CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 8, 2018

H.R. 4659

A bill to require the appropriate Federal banking agencies to recognize the exposure-reducing nature of client margin for cleared derivatives

As ordered reported by the House Committee on Financial Services on March 21, 2018

SUMMARY

H.R. 4659 would change the calculation of a bank's supplementary leverage ratio (SLR) to exclude from the ratio's denominator the amount that a nonbank entity pays to the bank as collateral for certain derivatives contracts.[1] Currently, that collateral—also called the segregated margin—must be included as an asset in the SLR's denominator.

CBO estimates that enacting H.R. 4659 would increase deficits by $44 million over the 2018-2028 period. That amount includes a net increase in direct spending of $46 million and an increase in revenues of $2 million. Most of those costs would be recovered from financial institutions in years after 2028. Because enacting the bill would affect direct spending and revenues, pay-as-you-go-procedures apply.

CBO estimates that enacting H.R. 4659 would not increase net direct spending by more than $2.5 billion or on-budget deficits by more than $5 billion in any of the four consecutive 10-year periods beginning in 2029.

H.R. 4659 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Additional fees imposed by the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) would increase the cost of an existing mandate on private entities required to pay those assessments. However, CBO estimates that the incremental cost of the mandate would fall well below the annual threshold established in UMRA for private-sector mandates ($160 million in 2018, adjusted for inflation).

1. The SLR is a capital-to-assets ratio that accounts for derivatives and other commitments that are not typically included in a bank's leverage ratio calculation.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 4659 is shown in the following table. The costs of the legislation fall within budget function 370 (advancement of commerce).

	By Fiscal Year, in Millions of Dollars												
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2019-2023	2019-2028
INCREASES IN DIRECT SPENDING													
Estimated Budget Authority	0	1	5	7	7	7	6	4	4	3	3	27	46
Estimated Outlays	0	1	5	7	7	7	6	4	4	3	3	27	46
INCREASES IN REVENUES													
Estimated Revenues	0	0	*	*	*	*	*	*	*	*	*	1	2
NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES													
Increase in the Deficit	0	1	5	7	7	7	5	4	3	3	2	26	44

Components do not sum to totals because of rounding; * = between zero and $500,000.

BASIS OF ESTIMATE

The budgetary effects of H.R. 4659 stem from a small increase in the chance that the FDIC would incur additional costs to resolve failed financial institutions. The change in the SLR calculation could reduce the amount of capital held by about 10 large bank holding companies and their subsidiary insured depository institutions. For this estimate, CBO assumes that the bill will be enacted near the end of 2018.

This cost estimate is based on the analysis underlying cost projections for the FDIC's financial resolution programs included in CBO's April 2018 baseline budget projections. Those projections incorporate a weighted probability of different possibilities for future failures of financial institutions. Most of those possibilities have a very small probability of occurring, but if they did, the costs to the FDIC's Deposit Insurance Fund (DIF) or the Orderly Liquidation Fund (OLF) would be very large.[2] In CBO's view federal regulations that require banks to maintain certain levels of capital and liquidity lower the

2. The DIF, which is funded by premiums paid by member institutions, resolves the assets of failed insured depository institutions and insures certain deposits up to $250,000 per person. The OLF was established to resolve failures of certain large, systemically important financial institutions—banks and nonbanks. In the event of such a failure, costs to the OLF would be recouped by assessments (which are recorded as revenues in the budget) collected from other large financial institutions.

FDIC's costs for resolving failed financial institutions because they increase the proportion of losses that would be absorbed by shareholders and other creditors.

CBO estimates that the bill would allow about 10 large bank holding companies and their insured depository institutions to exclude certain amounts paid by nonbanks on centrally cleared derivatives when calculating their SLR. The bill's provisions could reduce the capital that those institutions must hold relative to their assets. Changes in the amount of capital that a bank holds can affect its probability of failure, which in turn may affect costs incurred by the DIF and the OLF.[3] The net effect of implementing the bill would vary among eligible institutions because the SLR is only one measure used by federal regulators to determine how much capital a bank must hold.

The effects of the bill on bank holding companies that would be resolved by the OLF and on insured depository institutions that would be resolved by the DIF are different because of the different regulatory requirements for how much capital those entities must hold relative to their assets. Based on publicly available information about the current components of bank balance sheets, CBO expects that the total capital of the 10 bank holding companies affected by the bill could decrease by about two-tenths of one percent and that their associated insured depository institutions could reduce capital by less than three-quarters of one percent using the loss and failure rates that underlie CBO's April 2018 baseline projections for the FDIC. CBO used the estimates of the decreases in capital to calculate the additional cost to the government for resolving the affected financial institutions. As a result, CBO estimates that enacting H.R. 4659 would increase deficits by $44 million over the 2019-2028 period; that amount comprises an increase in direct spending of $46 million and an increase in revenues of $2 million.

UNCERTAINTY

CBO endeavors to develop estimates that are in the middle of the distribution of potential budgetary outcomes. In this case, budget projections are uncertain because future decisions by banks and market participants are unknown. Specifically the reduction in capital that banks hold (if any) in response to H.R. 4659 could be different than CBO has estimated. In addition, how any reduction in bank capital might increase federal costs in the event of a bank failure is also uncertain. Finally, CBO's estimates under current law are themselves uncertain because changes in the underlying economy could have a significant effect on bank health and bank failure rates. CBO's current law baseline includes a small chance, in every year, that the economy could experience a downturn that affects the banking sector.

3. The academic literature suggests that a 1 percent decrease in the capital-to-assets ratio for a bank can increase the probability of failure by between 5 percent and 60 percent. CBO used a midpoint of that range for this estimate.

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 were shown in the table on page 2.

INCREASE IN LONG-TERM DIRECT SPENDING AND DEFICITS

CBO estimates that enacting H.R. 4659 would not increase net direct spending by more than $2.5 billion or on-budget deficits by more than $5 billion in any of the four consecutive 10-year periods beginning in 2029.

MANDATES

H.R. 4659 contains no intergovernmental mandates as defined in UMRA. Additional fees imposed by the FDIC and the OCC would increase the cost of an existing mandate on private entities required to pay those assessments. However, CBO estimates that the incremental cost of the mandate would fall well below the annual threshold established in UMRA for private-sector mandates ($160 million in 2018, adjusted for inflation).

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