cash for a house, exchanging things of equal value means that buyer and seller have reached agreement on the final price. Imposing equal burdens on one another means that the buyer is to hand over the cash at the same time the seller transfers ownership and use of the house.

Buying a house becomes complicated when the buyer has to borrow the funds necessary to pay the seller. The seller has to transfer ownership and use of the house and is paid in full as agreed by a combination of the buyer's down payment and the lender's advance of funds via a mortgage. However, the lender must wait for repayment of the mortgage and is justified under commutative justice in charging interest to equalize the burden of accepting payment in full at a later date, and retains the title to the house in the event of homeowner default.

For regulators and supervisors of the financial system under distributive justice …

- **the actuating principle is the duty to enforce the laws regulating banking institutions knowledgeably, openly, fairly, treating an institution differently only when it poses a different regulatory or supervisory risk;**

- **the limiting principle is the duty not to exceed or fail to enforce their regulatory mandate.**

Regulators and supervisors are expected to discern the Golden Mean between too little regulation and too much, and to act accordingly. The systemic risk exception *per se* is justified under distributive justice. However, coercing the taxpayer to pay for any losses under TBTF is not justified.

For senior banking executives under contributive justice …

- **the actuating principle is the duty to report illegal or harmful behavior that threatens their institutions or others in the banking system;**

- **the limiting principle is the duty to resist taking action that has the effect of endangering other banking institutions and threatening the system.**

The actuating principle is necessary for financial institutions to retain some measure of self-governance in their routine day-to-day operations.

> **The limiting principle is the other side of the actuating-principle coin. When a financial institution operates in a way that threatens or takes advantage of others institutions, it cannot dismiss that threat on grounds that competition (with one's rivals) is a sufficient organizing principle for the financial sector.**
>
> **The organizing principle of cooperation (with one's partners) is necessary to hold the systemic-risk factor in check. Subprime mortgage lending by certain financial institutions in the reckless pursuit of greater profits and shareholder value in the end had a huge negative impact on their mortgage guarantors. It was exploitation.**

This perspective reinforces the duties of economic agents in financial affairs that when faithfully practiced help prevent tail-risk exposures that exploit TBTF. Banks that fail to carry out their duties under commutative justice or contributive justice invite greater regulatory and supervisory control.

Megabanks are not always subject to the same kind of regulatory and supervisory control as small banks. Consider how differently the Federal Reserve in 2018 handled issues with Well Fargo and NBRS Financial. Citing "recent and widespread consumer abuses and other compliance breakdowns," the Federal Reserve in February 2018 imposed a cap on the total asset holdings of Wells Fargo and ordered the megabank to replace four of its directors by the end of the year. Though it noted that "in recent years, Wells Fargo pursued a business strategy that prioritized growth without ensuring appropriate *management* at all key risks," the Federal Reserve took no direct personal action against then current CEO Timothy Sloan (presiding October 2016 – March 2019), its former Chairman and CEO John Stumpf,[7] or its past lead independent director Stephen Sanger (Moise and Henry 2019; Federal Reserve 2018b; Federal Reserve 2018a, emphasis added).[8]

In August 2018 citing his "self-dealing transactions involving bank loans [two loans improperly obtained totaling $350,000] and withholding material information from the NBRS board of directors," the Federal Reserve prohibited former president and CEO Jacob Goldstein from participating in the banking industry. NBRS Financial was closed in October 2014 with the FDIC named as receiver. Its deposit accounts were acquired by Howard Bank (Federal Reserve 2018c; FDIC 2014).

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[7] **The Office of the Comptroller of the Currency in 2020 imposed a $17.5 million Civil Money Penalty against Stumpf. Smaller penalties were imposed on two other former senior officials. These penalties were levied "for their roles in the bank's sales practices misconduct."**

[8] **Senator Elizabeth Warren used her position on the Senate Banking Committee to "push" Fed chair Janet Yellen in the direction of greater control over Wells Fargo (Warren 2018a, pp. 1-2). Warren more recently has taken the same stand with newly appointed Fed chair Jerome Powell (Warren 2018b pp. 1-2).**

Those kinds of substantial differences in the penalties used by the Federal Reserve to hold accountable the senior management of Wells Fargo and NBRS Financial send a message that in terms of their job tenure and professional careers persons in charge at megabanks may have less to fear from Federal Reserve intervention than their counterparts at small banks do.

