# CONGRESSIONAL BUDGET OFFICE
# COST ESTIMATE

February 21, 2018

## H.R. 4296
## A bill to place requirements on operational risk capital requirements for banking organizations established by an appropriate Federal banking agency

*As ordered reported by the House Committee on Financial Services on November 15, 2017*

## SUMMARY


H.R. 4296 would direct federal banking regulators to revise one of the formulas used to calculate the minimum amount of capital held by certain large, systemically important banks. Specifically, the bill would change the method banks use to estimate operating risk—the risk of losses stemming from inadequate or failed internal controls, fraud or errors caused by people and systems, or external events such as cyberattacks. Regulators currently require banks to estimate operating risk based in part on historical experience. Under the bill, such risk would be calculated largely on the basis of forward-looking models that reflect each bank's business activities.

CBO estimates that enacting H.R. 4296 would increase the deficit by $22 million over the 2018-2027 period. That figure includes an increase of $26 million in direct spending and an increase of $4 million in revenues. Because enacting the bill would affect direct spending and revenues, pay-as-you-go procedures apply.

CBO estimates that enacting H.R. 4296 would not increase net direct spending or on-budget deficits by more than $2.5 billion in one or more of the four consecutive 10-year periods beginning in 2028.

H.R. 4296 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).


## ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 4296 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 | 2018-2022 | 2018-2027 |
| **INCREASES IN DIRECT SPENDING** | | | | | | | | | | | | |
| Estimated Budget Authority | 0 | 1 | 2 | 3 | 4 | 4 | 3 | 3 | 3 | 3 | 10 | 26 |
| Estimated Outlays | 0 | 1 | 2 | 3 | 4 | 4 | 3 | 3 | 3 | 3 | 10 | 26 |
| **INCREASES IN REVENUES** | | | | | | | | | | | | |
| Estimated Revenues | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 0 | 4 |
| **NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES** | | | | | | | | | | | | |
| Effect on the Deficit | 0 | 1 | 2 | 3 | 4 | 4 | 2 | 2 | 2 | 2 | 10 | 22 |

## BASIS OF ESTIMATE

The budgetary effects of the bill stem from the small chance that the Federal Deposit Insurance Corporation (FDIC) would incur additional costs to resolve failed financial institutions. For this estimate, CBO assumes that the bill will be enacted near the end of 2018.

CBO's estimates for H.R. 4296 are based on the analysis underlying the projections for deposit insurance in its June 2017 baseline. Those projections incorporate a small probability of a financial crisis in any given year during 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 than in average years. Costs incurred by the DIF are recovered over time by assessments on insured depository institutions (IDIs). Fees paid to recover costs incurred by the OLF are classified in the budget as revenues. Both funds are administered by the FDIC.

CBO anticipates that the directives in H.R. 4296 would apply to around 10 bank holding companies and their insured depository subsidiaries that currently estimate capital requirements using what the FDIC refers to as advanced approaches. The net effect of implementing the bill would vary among those institutions because the measure that reflects operating risks is only one of many methods used by federal regulators to determine how much capital a bank must hold.[1] CBO estimates that in fiscal year 2017,

1. Regulators use several other methods of assessment, including information on a bank's standard measure of risk-weighted assets, a bank's assets adjusted for off-balance sheet activities, and the level of assets needed to absorb losses during times of stress.

the advanced-approaches formula was used to determine capital requirements for companies that accounted for about 20 percent of the assets held by bank holding companies subject to that standard and for about 5 percent of the assets held by IDIs.

Using studies by the Federal Reserve and others, CBO anticipates that changing to forward-looking models as required by H.R. 4296 probably would lower firm's estimates of their operating risks, thereby lowering the amount of capital they would be required to hold.[2] Although there is considerable uncertainty surrounding the magnitude of such changes, CBO expects that the net change would be limited to the difference in capital identified by the new method and that identified by existing regulatory formulas. On balance, CBO estimates that, relative to current practice, enacting the bill would reduce the total capital held by the all of the large bank holding companies by less than 2 percent and for the IDIs subject to the standard by less than 0.5 percent.

Changes in a bank's capital requirements may affect its probability of failure or the magnitude of future losses, which in turn may affect costs incurred by the DIF or the OLF. Most of the costs of enacting the legislation would be incurred by the OLF, CBO estimates, because enacting the bill would have a greater effect on the capital held by bank holding companies. (The OLF is authorized to resolve financial difficulties for large, systemically important financial firms that become insolvent or are in danger of becoming insolvent.) CBO estimates that enacting the bill would increase the deficit by $22 million, or by roughly 0.03 percent of CBO's June baseline projection of the 10-year cost of the FDIC's programs. That amount includes an increase in direct spending of $26 million and an increase of revenues of $4 million. CBO estimates that most of those costs would be offset after 2027 by increases in fees paid by financial firms.

## 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.

2. See Marco Migueis, *Forward-Looking and Incentive-Compatible Operational Risk Capital Framework*, Finance and Economics Discussion Series 2017-087 (Federal Reserve Board, May 2017), https://doi.org/10.17016/FEDS.2017.087 (PDF, 383 KB)

**CBO Estimate of Pay-As-You-Go Effects for H.R. 4296, as ordered reported by the House Committee on Financial Services on November 15, 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 ON-BUDGET DEFICIT** | | | | | | | | | | | | |
| Statutory Pay-As-You-Go Impact | 0 | 1 | 2 | 3 | 4 | 4 | 2 | 2 | 2 | 2 | 10 | 22 |
| **Memorandum:** | | | | | | | | | | | | |
| Changes in Outlays | 0 | 1 | 2 | 3 | 4 | 4 | 3 | 3 | 3 | 3 | 10 | 26 |
| Changes in Revenues | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 0 | 4 |

## 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. 4296 contains no intergovernmental or private-sector mandates as defined in UMRA.

## PREVIOUS CBO ESTIMATE

On May 18, 2017, CBO transmitted a cost estimate for H.R. 10, the Financial CHOICE Act, as ordered reported by the House Committee on Financial Services on May 4, 2017. H.R. 4296 is identical to section 152 of H.R. 10. The CBO cost estimates are different for this provision, however, because H.R. 10 also would eliminate the OLF. As a result, CBO's cost estimate for section 152 of H.R. 10 did not include any costs to the OLF.

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