CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 19, 2002

H.R. 3951

Financial Services Regulatory Relief Act of 2002

As ordered reported by the House Committee on the Judiciary on July 17, 2002

SUMMARY

H.R. 3951 would affect the operations of financial institutions and the agencies that regulate them. Some provisions would address specific sectors: national banks could more easily operate as S corporations; thrift institutions would be given some of the same investment, lending, and ownership options available to banks; credit unions would have new options for investments, lending, mergers, and leasing federal property; and certain privately insured credit unions could become members of the Federal Home Loan Bank system. The bill would modify regulatory procedures governing certain financial transactions, such as de novo branches and interstate mergers, and give agencies more flexibility in sharing data, retaining records, and scheduling exams. It also would limit the legal defenses that the United States could use against certain claims for monetary damages. Finally, H.R. 3951 would require insured depository institutions and credit unions to notify a consumer if information that may be construed as being adverse is being given to a credit reporting agency.

CBO estimates that enacting this bill would reduce federal revenues by $23 million over the next five years and by a total of $72 million over the 2003-2012 period. In addition, we estimate that direct spending would increase by $17 million over the next five years and by a total of $22 million over the 2003-2012 period. Because H.R. 3951 would affect direct spending and receipts, pay-as-you-go procedures would apply.

H.R. 3951 contains intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the cost of complying with those requirements would not exceed the threshold for intergovernmental mandates established in UMRA ($58 million in 2002, adjusted annually for inflation).

H.R. 3951 contains several private-sector mandates as defined by UMRA. Those mandates would affect insured depository institutions and credit unions, uninsured banks, nondepository institutions that control depository institutions, certain parties affiliated with

those depository institutions, and people charged with or convicted of crimes of dishonesty. At the same time, the bill would relax some restrictions on the operations of certain financial institutions. CBO estimates that the aggregate direct cost of private-sector mandates in the bill would exceed the annual threshold established in UMRA ($115 million in 2002, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3951 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars					
	2002	2003	2004	2005	2006	2007
CHANGES IN REVENUES						
Estimated Revenues[a]	0	-1	-3	-5	-6	-8
CHANGES IN DIRECT SPENDING[b]						
Estimated Budget Authority	0	1	1	1	7	7
Estimated Outlays	0	1	1	1	7	7

a. Negative revenues indicate a reduction in revenue collections.

b. CBO estimates that implementing H.R. 3951 could affect spending subject to appropriation, but we estimate that any such effect would be insignificant.

BASIS OF ESTIMATE

Most of the budgetary impacts of this legislation would result from three provisions: section 101, which would make it easier for national banks to convert to S corporation status; section 214, which would limit the government's legal defenses against certain claims for monetary damages, and section 302, which would allow certain federal credit unions to lease federal land at no charge. For this estimate, CBO assumes that H.R. 3951 will be enacted in the fall of 2002.

HR. 3951 also would affect the workload at agencies that regulate financial institutions, but we estimate that the net change in agency spending would not be significant. Based on information from each of the agencies, CBO estimates that the change in administrative expenses—both costs and potential savings—would average less than $500,000 a year over the next several years. Expenditures of the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the National Credit Union Administration (NCUA), and the Federal Deposit Insurance Corporation (FDIC) are classified as direct spending and would be covered by fees or insurance premiums paid by the institutions they regulate. Any change in spending by the Federal Reserve would affect net revenues, while adjustments in the budget of the Securities and Exchange Commission would be subject to appropriation.

Revenues

CBO estimates that enacting H.R. 3951 would reduce federal tax revenues collected from national and state-chartered banks and would have an insignificant effect on civil and criminal penalties collected for violations of the bill's provisions.

S Corporation Status. Under this bill, some national banks would find it easier to convert from C corporation status to S corporation status. Section 101 would allow directors of national banks to be issued subordinated debt to satisfy the requirement that directors of a bank own qualifying shares in the bank. This provision would effectively reduce the number of shareholders of a bank by removing directors from shareholder status, making it easier for banks to comply with the 75-shareholder limit that defines eligibility for subchapter S election.

Income earned by banks taxed as C corporations is subject to the corporate income tax, and post-tax income distributed to shareholders is taxed again at individual income tax rates. Income earned by banks operating as S corporations is taxed only at the personal income tax rates of the banks' shareholders and is not subject to the corporate income tax. The average effective tax rate on S-corporation income is lower than the average effective tax rate on C-corporation income. CBO estimates that enacting this provision would reduce revenues by a total of $23 million over the 2003-2007 period and by $72 million over the 2002-2012 period.

Based on information from the Federal Reserve Board, the OCC, and private trade associations, CBO expects that most of the banks that would be affected are small, although banks and bank holding companies with assets over $500 million would also be affected. In addition, states are likely to amend the rules for state-chartered banks to match those for national banks. CBO expects that most conversions to Subchapter S status would occur between 2003 and 2006 and that national banks would convert earlier than state-chartered banks.

Civil and Criminal Penalties. H.R. 3951 would make all depository institutions—not just insured institutions—subject to certain civil and criminal fines for violating rules regarding breach of trust, dishonesty, and certain other crimes. CBO estimates that any additional penalty collections under those provisions would not be significant.

Direct Spending

CBO estimates that enacting H.R. 3951 would increase direct spending by a total of about $15 million over the 2003-2012 period to pay for increased litigation costs and larger payments for "goodwill" claims against the government. The bill also would reduce offsetting receipts from credit unions that lease federal facilities, and it could affect the cost of deposit insurance.

Monetary Damages in Goodwill Cases. Section 214 would preclude the use of certain legal defenses in claims for damages against the United States arising out of the implementation of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). CBO estimates that enacting this provision would increase the cost of litigating and resolving such claims by a total of $15 million over the next five years.

Background on Goodwill Cases. Under section 214, courts could not dismiss a claim arising out of the implementation of FIRREA on the basis of res judicata, collateral estoppel, or similar defenses if the defense was based on a decision, opinion, or order of judgment entered by any court prior to July 1, 1996. On that date, the Supreme Court decided *United States v. Winstar Corp*., 518 U.S. 839 (1996), holding that the government became liable for damages in breach of contract when the accounting treatment of "supervisory goodwill" that it had previously approved was prevented by enactment of FIRREA. About 100 "goodwill" cases against the government are still pending before the courts, with claims totaling about $20 billion. CBO estimates that, under current law, such claims will cost the government about $2 billion over the 2003-2012 period. Judgments, settlements, and litigation expenses for such claims are paid from the FSLIC Resolution Fund, and such payments do not require appropriation action.

By eliminating some defenses currently available to the United States in such cases, section 214 would increase the likelihood that some claims would reach a hearing on the merits, thereby allowing cases to proceed further in the judicial process than may otherwise be likely. According to the Department of Justice (DOJ) and the FDIC, this provision would affect only a few of the goodwill cases; claims in the affected cases could total about $200 million. (This provision also could affect cases in which the FDIC is the plaintiff as the receiver of a failed thrift, but any monetary awards to the FDIC would be intragovernmental payments and would have no net effect on the federal budget.)

Estimated Cost of This Provision. CBO expects that enacting section 214 would increase the cost of litigation and potential settlements or judgments against the United States. Whether those costs are large or small would depend on the role those defenses would otherwise play in the outcome of each case. For example, the cost could be significant if the loss of those defenses resulted in a judgment for plaintiffs on the merits, but could be negligible if the judgment were against the plaintiffs.

For this estimate, CBO assumes that defenses of res judicata and collateral estoppel would be just two of several possible defenses and other factors affecting awards of monetary damages and that barring them would therefore have a small effect on the potential costs of such claims. We estimate that enacting this provision would increase expected payments for such claims by about $10 million—or 5 percent of the $200 million in claims that may be affected by this provision. Given the pace of such litigation, we expect that those added costs would occur in 2006 and 2007. In addition, CBO estimates that DOJ's administrative costs would increase by an average of about $1 million a year as a result of the added time and workload associated with those cases. This estimate is based on historical trends in the cost of litigating such claims.

Nongoodwill Cases. Because section 214 would not limit the affected claims to goodwill cases, this provision also could affect other types of claims for monetary damages arising out of the implementation of FIRREA that meet the criteria in the bill. This provision could encourage the filing of such claims that were resolved prior to July 1, 1996; however, DOJ is currently unaware of any such claims.

Offsetting Receipts From Federal Leases. Section 302 would allow federal agencies to lease land to federal credit unions without charge under certain conditions. Under existing law, agencies may allocate space in federal buildings without charge if at least 95 percent of the credit union's members are or were federal employees. Some credit unions, primarily those serving military bases, have leased federal land to build a facility. Prior to 1991, leases awarded by the Department of Defense (DoD) were free of charge and for terms of up to 25 years; a statutory change enacted that year limited the term of such leases to five years and required the lessee to pay a fair market value for the property. According to DoD, about 35 credit unions have leased land since 1991 and are paying a total of about $525,000 a year to lease federal property. Those proceeds are recorded as offsetting receipts, and any spending of those payments is subject to appropriation.

CBO expects that enacting this provision would result in a loss of offsetting receipts from all credit union leases. Those lessees currently paying a fee would stop making those payments after they renew their current leases, all of which should expire within the next five years. In addition, credit unions that have long-term, no-cost leases would be able to renew them without becoming subject to the fees they otherwise would pay under current law.

CBO estimates that enacting this provision would cost a total of about $2 million over the next five years and would cost an average about $700,000 annually after 2007.

Deposit Insurance. Several provisions in the bill could affect the cost of federal deposit insurance. For example, the bill would streamline the approval process for mergers, branching, and affiliations, which could give eligible institutions the opportunity to diversify and compete more effectively with other financial businesses. In some cases, such efficiencies could reduce the risk of insolvency. It is also possible, however, that some of the new lending and investment options could increase the risk of losses to the deposit insurance funds.

CBO has no clear basis for predicting the direction or the amount of any change in spending for insurance that could result from the new investment, lending, and operational arrangements authorized by this bill. The net budgetary impact of such changes would be negligible over time, however, because any increase or decrease in costs would be offset by adjustments in income from insurance premiums from banks, thrifts, or credit unions.

Spending Subject to Appropriation

Section 312 would exempt federally insured credit unions from filing certain acquisition or merger notices with the Federal Trade Commission (FTC). Under current law, the FTC charges filing fees ranging from $45,000 to $280,000, depending on the value of the transaction. The collection of such fees is contingent on appropriation action. Based on information from the FTC, CBO estimates that this exemption would have no significant effect on the amounts collected from such fees.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects through fiscal year 2006 are counted.

	By Fiscal Year, in Millions of Dollars										
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Changes in outlays	0	1	1	1	7	7	1	1	1	1	1
Changes in receipts	0	-1	-3	-5	-6	-8	-9	-10	-11	-9	-10

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3951 would preempt certain state laws and place new requirements on certain state agencies that regulate financial institutions. Both the preemptions and the new requirements would be mandates as defined in UMRA.

Section 209 would preempt certain state securities laws by prohibiting states from requiring agents representing a federal savings association to register as brokers or dealers if they sell deposit products (CDs) issued by the savings association. Specifically, this provision would affect states that register exclusive agents of certain insurance companies who offer or sell CDs issued by the thrift they are affiliated with. Such a preemption would impose costs (in the form of lost revenues) on those states that currently require such registration. Information from representatives of the securities industry and securities regulators indicates that 16 states could be affected by this provision, but that only a small number of agents would fall under the preemption. CBO estimates that losses to states as a result of this prohibition would total less than $1 million a year.

Section 301 would authorize certain privately insured credit unions to apply for membership in a federal home loan bank. Part of the application process would require the relevant state regulators of credit unions to determine whether an applicant is eligible for federal deposit insurance. This requirement would be a mandate, but because the regulators already make that determination under state law, the additional cost to comply with the requirement would be minimal.

Upon becoming a member of a federal home loan bank, such a credit union would be eligible for loans from that bank. To preserve the value of these loans, section 301 would preempt certain state contract laws that otherwise would allow defaulting credit unions to avoid certain contractual obligations. Because those credit unions are not currently eligible for membership in a federal home loan bank, and accordingly, have no contracts for credit, this preemption, while a mandate, would impose no costs on state, local, or tribal governments.

Section 302 would require state regulators of credit unions to provide certain information when requested by the NCUA. Because this provision would not require states to prepare any additional reports, merely to provide them to NCUA upon request, CBO estimates the cost to states would be minimal.

Section 401 would expand an existing preemption of state laws related to mergers between insured depository institutions chartered in different states. Current law preempts state laws that restrict mergers between insured banks with different home states. This section would expand that preemption to cover mergers between insured banks and other insured depository institutions or trust companies with different home states. This expansion of a preemption would be a mandate under UMRA but would impose little or no cost on states.

Section 401 also would preempt state laws that regulate certain fiduciary activities performed by insured banks and other depository institutions. The bill would allow banks and trusts of a state (the home state) to locate a branch in another state (the host state) as long as the services provided by the branch are not in contravention of home state or host state law. Further, if the host state allows other types of entities to offer the same services as the branch bank or trust seeking to locate in the host state, home state approval of the branch would not be in contravention of host state law. This provision could preempt laws of the host state but would impose no costs on them.

CBO estimates that the cost of those mandates taken together would not exceed the threshold established in UMRA ($58 million in 2002, adjusted annually for inflation).

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3951 contains several private-sector mandates as defined by UMRA. At the same time, the bill would relax some restrictions on the operations of certain financial institutions. CBO estimates that the aggregate direct costs of mandates in the bill would well exceed the annual threshold established in UMRA ($115 million in 2002, adjusted annually for inflation). CBO does not have sufficient data to provide an estimate of the total private-sector cost of complying with mandates in the bill, but we estimate that start-up costs would be at least $250 million and ongoing costs at least $600 million a year.

Mandates

The bill would impose mandates on insured depository institutions and credit unions, uninsured banks, nondepository institutions that control depository institutions, certain parties affiliated with those depository institutions, and people charged with or convicted of crimes of dishonesty. Mandates in the bill include a new consumer notification requirement, an expansion of the authority of the Federal Deposit Insurance Corporation over insured depositories controlled by a company that is not a depository institution holding company, and expanded prohibitions on employment at financial institutions of people convicted of certain crimes.

Consumer Notification Requirement. Section 409 would require insured depository institutions and insured credit unions to notify customers when information that is, or may be construed as, adverse to the interests of the customer is furnished to a consumer reporting agency.

To comply with this mandate, the affected institutions would incur start-up and ongoing costs. Start-up costs would include additional data processing, legal services, personnel training, and the design of notification forms. Primary ongoing costs would include the costs of producing and mailing notices and any additional personnel needed to answer customers' questions about the new notifications and to handle customer disputes.

Start-up Costs. Institutions that report information to consumer credit reporting agencies would have to keep track of the information furnished to such agencies and report it to the customer at the same time it is reported to the agency. The costs of required data processing changes could include the purchase and installation of software and equipment, programming and testing, and charges by third-party processors. Based on data from a Federal Reserve study of the cost of implementing the Truth in Savings Act, CBO estimates that the cost to set up data-processing systems could average about $15,000 per institution. About 16,500 insured depository institutions and credit unions furnish customer data to consumer reporting agencies. Thus, CBO estimates that the cost of data-processing systems would amount to at least $250 million. To the extent that the data processing changes necessary to comply with this mandate would likely be more complicated than what was necessary to comply with the Truth in Savings Act, the compliance costs would be larger.

Institutions also would likely incur legal costs, training costs, and the costs of designing and producing notification forms. CBO does not have adequate information to estimate those costs of complying with this mandate.

Ongoing Costs. According to industry sources, consumer reporting agencies receive about 2 billion updates per month on consumer accounts from all types of financial service firms. About 200 million to 300 million of those notices are obviously adverse reports, such as a report of late payments. Assuming that about half of those adverse notices are furnished by insured depository institutions, they would be responsible for at least 100 million to 150 million notices per month. Many additional types of reports, however, may be construed as an adverse report under the bill. For example, opening a new credit card account may be construed as adverse by a lender reviewing a credit report if an individual already has several lines of credit.

The ongoing cost of compliance would depend on whether the notices would have to be sent out separately to qualify as notifying the customer "at the same time" as the information is furnished to the consumer reporting agencies. Because the notices would have to be personalized (as opposed to a blanket policy disclosure that is the same for all customers), they would have to be mailed at a first-class rate. Depending upon the presorting done by the depository institution, first-class postage could range from 28 cents to 37 cents a piece. In addition to postage, mailing costs would include the cost of paper, envelopes, printing, and labor. According to industry sources, outside letter shops might charge between 50 cents and $1 a piece to mail such notices, including postage. (If insured depository institutions are allowed to include notices in monthly statements that they already send, the incremental cost of mailing could be much lower.) If separate notices are required, and if 100 million notices would be mailed per month at a cost of 50 cents each, the ongoing costs of producing and mailing such notices would be $600 million per year. But CBO expects the printing and mailing costs would probably be higher than this amount. In addition to those costs, institutions would incur ongoing expenses for any additional personnel who would be needed to respond to customers' inquiries, correct errors, and resolve disputes.

Because reporting to consumer credit reporting agencies is voluntary, it is possible that insured depository institutions might mitigate their cost of compliance by decreasing the frequency with which they report customer data to such agencies, or by reducing the information they report, or stop such reporting altogether. However, depository institutions would have to weigh the costs and benefits of reducing their reporting to consumer credit reporting agencies. For example, depository institutions themselves benefit from having more comprehensive information about a potential borrower's credit history when making decisions about extending credit to that individual.

Expansion of the FDIC's Authorities. The Gramm-Leach-Bliley Act allowed new forms of affiliations among depositories and other financial services firms. Consequently, insured depository institutions may now be controlled by a company other than a depository institution holding company (DIHC). H.R. 3951 would amend current law so that certain regulatory authorities of the FDIC would apply to all commonly controlled depository institutions, regardless of the form of their holding company.

Under current law, if the FDIC suffers a loss from liquidating or selling a failed depository institution, the FDIC has the authority to obtain reimbursement from any insured depository institutions within the same DIHC. Section 407 would expand the scope of the FDIC's reimbursement power to include all insured depository institutions controlled by the same company, not just those controlled by the same DIHC. Section 408 would broaden the FDIC's authority to prohibit or limit any company that controls an insured depository from making "golden parachute" payments or indemnification payments to institution-affiliated parties of insured depositories. (Institution-affiliated parties include directors, officers, employees, and controlling shareholders.) CBO has no basis to estimate the costs of these mandates.

Employment Practices. The bill would prevent people convicted of certain crimes from participating in the affairs of uninsured banks and would give bank regulatory agencies the authority to bar individuals charged with certain crimes of dishonesty from working at any depository institution. Section 604 would give the OCC and the Federal Reserve the authority to penalize uninsured banks for unauthorized participation by individuals convicted of certain crimes. Section 608 would expand the suspension, removal, and prohibition authority of federal banking agencies and the National Credit Union Administration Board with regard to individuals charged with certain crimes. CBO has no basis to estimate the cost of these mandates.

Other Private-Sector Effects

Several provisions of the bill would benefit financial institutions by allowing for greater flexibility of operations and relaxing certain restrictions. However, those provisions do not qualify as direct savings under UMRA since those benefits do not result directly from compliance with the mandates or affect the same activities as the mandates and cannot be netted against the mandate costs. Some of the provisions that would benefit the private sector are listed below:

- Section 101 would make it easier for some national banks to meet the requirements for S-corporation status, and could lower the taxes paid by those banks.

- Title II would give federal thrift institutions some of the same powers available to banks, such as parity with banks with respect to investment adviser and broker-dealer registration requirements, allowing investments in community development and small businesses, ownership by trusts, and mergers with nonthrift affiliates.

- Title III would give federal credit unions new options for investments, lending, and mergers, subject to certain terms and conditions. Section 302 would allow federal agencies to lease land to federal credit unions without charge under certain conditions. Section 312 would exempt insured credit unions from the requirement to file a notification and report form with the federal government in advance of a merger.

- Title IV would ease restrictions on interstate branching and mergers and eliminate reporting requirements regarding insider lending imposed on banks and banks' executive officers.

PREVIOUS ESTIMATES

On July 17, 2002, CBO transmitted a cost estimate for H.R. 3951 as ordered reported by the House Committee on Financial Services on June 6, 2002. The version ordered reported by the Committee on the Judiciary differs only with regard to the timing of antitrust reviews and the filing of pre-merger notifications by federally insured credit unions. CBO estimates that those differences would have no significant effect on the impact of the bill on the federal budget or on the costs of the intergovernmental or private-sector mandates imposed by the bill.

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