CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

January 14, 2014

H.R. 3448
Small Cap Liquidity Reform Act of 2013

As ordered reported by the House Committee on Financial Services on November 13, 2013

CBO estimates that implementing H.R. 3448 would have an insignificant effect on gross spending by the Securities and Exchange Commission (SEC) to establish a pilot program that would change the minimum increment that the price of a stock could change (the tick size) for certain securities. Pay-as-you-go procedures do not apply to this legislation because it would not affect direct spending or revenues.

H.R. 3448 would establish a five-year program that would allow the price of securities issued by smaller companies to change in increments of 5 or 10 cents, rather than the penny increments that are currently the standard for most stocks traded on U.S. exchanges. Under the pilot program the SEC would set the tick size for certain small companies at 5 cents; however, those companies would have the option to select a 10-cent increment. Further, the program would allow a one-time option to change the tick size from 5 cents to 10 cents or vice versa. H.R. 3448 also would require the SEC to submit biannual reports to the Congress showing the extent to which different tick sizes are affecting liquidity and trading activity. CBO expects that changes in the workload of the SEC to implement the pilot program would not be significant because the agency has already begun efforts to develop such a program.

H.R. 3448 would impose intergovernmental and private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), by providing liability protection to issuers of securities of companies participating in the pilot program. Such issuers would not be liable for any losses caused by the quoting or trading of their securities at increments established under the program. Providing such protection would impose a mandate on both public and private investors that would otherwise be able to sue the issuers to recover losses related to tick size. The protection also would impose an intergovernmental mandate by preempting state and local liability laws.

The cost of the mandate would be the forgone value of awards and settlements in such claims. Because the securities of companies covered by the liability protection are more risky than other securities, few public entities invest in them, and those that do limit the size of such investments. Consequently, CBO estimates that any potential losses tied to the mandate would be small. In addition, the costs, if any, of the preemption would be small because it would impose no duty that would result in additional spending or a loss of revenues. Therefore, CBO estimates the cost to public entities of complying with the mandates in the bill would fall below the annual threshold for intergovernmental mandates established in UMRA ($76 million in 2014, adjusted annually for inflation).

Because of uncertainty about both the value of awards in such cases and the number of claims that would be filed in the absence of this provision, CBO cannot estimate the level of potential awards or settlements that would otherwise accrue to private investors. Therefore, CBO cannot determine whether the cost of the mandate would exceed the annual threshold established in UMRA for private-sector mandates ($152 million in 2014, adjusted annually for inflation).

In addition to those mandates, the bill would impose a private-sector mandate on companies in the pilot program established in the bill by requiring them to notify the SEC if they elect to not participate. Based on information from the SEC, CBO estimates that the cost to comply with that mandate would be minimal.

The CBO staff contacts for this estimate are Susan Willie (for federal costs), Melissa Merrell (for the state and local impact), and Paige Piper/Bach (for the impact on the private sector). The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.