CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 9, 2018

H.R. 4293
Stress Test Improvement Act of 2017

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

SUMMARY

Twice a year, large financial intuitions prepare reports for federal financial regulators regarding their ability to withstand financial stress. Under H.R. 4293 those institutions would prepare annual reports instead. The bill also would prohibit the Federal Reserve from using its qualitative assessment of a financial institution's ability to withstand financial stress as a basis for objecting to that institution's plan to draw down capital.

CBO estimates that enacting H.R. 4293 would increase the deficit by $14 million over the 2018-2027 period. That figure includes an increase in direct spending of $16 million and an increase in revenues of $2 million. Because enacting the bill would affect direct spending and revenues, pay-as-you-go procedures apply.

CBO estimates that enacting H.R. 4293 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. 4293 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. 4293 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											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-2022	2018-2027
INCREASES IN DIRECT SPENDING												
Estimated Budget Authority	0	1	1	2	2	2	2	2	2	2	6	16
Estimated Outlays	0	1	1	2	2	2	2	2	2	2	6	16
INCREASES IN REVENUES												
Estimated Revenues	0	0	0	0	0	0	0	0	1	1	0	2
NET INCREASE IN THE DEFICIT FROM INCREASES IN DIRECT SPENDING AND REVENUES												
Effect on the Deficit	0	1	1	2	2	2	2	2	1	1	6	14

BASIS OF ESTIMATE

The estimated budgetary effects of H.R. 4293 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 estimate for H.R. 4293 is based on the analysis underlying its projections for banking programs in its June 2017 baseline. Those projections incorporate the small probability of a financial crisis in each 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 represents a weighted probability of different outcomes for future failures of financial institutions. Some of those outcomes have a very low probability of occurring but if they do, the costs to the Deposit Insurance Fund (DIF) or the Orderly Liquidation Fund (OLF) are very large. Costs incurred by the DIF are recovered over time by assessments on insured depository institutions. Fees paid to recover costs incurred by the OLF are classified in the budget as revenues. Both of those funds are administered by the FDIC.

The estimated costs result from provisions that would prohibit the Federal Reserve from using its qualitative assessments of the ability of large banking intuitions to withstand financial stress as a basis for objecting to a financial institution's plan to draw down capital. According to the major private credit-rating agencies and other financial analysts, the Federal Reserve's quantitative and qualitative stress tests have improved the financial strength and resiliency of large banking institutions.[1] Companies typically resolve shortcomings identified by the tests by strengthening internal controls and reducing the portion of equity used for dividends and stock repurchases, which increases the capital held by the company.

Since 2013, only a few financial institutions have been cited for qualitative shortcomings, and most of those cases were resolved quickly. The actions required by the Federal Reserve were relatively minor, in part because those institutions were still recovering from the financial crisis.[2] Based on those actions of the Federal Reserve, CBO estimates that implementing H.R. 4293 would reduce the average amount of capital held by all large, systemically important banking institutions by less than 1 percent.

Changes in the amount of capital that a financial institution holds may affect both that institution's likelihood of failure and the costs incurred by the OLF or DIF to resolve failed assets. Most of the costs from enacting the legislation would primarily be incurred by the OLF. CBO estimates that implementing the bill would increase the deficit by $14 million, or by roughly 0.02 percent of that baseline's projection of the FDIC's programs over the next decade. That total consists of an increase in direct spending of $16 million and an increase of revenues of $2 million. CBO expects that most of the costs over the 2018-2027 period under the bill would be offset after 2027 by an increase in fees paid to the FDIC by financial institutions.

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.

---

1. See Office of Financial Research, *Capital Buffers and the Future of Bank Stress Test,* Brief 7-20 (February 2017), www.financialresearch.gov/briefs; Government Accountability Office, *Federal Reserve: Additional Actions Could Help Ensure the Achievement of Stress Test Goals*, GAO-17-49 (November 2016), www.gao.gov/products/GAO-17-48; and Moody's Investors Service, "Fed Stress Testing Has Strengthened Banks' Capital and Risk Management (June 21, 2016), http://tinyurl.com/yd7uhz7r.

2. Daniel K. Tarullo, Governor, Federal Reserve, "Next Steps in the Evolution of Stress Testing" (speech at the Yale University School of Management Leaders Forum, New Haven, Conn., September 26, 2016), https://go.usa.gov/xnJZc.

CBO Estimate of Pay-As-You-Go Effects for H.R. 4293, the Stress Test Improvement Act of 2017, 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 DEFICIT												
Statutory Pay-As-You-Go Impact	0	1	1	2	2	2	2	2	1	1	6	14
Memorandum:												
Changes in Outlays	0	1	1	2	2	2	2	2	2	2	6	16
Changes in Revenues	0	0	0	0	0	0	0	0	1	1	0	2

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. 4293 contains no intergovernmental or private-sector mandates as defined in UMRA.

ESTIMATE PREPARED BY

Federal Costs: Sarah Puro and Kathleen Gramp (for the FDIC) and Nathaniel Frentz (for the Federal Reserve)
Mandates: Rachel Austin

ESTIMATE APPROVED BY

H. Samuel Papenfuss
Deputy Assistant Director for Budget Analysis