PRINCIPLE OF THE DOUBLE EFFECT

The principle of the double effect applies because there are two effects associated with TBTF as it has been administered to date. The first is the good effect of rescuing the financial sector from collapse and presumably helping to stabilize the real economy. The second is the primary bad effect of using public funds thereby making the taxpayer the fall guy for the faulty decision-making of megabank executives. There is a secondary bad effect, already mentioned, to the effect is that TBTF incentivizes megabanks to engage in even riskier investments in the future for the additional financial gains possible.

The principle of the double effect asserts that four conditions must be met before TBTF can be considered permissible (Mangan 1949, pp.60-61).

First, the action taken (in this case, by the Secretary of the Treasury who calls upon the systemic risk exception) must be morally good or at least indifferent.

Second, the good effect is intended; the bad effect is not intended.

Third, the good effect must not proceed from the bad effect.

Fourth, there must a grave reason for permitting the bad effect.

We take up the fourth condition first. Was there sufficient reason to permit the primary and secondary bad effects? More precisely, was the threat of systemic failure, along with any serious adverse economic conditions associated with that failure (cf. FDIC 1991, Section 141), sufficient reason to shift banking losses to the taxpayer and potentially heighten the risk that bankers, taking into account the TBTF safety net, would engage in even riskier decision-making in the future? Our interpretation of "grave reason" takes into account systemic failure defined not narrowly as an end in itself but more broadly as the means by which adverse economic conditions might be triggered.

When TBTF was employed by the Secretary of the Treasury in 2008, allowing Citigroup/Wells Fargo to acquire Wachovia, no one knew the full extent of the risk of system failure and the probability of any adverse economic consequences or the extent of either bad effect. It follows that any examination of the issue in terms of the fourth condition must be handled at some distance from the initial Treasury decision.

Lewis (2011, pp.160-178) claims that before and during the early years of the financial crisis, there was a breakdown in due diligence among big bank CEOs. As late as September

2007 Federal Reserve Chair Ben Bernanke stated publicly that there was no more than $100 billion in the subprime mortgage market. At that time "Steve [Eisman] was one of about two investors who completely understood what was going on." In other words, had those with the duty to know what they were doing not failed in that duty the financial crisis might not have happened, and the primary bad effect of forcing the taxpayer to clean up the financial mess might have been averted.

The entire financial establishment, including traders, bankers, regulators, never openly and fully admitted they made serious mistakes in the pursuit of profits and stockholder value that brought the financial sector to the brink of disaster. Furthermore, because they were unable or unwilling to pay for their mistakes, they turned to the only party – the taxpayer – with the deep pockets to cover those losses. In order to escape from holding themselves accountable for their mistakes, the powerful fault-ridden establishment was working behind the scene to saddle the blameless taxpayer with their losses. "The profits belong to us, the losses to you," or, if you like, "heads we win, tails you lose." Adding severe injury to this cynical insult, none of their legerdemain averted the Great Recession. The intended good effect of stabilizing the real economy never happened.

It is essential to note that the primary bad effect was linked not to the Treasury's decision to intervene in Citigroup/Wells Fargo/Wachovia but to another decision taken by Congress and the president that made the taxpayer accountable for the losses. It wasn't sheer size that trumped faulty establishment decision-making. It was raw power that trumped justice.

True enough, the megabanks were rescued from their own faulty decision-making, but the public paid twice over for this bailout that in the end did not prevent the economic collapse that followed. First, Congress saddled the public with the taxes needed to bail out the banks at fault. Second, the public suffered through the worst recession since the Great Depression of the 1930s. Had the bailout helped soften the blow of the Great Recession, we might admit that indeed there was a grave reason to permit the bad effects. The evidence simply does not support that conclusion.

This gross failure on the part of those who should have known but did not means that, as to the first condition, using the systemic risk exception amounted to a cover up and therefore cannot be regarded as either morally good or indifferent.

Regarding the second condition, both bad effects were intended. The responsible regulators including the Treasury Secretary and the Federal Reserve Chair knew beforehand that the TBTF safety net likely would set in motion incentives for banking institutions to engage in even riskier behavior in the future. At the very same time Congress along with the President intended the primary bad effect in the sense that they held taxpayers liable for the banking losses and forced them to supply the funds necessary to cover those losses.

As to the third condition, the good effect proceeds from the bad effect in that the needed public funds were deliberately put in place in order to execute the bailout strategy. *No public funds, no bailout.* This indicates that, as suggested earlier, the decision to intervene and the decision to hold the taxpayer accountable were related but separate and distinct.

