CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 4, 2018

H.R. 5749
Options Markets Stability Act

As passed by the House of Representatives on July 10, 2018

SUMMARY

H.R. 5749 would direct federal financial regulators to change the calculation of the amount of capital that must be held by banking institutions to cover potential financial risks associated with certain derivative contracts. CBO estimates that enacting H.R. 5749 would increase deficits by $14 million over the 2018-2028 period. That amount includes a net increase in direct spending of $18 million and an increase in revenues of $4 million. Most of the cost would be recovered from financial institutions in years after 2028.

Because enacting the legislation would affect direct spending and revenues, pay-as-you-go-procedures apply.

CBO estimates that enacting H.R. 5749 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. 5749 contains no intergovernmental mandates as defined in the Unfunded Mandate Reform Act (UMRA). The act would impose a private-sector mandate as defined in UMRA. If financial regulators increased fees to offset some of the costs of implementing the act, H.R. 5749 would increase the cost of an existing mandate on private entities required to pay those fees. CBO estimates that the cost of the mandate would be small and below the annual private-sector threshold established in UMRA ($160 million in 2018, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 5749 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	2	2	3	2	2	2	2	2	8	18
Estimated Outlays	0	*	1	2	2	3	2	2	2	2	2	8	18
INCREASES OR DECREASES IN REVENUES													
Estimated Revenues	0	*	*	*	*	*	*	1	1	1	1	*	4
NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES													
Increase in the Deficit	0	*	1	2	2	3	2	1	1	1	1	8	14

Components do not sum to totals because of rounding.

* = between -$500,000 and $500,000.

BASIS OF ESTIMATE

The budgetary effects of H.R. 5749 stem from a small increase in the probability that the Federal Deposit Insurance Corporation (FDIC) would incur additional costs to resolve failed financial institutions. Under the act, the federal banking regulators would be required to change the calculation of the risk associated with centrally cleared derivatives held for certain clients, which would reduce the amount of capital held by large financial institutions. For this estimate, CBO assumes that H.R. 5749 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 likelihood 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.[1] In CBO's view, federal regulations that require banks to maintain certain levels of capital and liquidity lower the FDIC's costs for resolving failed financial institutions because they increase the proportion of losses that would be absorbed by shareholders and other creditors.

1. 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.

Costs to Resolve Failures of Financial Institutions

Under current law, federal financial regulators periodically update guidelines for calculating the amount of capital that financial institutions must hold to absorb possible future losses. For example, federal regulators often revise standards in response to recommendations by the Basel Committee on Banking Supervision, which has proposed alternative methods for calculating risks associated with centrally cleared derivatives held on behalf of certain clients.[2] Enacting H.R. 5749 would make certain that such federal regulations are revised in a manner that would reduce the capital that institutions must hold relative to their assets. Changes in the amount of capital held by a financial institution can affect its net losses in the event of a failure, which in turn may affect costs incurred by the OLF and the DIF.[3]

Using publicly available information about the current components of bank balance sheets and their derivative-related activities, CBO estimates that under H.R. 5749 the total capital held by globally significant financial institutions could decrease by about 10 basis points (a basis point is 1 one-hundredth of a percentage point, or 0.01 percent). That estimate reflects CBO's expectation that there is a 50 percent chance that regulators would make similar changes to capital requirements under current law and that those changes would reduce by about one-third the amount of capital required to be held for the affected transactions.

CBO expects that implementing H.R. 5749 would have no significant net effect on the total capital held by insured depository institutions. CBO used the estimates of the decreases in capital to calculate the additional cost to the government for resolving the failure of financial institutions through the OLF. As a result, CBO estimates that enacting H.R. 5749 would increase deficits by $14 million over the 2019-2028 period; that amount constitutes an increase in direct spending of $18 million and an increase in revenues of $4 million.

Administrative Costs to the Federal Financial Regulators

Enacting H.R. 5749 would require the federal financial regulators to complete rulemaking regarding the methods used for calculating the risks associated with centrally cleared derivatives held on behalf of certain clients. Costs incurred by the FDIC and the Office of the Comptroller of the Currency (OCC) are recorded in the budget as increases

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2. See, for example, Duncan Wood, "Fed, Goldman: Wide Use of SA-CCR Creates Problems," *Risk.Net* (April 30, 2018), http://tinyurl.com/ya96gs95.

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's estimate of the budgetary effects of a decrease in capital for the types of financial institutions that may be resolved through the OLF is equivalent to a change at the low end of that range.

in direct spending, but those agencies are authorized to collect premiums and fees from the financial institutions that they regulate to cover administrative expenses. Thus, CBO estimates that enacting H.R. 5749 would not have a significant net effect on direct spending over the 2019-2028 period. Costs incurred by the Federal Reserve System for the same purpose would reduce remittances to the Treasury, which are recorded in the budget as revenues. CBO estimates that enacting H.R. 5749 would decrease revenues for administrative expenses by less than $500,000 over the 2019-2028 period.

UNCERTAINTY

CBO works to develop estimates that are in the middle of the distribution of potential budgetary outcomes. In the case of H.R. 5749, budget projections are uncertain because future decisions by banks and market participants are unknown. Specifically, the reduction in capital (if any) that is held by financial institutions in response to the legislation could differ from CBO’s estimate. The probability that the regulators will modify capital requirements under current law may be more or less than 50 percent. In addition, how any reduction in capital held by financial institutions might increase federal costs in the event of a 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 failure rates. CBO’s current-law baseline includes a small chance, in every year, that the economy could experience a downturn that affects the financial sector.

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. 5749 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. 5749 would impose a private-sector mandate as defined in UMRA. If the Federal Reserve, the FDIC, or the OCC increased fees to offset the costs of the required rulemaking, H.R. 5749 would increase the cost of an existing mandate on private entities required to pay those fees. CBO estimates that the increase would amount to $3 million, which would fall well below the annual threshold for private-sector mandates established in UMRA ($160 million in 2018, adjusted annually for inflation).

H.R. 5749 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATE PREPARED BY

Federal Costs: Kathleen Gramp and Sarah Puro
Mandates: Rachel Austin

ESTIMATE REVIEWED BY

Kim P. Cawley
Chief, Natural Resources Cost Estimating Unit

Susan Willie
Chief, Mandates Unit

H. Samuel Papenfuss
Deputy Assistant Director for Budget Analysis

Theresa Gullo
Assistant Director for Budget Analysis