CONGRESSIONAL BUDGET OFFICE
PAY-AS-YOU-GO ESTIMATE

November 23, 1999

S. 900
Gramm-Leach-Bliley Act

As cleared by the Congress on November 4, 1999

SUMMARY

S. 900, enacted as Public Law 106-102, eliminates certain barriers to ties between insured depository institutions and other financial services companies, including insurance and securities firms. While these changes could affect the government's spending for deposit insurance, CBO has no basis for predicting whether the long-run costs of deposit insurance will be higher or lower than under current law. Because insured depository institutions pay premiums to the Federal Deposit Insurance Corporation (FDIC) to cover these costs, any such changes will have little or no net impact on the budget over the long term.

CBO estimates that implementing S. 900 will decrease direct spending by $31 million in 2000 and $146 million over the 2000-2004 period, and will decrease revenues by $3 million in 2000 and $15 million over the 2000-2004 period. Because the act affects direct spending and receipts, pay-as-you-go procedures apply. Under the Balanced Budget and Emergency Deficit Control Act, however, provisions providing the funding necessary to meet the government's deposit insurance commitment are excluded from pay-as-you-go procedures. CBO believes that this exclusion applies to certain provisions in S. 900 that will result in estimated costs of $15 million in direct spending and decreases in revenues of $20 million over the 2000-2004 period. For purposes of pay-as-you-go-procedures, CBO estimates net reductions in direct spending of $34 million in 2000 and $161 million over the 2000-2004 period, and increases in revenues of about $1 million in 2000 and $5 million over the five-year period.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO's estimate of the impact of S. 900 on direct spending and revenues is shown in the following table. Only the estimated changes in the budget year and the succeeding four years are counted for pay-as-you-go purposes.

	By Fiscal Year, in Millions of Dollars									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CHANGES IN DIRECT SPENDING—Subject to Pay-as-you-go Procedures										
Estimated Budget Authority										
Federal Home Loan Banks	-35	-41	-31	-28	-31	-50	-66	-65	-72	-87
Federal Deposit Insurance Corporation	0	0	0	0	0	0	0	0	0	0
Total	-35	-41	-31	-28	-31	-50	-66	-65	-72	-87
Estimated Outlays										
Federal Home Loan Banks	-35	-41	-31	-28	-31	-50	-66	-65	-72	-87
Federal Deposit Insurance Corporation	1	1	1	1	1	1	1	1	1	1
Total	-34	-40	-30	-27	-30	-49	-65	-64	-71	-86
CHANGES IN REVENUES—Subject to Pay-as-you-go Procedures										
Estimated Receipts from the Federal Reserve	1	1	1	1	1	1	1	1	1	1
CHANGES IN DIRECT SPENDING—Not Subject to Pay-as-you-go Procedures										
Federal Deposit Insurance Corporation										
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	3	3	3	3	3	3	3	3	3	3
CHANGES IN REVENUES—Not Subject to Pay-as-you-go Procedures										
Estimated Receipts from the Federal Reserve	-4	-4	-4	-4	-4	-4	-4	-4	-4	-4

BASIS OF ESTIMATE

Several provisions of S. 900 affect direct spending or receipts. Under current law, the provisions that affect direct spending related to the increase in regulatory costs associated with maintaining the deposit insurance commitment are excluded from pay-as-you-go calculations. CBO believes that the changes in direct spending and revenues associated with provisions affecting consumer information and privacy, and loans for community investment purposes, are not exempt from pay-as-you-go procedures.

The Gramm-Leach-Bliley Act may affect direct spending for deposit insurance by increasing or decreasing amounts paid by the deposit insurance funds to resolve insolvent institutions and to cover the administrative expenses necessary to implement its provisions. Changes in the spending of the deposit insurance funds related to failed banks and thrifts could be volatile and vary in size from year to year, but any such costs will be offset by insurance premiums—thus, the budgetary impact will be negligible over time. The major budgetary impact of S. 900 will stem from an increase in the annual payments by the Federal Home Loan Banks (FHLBs) for interest on bonds issued by the Resolution Funding Corporation (REFCORP). As a result, spending by the Treasury for such interest payments will decline. In addition, certain changes in regulatory activities made by the legislation will result in a small spending increase and a small revenue decrease.

Deposit Insurance Funds

The act might affect the federal budget by causing changes in the government's spending for deposit insurance, but CBO has no clear basis for predicting the direction or the amount of such changes. Changes in spending for deposit insurance could be significant in some years, but are expected to have little or no net impact on the budget over time.