TBTF meets none of the four conditions established under the principle of the double effect. With hindsight we have a much better grip on the extent of both bad effects and might find it tempting to permit TBTF on grounds of the devastating effects of the Great Recession. For sure, TBTF succeeded in keeping megabanks and other financial institutions from collapsing, but it did NOT prevent the Great Recession in which millions of Americans were heavily burdened not only by higher taxes but also by lost jobs and reduced household incomes leading in many cases to lost homes and missed opportunities to pursue other worthy goals such as additional education. Neither did it eliminate or even mitigate the conditions that might prevent future economic instability.

In terms of the principle of the double effect and at a very personal level, TBTF is a dismal failure. It protected the lofty positions of those who failed in their duties and held accountable those who had done nothing wrong. With the help of Congress, the president, and federal regulators, it flipped the winning and losing sides in a zero-sum tragedy.

DUE DILIGENCE AND SUBSIDIARITY

The principle of subsidiarity consists of two sets of instructions, one limiting and one actuating. The limiting set states that larger, stronger organizational units should not take over the functions of smaller, weaker units. The actuating set urges the larger, stronger units to help the smaller, weaker units function more effectively. In Abraham Lincoln's formulation, the principle of subsidiarity asserts that "In all that the people can individually do as well for themselves, the government ought not to interfere" (McGinnis 1977, p.41). In other words, the government should do for the people only what the people are unable to do for themselves.[9]

Subsidiarity reinforces the democratic principle by widening opportunities for smaller less powerful functional elements in the economic order, including in this instance the financial sector, to participate in decision-making processes that bear upon their well-being, thereby limiting the abuse of highly decentralized decision-making that may misconstrue the problem or the proper remedy and identifying the remedy that works best. In that regard, subsidiarity accentuates the dignity of the human person as an intelligent being.

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[9] **See Becker 1959, pp.4-9, for more on the principle of subsidiarity.**

Due diligence, simply put, means that the decisions made by banking executives are to be made thoughtfully based on all relevant and available information on the products they are buying or selling and on their trading partners especially when those executives are acting in place of another person or institution. Due diligence is fiduciary is in nature. A financial agent who has done his/her due diligence is a person who may be presumed to be trustworthy.

The practice of forcing taxpayers to help bailout banks that are too big to fail tramples on the principle of subsidiarity in the sense that megabank executives already know or should know the importance of due diligence in conducting bank affairs without implicating taxpayers who are entirely detached from the financial decisions that led to the crisis. To restate the principle of subsidiarity in the context of TBTF, "the weaker individual citizen-taxpayer should not be forced by a much more powerful government to pay for the mistakes of those in the financial sector who had a duty to know what they were doing but failed in that duty."

TBTF challenges the intelligence and trustworthiness of megabank decision-makers in a financial emergency but for reasons of expediency bails them out and forces the taxpayer to pay for their poor decision-making. In effect, by subordinating due diligence to profit and stockholder value or ignoring it megabank executives have undermined the very principle that argues for maintaining banks as private institutions. As a consequence of TBTF, government plays a larger role in deciding which banks survive and which ones fail, who wins and who loses. TBTF is a direct blow to the principle of subsidiarity.

LAST WORD

The Great Recession had horrendous effects on the U.S. economy, notably on workers, homeowners, and banking institutions. Between 2008 and 2013 an estimated 8.8 million jobs were lost, 2.8 million mortgage loans went into foreclosure,[10] and with assets of $686 billion 489 banks failed, draining the FDIC deposit insurance fund of $73 billion. The cumulative net cost was an estimated at $10-14 trillion (FDIC 2017, pp. xii, xiii, 299). In addition, median household wealth dropped by 44 percent between 2007 and 2011 (Wolff, p.2).

At this point it is necessary to raise this question: is TBTF ethically permissible? Based on the principle of the double effect the answer must an unequivocal NO. Is TBTF essentially

[10] In a quarterly report filed with the SEC on August 3, 2018, Wells Fargo admitted that relative to foreclosures pending between April 13, 2010 and October 20, 2015 a calculation error in its mortgage loan modification underwriting tool led to approximately 400 foreclosures that had not been offered the loan modification for which the mortgagees were in fact eligible (Wells Fargo 2018, p.5). The full extent of the effects of the Great Recession may never to known. One such effect that may never be known is the number of suicides.

just? Based on commutative and contributive justice, the answer is NO. However, the systemic risk exception *per se* is reasonable and for that reason is not unjust from the perspective of distributive justice. This in no way justifies coercing taxpayers to pay for the losses of TBTF megabanks.

Justice specifies what the parties involved in a trade or investment *owe* one another. Insolvent megabanks that acted *recklessly* are not exempt from the cold and calculating demands of justice. Any plea on their part that the market system failed to deploy the necessary preventive measures and as a result they are not responsible for their losses does not release them from their obligations. If it is not grounded in justice, due diligence is an empty exercise.

Nevertheless, the faithful practice of justice does not rule out insolvency for a megabank that has operated with due regard for its obligations under justice in calculating risk and reward. Clearly the everyday practice of commutative, distributive, and contributive justice, though necessary, is not sufficient to stave off a financial crisis. More is needed to deal with systemic risk.

Today financial experts are struggling to find what more is needed because TBTF does not and cannot *prevent* or *cure* a financial crisis. All TBTF can do is help *alleviate* some of the consequences of poor megabank decision-making.

As in the world of vaccines where viruses over time tend to mutate and vaccines become less effective, in the financial world new products develop that call for renewed due diligence to avert the faulty decision-making that leads to demands for bailing out insolvent megabanks on grounds of the systemic risk exception.

To use a different analogy, this time from human anatomy, the financial sector is the heart of the real economy that pumps the credit necessary to sustain the introduction of new products, services, and processes, the penetration of new markets, not to mention everyday economic exchange. Just as blood clots often develop in the human body as a result of poor personal decision-making with regard to eating, drinking, smoking, and exercise, faulty personal decision-making in the financial sector heightens the risk of blood clotting and endangers the entire economic order. Too big to fail means that we have to wait until the clot develops, the heart attack or stroke takes place, before we can intervene. A taxpayer-financed TBTF bailout is the equivalent of a cardiologist recommending that a grossly obese patient does not have to change eating, drinking, smoking, and exercising habits because a strict regimen has been imposed on someone else.

Given that bad luck and faulty decision-making by small bankers who drive their banks into insolvency forces financial losses on their shareholders and creditors, shouldn't the tail risks taken by big bankers have dire personal consequences for persons at fault? If megabank executives cannot be trusted to incorporate their obligations under justice into

their decision-making process, have little or no regard for any bad effects from their unrelenting pursuit of profit and shareholder value, cannot be expected to exercise due diligence, shouldn't they have to pay for bringing the financial sector to the edge of collapse and threatening the real economy?

Are we stuck with TBTF indefinitely? As long as taxpayers are treated as chumps and the big players in financial affairs call attention to the devastating effects of the Great Recession to frighten policy makers into accepting it all the while the public is kept in the dark regarding the cost of the poor megabank decision-making, the answer is YES. If we are able to find and implement ways to *privatize* the cost of insolvency at megabanks that TBTF presently imposes as a social cost on the taxpayer, the answer is NO.

Kane (2014, 29pp) has suggested one such way to do just that. His proposal calls for (1) recognizing that the taxpayer has an equity position in financial institutions that originates from the safety net and ill-gotten gains of those who have gamed the system, and (2) requiring every bank to set up a trust fund to manage that equity position with income from the dividends declared by that institution.

Kane's proposed reform is experience-rated in that the dividends paid to the trust fund would be higher for a bank that operates recklessly. In that way, bankers are incentivized to be more prudent in their decision-making. The taxpayer becomes a shareholder instead of a chump. "Heads we win, tails you lose" is replaced by "you win when we win, you lose when we lose."

As mentioned previously, Kane uses Kant's second categorical imperative to condemn the gains gotten through the TBTF safety net. Our argument, which is intended to strengthen Kane's proposal, is that the taxpayer is forced to bear the burden of megabank decision-making in trades that have failed with no regard for any benefit when trades succeed. By TBTF in effect making the taxpayer a partner on the downside but not the upside, contributive justice is violated. With TBTF the taxpayer is force to become a member of a group of bank decision-makers, gets no benefits from that membership, yet is required to bear the cost of the faulty decision-making of those banking executives who at the very same time are not personally held accountable for their ill-gotten gains. Kane's trust fund makes the taxpayer a partner on both the profit and loss sides.

Unless reforms like Kane's are implemented and *actually change the practices of megabank decision-makers* who otherwise pursue profit and shareholder value with little or no regard for due diligence, TBTF will be re-visited because in the worst-case scenario it's the taxpayer not the banker who is forced to cover the losses.

Sadly Michael Lewis (2011, p.264) has it right. "Something for nothing. It never loses its charm."

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