CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 6, 2016

H.R. 4894
A bill to repeal title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act

As ordered reported by the House Committee on Financial Services on April 13, 2016

SUMMARY

H.R. 4894 would repeal title II of the Dodd-Frank Wall Street Reform Act of 2010. That title provides the Federal Deposit Insurance Corporation (FDIC) with the authority and funding through the Orderly Liquidation Fund (OLF) to liquidate large, systemically important financial firms (including banks and nonbank firms) that become or are in danger of becoming insolvent, subject to certain conditions.

Enacting H.R. 4894 would eliminate the FDIC's authority to use the OLF. Under current law CBO estimates there is a small chance that the OLF will be used over the next 10 years to resolve very costly financial failures of large firms. CBO estimates that any spending by the OLF will eventually be offset by fees imposed on a portion of the financial industry. However, because of the anticipated lag between OLF expenditures and fee collections, CBO estimates that the fund will operate at a net cost over the 2017-2026 period.

CBO estimates that ending the FDIC's authority to use the OLF would reduce the deficit by $15.2 billion over the 2017-2026 period, reflecting an estimated reduction in both direct spending and revenues of $20.3 billion and $5.1 billion, respectively. That estimated reduction in the deficit includes an estimated increase in net costs to the Deposit Insurance Fund (DIF) of $1 billion over the same period to resolve additional failures of federally insured depositary institutions.

Pay-as-you-go procedures apply because enacting the legislation would affect direct spending and revenues. CBO estimates that implementing H.R. 4894 would have no significant effect on spending subject to appropriation.

CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits by more than $5 billion in one or more of the four consecutive 10-year periods beginning in 2027.

H.R. 4894 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

CBO expects that the FDIC would raise assessments on insured deposits to cover the cost of increased losses to the DIF. Doing so would increase the cost of an existing mandate on institutions responsible for paying those assessments. Some of those institutions may also experience savings as the bill would eliminate assessments associated with the OLF. CBO estimates that the incremental cost of the mandate would fall well below the annual threshold established in UMRA for private-sector mandates ($154 million in 2016, adjusted for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 4894 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											
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2017-2021	2017-2026
INCREASES OR DECREASES (-) IN DIRECT SPENDING												
Orderly Liquidation Fund												
Estimated Budget Authority	-800	-1,400	-2,100	-2,900	-2,500	-2,200	-2,200	-2,300	-2,400	-2,500	-9,700	-21,300
Estimated Outlays	-800	-1,400	-2,100	-2,900	-2,500	-2,200	-2,200	-2,300	-2,400	-2,500	-9,700	-21,300
Deposit Insurance Fund												
Estimated Budget Authority	0	100	150	150	150	150	100	100	50	50	550	1,000
Estimated Outlays	0	100	150	150	150	150	100	100	50	50	550	1,000
Total Changes												
Estimated Budget Authority	-800	-1,300	-1,950	-2,750	-2,350	-2,050	-2,100	-2,200	-2,350	-2,450	-9,150	-20,300
Estimated Outlays	-800	-1,300	-1,950	-2,750	-2,350	-2,050	-2,100	-2,200	-2,350	-2,450	-9,150	-20,300
DECREASES (-) IN REVENUES												
Estimated Revenues	0	-100	-100	-200	-400	-600	-700	-800	-1,000	-1,200	-800	-5,100
NET DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Impact on Deficit	-800	-1,200	-1,850	-2,550	-1,950	-1,450	-1,400	-1,400	-1,350	-1,250	-8,350	-15,200

BASIS OF ESTIMATE

For this estimate, CBO assumes that the legislation will be enacted near the beginning of fiscal year 2017. CBO estimates that enacting H.R. 4894 would reduce the deficit by $15.2 billion over the 2017-2026 period. That estimate reflects effects on both the OLF and the DIF, both of which are administered by the FDIC.

Orderly Liquidation Fund

Current law provides the FDIC with the authority and funding to resolve the failure—or possible failure—of large, systemically important bank and nonbank financial firms. Use of that authority is contingent on certain conditions, including findings by the Secretary of the Treasury that the bankruptcy process would not be appropriate for the resolution of the firm's financial difficulties and that the firm's failure would threaten the stability of the nation's financial system.

If the necessary conditions are met, the FDIC is authorized to borrow funds from the Treasury and implement alternative legal arrangements to resolve the firms' financial problems. The FDIC is required to collect fees from other large financial firms to offset the cost of any losses resulting from those activities. The net outlays for any financial transactions stemming from the use of the OLF are recorded in the budget on a cash basis and any income from fees is recorded as revenue.

Although the probability that the FDIC will have to liquidate a systemically important firm in any year is small, the potential cash flows associated with resolving them would likely be large. CBO's baseline projections reflect the estimated probability of various scenarios regarding the frequency and magnitude of systemic financial problems. On an expected value basis, CBO estimates that the potential use of those authorities under current law will increase the deficit by $16.2 billion over the 2017-2026 period, reflecting net direct spending for the OLF of $21.3 billion (which includes recoveries from the sale of assets) and revenues from fees of $5.1 billion, net of effects on payroll and income taxes. CBO estimates that repealing the authorities in title II would reduce the deficit by a corresponding amount.

Deposit Insurance

Repealing the FDIC's orderly liquidation authorities could change how failures of large, systemically important firms would be resolved in the future and who would bear those costs. In the absence of the OLF authority, CBO expects that any future defaults of such firms would have to be resolved through bankruptcy courts using financial resources available from the private sector. After considering the possibility of different outcomes, as detailed below, CBO estimates that without the OLF, the FDIC would realize additional net costs of about $1 billion through the DIF over the next 10 years.

CBO expects that if a systemically important financial firm were to fail, some federally insured depository institutions would be among its creditors, increasing the probability of losses to the DIF. CBO also expects that the losses of those creditors would be larger under a bankruptcy proceeding than a resolution under current law using the OLF because the timing and mechanisms of the bankruptcy process would probably place additional stress on the firm's creditors and other financial institutions.

The potential effects on the DIF from enacting this legislation would depend on many legal, financial, and economic factors that are difficult to quantify. For example the risk to the DIF of additional bank failures would depend on the exposure of insured depository institutions to higher costs because of the bankruptcy proceedings undertaken to resolve systemically important firms, and whether such banks could remain financially solvent after absorbing such costs. To estimate the additional cost to the DIF under H.R. 4894, CBO considered the estimated cash flows of the OLF and also considered the types of interrelated financial institutions (knowns as counterparties) that would accrue losses because only insured depository institutions that fail would be resolved by the DIF.

CBO's baseline estimate of the net budgetary effects of the DIF is an average reduction in the deficit of about $9 billion per year. That figure includes average income to the fund from insurance premiums and recoveries of $13 billion per year and costs to the fund to resolve failed institutions of $2 billion or $3 billion per year (excluding operating costs). Those estimates include a very small chance that a large, financially complex institution would fail and that any part of such a firm that is an insured depository institution would be resolved by the DIF.

CBO estimates that under H.R. 4894, the value of assets of failed institutions requiring resolution by the FDIC would increase by about 5 percent above the amount in CBO's baseline estimates. (The DIF would reflect the overwhelming majority of the effects, although insurance funds, administered by the NCUA, could also experience a loss. This estimate includes the estimated cost to both.) To calculate the net effect on the federal budget, CBO considered conditions where the FDIC's loss ratio (loss given default, or the net cost of resolving a failed institution before changes in insurance assessment) varied from historical averages of about 18 percent to as high as 30 percent. Furthermore, CBO expects that the FDIC would eventually recover the cost of any additional losses by raising assessments on insured deposits; however, CBO estimates that such recoveries would occur over many years.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R.4894, as ordered reported by the House Committee on Financial Services on April 13, 2016

	By Fiscal Year, in Millions of Dollars												
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2016-2021	2016-2026
NET DECREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	-800	-1,200	-1,850	-2,550	-1,950	-1,450	-1,400	-1,400	-1,350	-1,250	-8,350	-15,200
Memorandum:													
Changes in Outlays	0	-800	-1,300	-1,950	-2,750	-2,350	-2,050	-2,100	-2,200	-2,350	-2,450	-9,150	-20,300
Changes in Revenues	0	0	-100	-100	-200	-400	-600	-700	-800	-1,000	-1,200	-800	-5,100

INCREASE IN LONG-TERM DIRECT SPENDING AND DEFICITS

CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 4894 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

CBO expects that the FDIC would raise assessments on insured deposits to cover the cost of increased losses to the DIF. Doing so would increase the cost of an existing mandate on institutions responsible for paying those assessments. Some of those institutions may also experience savings, as the bill would eliminate the FDIC's authority to collect fees to offset losses associated with the OLF. CBO estimates that the incremental cost of the mandate would fall well below the annual threshold established in UMRA for private-sector mandates ($154 million in 2016, adjusted for inflation).

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