A number of provisions in the act may affect spending by the deposit insurance funds. Some are likely to reduce the risks of future bank failures. For example, the act permits affiliations of banking, securities, and insurance companies, thereby giving such institutions the opportunity to diversify and to compete more effectively with other financial businesses. Changes in the marketplace, particularly the effects of technology, have already helped to blur the distinctions among financial service firms. Further, regulatory and judicial rulings continue to erode many of the barriers separating different segments of the financial services industry. For example, banks now sell mutual funds and insurance to their customers and, under limited circumstances, may underwrite securities. At the same time, some securities firms offer checking-like accounts linked to mutual funds and extend credit directly to businesses. Because the legislation clarifies the regulatory and legal structure that currently governs bank activities, CBO expects that it will allow banks to compete more effectively and efficiently in the rapidly evolving financial services industry. Diversifying income sources also could result in lower overall risks for banks, assuming that the expansion of their activities is accompanied by adequate safeguards. S. 900 specifically prohibits the FDIC from using the resources of the Bank Insurance Fund (BIF) to assist affiliates or subsidiaries of insured financial institutions.

It is also possible, however, that losses to the deposit insurance fund might increase under Public Law 106-102. The increase in scale and complexity of the new financial holding companies might challenge the ability of the regulators to manage any additional risk of losses to the deposit insurance funds. If additional losses occur, the BIF will increase premiums that banks pay for deposit insurance. Similarly, if losses decrease, banks might pay smaller premiums. As a result, the net budgetary impact over the long term is likely to be negligible in either case.

Federal Home Loan Banks

The act makes a number of reforms to the FHLB system. Beginning in 2000, membership in the FHLB system will be voluntary. The act also requires the FHLBs to replace the $300 million annual payment for the interest on bonds issued by the REFCORP with an assessment of 20 percent of the FHLBs' net income. The Federal Housing Finance Board, which regulates the FHLBs, is authorized to extend or shorten the period over which payments are made such that, over time, the average payment equals $300 million a year, on a present-value basis. The Board also must issue regulations prescribing new capital standards applicable to each FHLB.

Based on CBO's analysis of the FHLB system's balance sheet and income statement, and using CBO's baseline economic assumptions, we estimate that the provisions affecting the FHLBs will increase their payments to REFCORP by $35 million in 2000 and a total of $166 million over the 2000-2004 period. CBO expects that the estimated increase in payments in the near term will be offset by a decrease in payments of an equal amount (on a present-value basis) in future years.

The FHLB system is a government-sponsored enterprise and its activities are not included in the federal budget. Because the Treasury pays the interest on REFCORP bonds not covered by the FHLBs, this provision will reduce Treasury outlays by $166 million over the five-year period.

Regulatory Costs

The state banking regulators, the Federal Reserve, and other federal banking regulators—the Office of the Comptroller of the Currency (OCC), the FDIC, and the Office of Thrift Supervisions (OTS)—will have primary responsibility for monitoring compliance with this statute. These banking agencies will be required to implement new regulations, policies, and training procedures related to securities, insurance, consumer protection, and other areas. Offsetting these costs will be savings resulting from fewer exams of depository institutions to ensure compliance with the Community Reinvestment Act (CRA) when the banks and thrifts achieve satisfactory and outstanding ratings. CBO expects that net spending for the FDIC will total about $4 million annually for these new regulatory activities. The OTS and the OCC will also incur annual expenses for these purposes—estimated to total less than $2 million for the OTS and about $5 million for the OCC, but those costs will be offset by increased fees, resulting in no net change in spending for those agencies. We expect that other provisions affecting the FDIC, the OCC, or the OTS will have no significant budgetary impact.

CBO believes that the various costs of the legislation related to consumer protection, CRA, and eliminating the Savings Association Insurance Fund (SAIF) special reserve does not qualify for the exemption that applies to the full funding of the deposit insurance commitment, and thus counts for pay-as-you-go purposes. We estimate that these changes will result in a net increase in the FDIC's supervisory costs of about $1 million annually, for a total of $10 million over the 2000-2009 period. Costs each year for similar activities of the OCC and the OTS, which we estimate will be about $1 million annually for each agency, will be offset by increases in fees of an equal amount, resulting in no significant net budgetary impact for those agencies.

