CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

February 23, 2018

H.R. 2121

Pension, Endowment, and Mutual Fund Access to Banking Act

As ordered reported by the House Committee on Financial Services on October 12, 2017

SUMMARY

H.R. 2121 would adjust the calculation of a financial ratio called the supplementary leverage ratio (SLR), for certain banks that engage predominately in banking activities that the bill defines as custody, safekeeping, and asset serving.[1] The bill would permit certain large financial institutions to omit cash balances held at the Federal Reserve and other central banks from their SLR calculations. Currently, all assets must be included in the denominator of that ratio.

CBO estimates that enacting H.R. 2121 would increase deficits by $45 million over the 2018-2027 period. That amount includes a net increase in direct spending of $50 million and an increase in revenues of $5 million. Most of those costs would be recovered from financial institutions in years after 2027. Because enacting the bill would affect direct spending and revenues, pay-as-you-go procedures apply.

CBO estimates that enacting H.R. 2121 would not increase net direct spending or on-budget deficits by more than $2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

H.R. 2121 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

If the Federal Deposit Insurance Corporation (FDIC) increases fees to offset some of the costs of implementing the bill, H.R. 2121 would increase the cost of an existing mandate on the depository and large financial institutions that are required to pay those fees. Using information from the affected agencies, CBO estimates that the incremental cost of the mandate would fall well below the annual threshold for private-sector mandates established in UMRA ($156 million in 2017, adjusted annually for inflation).

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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. 2121 is shown in the following table. The costs of this 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	2018-2022	2018-2027
INCREASES IN DIRECT SPENDING												
Estimated Budget Authority	0	3	5	7	7	6	6	5	5	6	22	50
Estimated Outlays	0	3	5	7	7	6	6	5	5	6	22	50
INCREASES IN REVENUES												
Estimated Revenues	0	0	0	0	0	1	1	1	1	1	0	5
NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES												
Effect on the Deficit	0	3	5	7	7	5	5	4	4	5	22	45

BASIS OF ESTIMATE

The budgetary effects of H.R. 2121 stem from a small increase in the chance that the FDIC would incur additional costs to resolve failed financial institutions, because of the change in the SLR, which could reduce the amount of capital that a few banks hold. For this estimate, CBO assumes that the bill will be enacted late in 2018.

CBO's estimate for H.R. 2121 is based on the analysis that underlies projections for deposit insurance in its June 2017 baseline. Those projections incorporate the small probability of a financial crisis in any given year within the projection period and the more likely scenario of an average number of bank and credit union failures in any given year. As a result, the estimated cost of this legislation represents a weighted probability of outcomes—including some cases for which the probability is very low but for which the costs to the Deposit Insurance Fund (DIF) or the Orderly Liquidation Fund (OLF) are much larger. Both of those funds are administered by the FDIC.[2]

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

CBO estimates that the bill would effectively allow up to five large financial institutions to omit their cash balances held at the Federal Reserve and other central banks when calculating the SLR. The bill's provisions could reduce the capital that those institutions must hold relative to their assets. 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 net budgetary effects of implementing the bill also would be different for the DIF and the OLF.

The number of financial institutions and the amount of assets that could be affected depend on how the federal financial regulators implement the bill. Specifically, H.R. 2121 stipulates that the change in the calculation of the SLR would apply to banks that are "predominately" in the business of custody services.[3] CBO expects that the three traditional custody banks in the United States—Bank of New York, State Street, and Northern Trust—would clearly qualify for the SLR adjustments authorized by the bill. Their combined assets were about $720 billion in 2017. CBO estimates that regulators also may determine that other institutions would be eligible for the SLR adjustment if the value of their custodial activities is similar to that of the three traditional custody banks. For this estimate, CBO assumes that there is a 50 percent chance that regulators would allow two other financial institutions—JP Morgan and Citibank, with combined assets of $4.4 trillion—to adjust their SLRs under the terms in the bill.[4]

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.[5] Costs to the DIF would stem primarily from decreases in capital at JP Morgan and Citibank because the three traditional custody banks hold few insured deposits. In contrast, costs to the OLF would stem primarily from decreases in capital at the three traditional custody banks.

Based on publicly available information about the components of bank balance sheets and on the loss and failure rate estimates that underlie CBO's June 2017 baseline projections, CBO estimates that over the 2018-2027 period, implementing the bill would increase the deficit by $45 million, or by roughly 0.05 percent of the June baseline projection for FDIC programs. That amount includes an increase in direct spending of $50 million and an increase of revenues of $5 million. CBO estimates that most of the costs would be offset after 2027 by an increase in fees paid by financial institutions.

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3. Custody services include holding and servicing assets on behalf of other clients. Custody services often are provided to large institutional investors and private wealth clients and include the settlement, holding, and reporting of customers' marketable securities and cash.

4. See The Clearing House, *The Custody Services of Banks* (July 2016), page 16, http://tinyurl.com/yat2wep7.

5. 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 are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 2121, the Pension, Endowment, and Mutual Fund Access to Banking Act, as ordered reported by the House Committee on Financial Services on October 12, 2017

	By Fiscal Year, in Millions of Dollars											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-2022	2018-2027
NET INCREASE IN THE DEFICIT												
Statutory Pay-As-You-Go Impact	0	3	5	7	7	5	5	4	4	5	22	45
Memorandum:												
Changes in Outlays	0	3	5	7	7	6	6	5	5	6	22	50
Changes in Revenues	0	0	0	0	0	1	1	1	1	1	0	5

INCREASE IN LONG-TERM DIRECT SPENDING AND DEFICITS

CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits by more than $2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

MANDATES

H.R. 2121 contains no intergovernmental mandates as defined in UMRA.

If the FDIC increases premiums or fees to offset the costs of implementing the bill, H.R. 2121 would increase the cost of an existing mandate on the depository and large financial institutions required to pay those fees. Using information from the agencies, CBO estimates that the incremental cost of the mandate would be below the annual threshold for private-sector mandates established in UMRA ($156 million in 2017, adjusted annually for inflation).

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