CBO estimates that, under the Gramm-Leach-Bliley Act, the Federal Reserve will spend an additional $15 million over the 2000-2004 period. The act requires it to supervise the activities of new bank holding companies. In conjunction with the Treasury Department, the Federal Reserve is also responsible for approving the new and expanded financial activities of banking organizations. Based on information provided by the Federal Reserve Board, CBO estimates that the Federal Reserve's new supervisory activities will result in added examination costs of about $4 million per year. CBO believes that these provisions provide the funding necessary to meet the government's deposit insurance commitment and are therefore excluded from pay-as-you-go procedures.

The Gramm-Leach-Bliley Act also requires the Federal Reserve Board to complete several studies including the default rates, delinquency rates, and profitability of lending under the CRA. In addition, the act requires all federal banking agencies to collect and monitor data on CRA agreements made between depository institutions and other parties. CBO estimates that the Federal Reserve will not incur significant additional costs in providing these services. The legislation will probably not affect the Federal Reserve's cost of processing applications. CBO expects that applications for the newly authorized activities of holding companies will increase, but the added workload is likely to be offset by a decrease in applications for nonbanking activities, resulting in no significant net budgetary impact.

Offsetting the cost of these new supervisory activities will be a lowering of examination costs resulting from less frequent CRA exams for small banks. Depository institutions with assets of no more than $250 million will be required to have a CRA exam every four years if they received a satisfactory rating on their most recent CRA exam and every five years if they receive an outstanding rating. Less frequent CRA exams will decrease the operating costs of the Federal Reserve System. Based on information provided by the Federal Reserve, CBO estimates that the CRA extension will save the Federal Reserve System approximately $1 million annually beginning in 2000, for a total of $5 million over the 2000-2004 period. CBO believes that the various costs or savings associated with the CRA provisions do not qualify for the exemptions under the full funding of the deposit insurance commitment and, therefore, count for pay-as-you-go purposes. Other provisions in the act will not significantly affect spending by the Federal Reserve.

CBO estimates that the total effect of these provisions on the administrative costs of the Federal Reserve will be an increase in costs of $15 million over the 2000-2004 period. Because the Federal Reserve System remits its surplus to the Treasury, the increased costs will reduce governmental receipts, or revenues, by the same amount.

SAIF Special Reserves

The act repeals the requirement that previously existed for the Savings Association Insurance Fund (SAIF) to retain a special reserve fund. CBO expects that the cost of that repeal will total less than $500,000 in any year. The Deposit Insurance Funds Act of 1996 required the Federal Deposit Insurance Corporation to set aside, on January 1, 1999, all balances in the SAIF in excess of the required reserve level of $1.25 per $100 of insured deposits. The funds in this special reserve become available to pay for losses in failed institutions only if the SAIF's balance (excluding the reserve) subsequently falls below 50 percent of the required reserve level, and the FDIC determines that it is expected to remain at that level for a year. In January 1999, the FDIC allocated $1 billion of the SAIF's balances to the special reserve. CBO's baseline assumes administrative costs and thrift failures will remain sufficiently low to avoid raising assessment rates on SAIF-insured institutions through 2004. We expect that the SAIF's fund balances of about $10 billion will continue to earn interest, and that the fund's ratio of reserves to insured deposits will climb each year, reaching more than 1.4 percent by 2004.

Although CBO's baseline estimates do not assume that the cost of thrift failures in any year will exceed the net interest earned by the SAIF, unanticipated thrift failures could result in a drop in the SAIF's reserve ratio below 1.25 percent. The baseline reflects CBO's best judgment as to the expected value of possible losses during a given year, but annual losses will likely vary from the levels assumed in the CBO baseline. Thus, some small probability exists that thrift failures could increase sufficiently to drive the reserve ratio below the required level of 1.25 percent, but not so low as to trigger use of the special reserve.

When the balance of an insurance fund dips below the required ratio, the FDIC is forced to increase assessments for deposit insurance to restore the fund balance to the required level. Thus, if thrift losses were to exceed baseline estimates by a significant amount, we expect the FDIC to increase insurance premiums to maintain the SAIF's fund balance. Eliminating the special reserve will add to the fund balances and will make it less likely that the FDIC will have to raise insurance premiums. The probability that this change will affect premium rates is quite small, however, so CBO expects that any loss of deposit insurance premiums from eliminating the special reserve will total less than $500,000 in any year.

ESTIMATE PREPARED BY:

Federal Deposit Insurance Corporation: Mary Maginniss
Federal Home Loan Banks: Robert Seiler
Revenues: Carolyn Lynch

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis