CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 7, 2000

H.R. 1161
Financial Contract Netting Improvement Act of 2000

As ordered reported by the House Committee on Banking and Financial Services on July 27, 2000

SUMMARY

H.R. 1161 would amend banking and bankruptcy laws to provide consistent treatment of certain financial contracts and to encourage the settlement by a single payment, on a net basis, of all the contracted-but-not-yet-due claims and liabilities of an insolvent institution. The purpose of netting is to reduce the risks, especially the systemic risk associated with activities in derivatives markets, that the failure of one entity will disrupt and endanger financial markets. H.R. 1161 would affect direct spending, but CBO estimates that any such changes would be less than $500,000 annually.

H.R. 1161 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments. H.R. 1161 would impose a new private-sector mandate as defined in UMRA, but CBO estimates that the direct costs of the mandate would be below the annual threshold established by UMRA for private-sector mandates ($109 million in 2000, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

H.R. 1161 would require the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) to issue regulations to implement the provisions of the legislation. The OCC charges fees to cover all its administrative costs; therefore, additional spending by the OCC would have no net budgetary effect over time. That is not the case with the FDIC, however, which uses deposit insurance premiums paid by all banks to cover the expenses it incurs to supervise state-chartered banks. Because the balances in the deposit insurance funds exceed the levels required under current law, very few banks or savings and loans pay premiums for deposit insurance at this time. Therefore, CBO expects that the FDIC would recover from premium income very little, if any, of the administrative costs associated with implementing H.R. 1161. However, we do not expect these costs to be significant.

The bill would give the FDIC, acting as receiver for insolvent financial institutions, additional flexibility to determine the most appropriate method for resolving a failing bank or savings and loan. As a result, we expect that enacting H.R. 1161 could help reduce the losses associated with closing insured institutions. Although it is difficult to assess the amount of savings, if any, associated with the bill's clarification of the treatment of certain financial transactions affecting failing banks and savings and loans, CBO estimates that the net effect on FDIC outlays would probably be negligible.

Although enacting this bill could eliminate certain bankruptcy proceedings, CBO estimates that any reduction in workload would not have a significant impact on the budgets of the Executive Office for United States Trustees or the federal court system.

PAY-AS-YOU-GO CONSIDERATIONS

Under the Balanced Budget and Emergency Deficit Control Act, provisions providing funding necessary to meet the government's deposit insurance commitment are excluded from pay-as-you-go procedures. CBO believes that the administrative costs associated with the FDIC issuing regulations under H.R. 1161 are related to safety and soundness of deposit insurance, and thus, would be excluded. In any case, we estimate that those changes would be less than $500,000 annually.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 1161 contains no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

By requiring insured depository institutions to keep more detailed records for certain financial contracts, H.R. 1161 would impose a new private-sector mandate as defined by UMRA. CBO estimates that the cost of that mandate would not exceed the statutory threshold ($109 million in 2000, adjusted annually for inflation). Section 9 would authorize the Federal Deposit Insurance Corporation to prescribe additional recordkeeping requirements for certain qualified financial contracts (QFCs) held by depository institutions.

Under the Federal Deposit Insurance Act (FDIA), QFCs are defined for five types of financial contracts: securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements. FDIA provides special rules for the treatment of QFCs held by an insured depository institution in default for which the FDIC is appointed conservator or receiver. Upon appointment of the FDIC as receiver for an institution, parties to QFCs receive certain benefits and rights which are not available to parties to other types of contracts.

According to the FDIC, the principal purpose of a new recordkeeping rule under the bill would be to make certain information on QFCs readily available in the event that the FDIC is appointed as conservator or receiver of an insolvent institution. Under the bill (and in current practice), the FDIC would have the authority to transfer qualified financial contracts of an insolvent institution to another financial institution within 24 hours of being appointed as receiver. Other parties to the QFCs of the insolvent institution would not be able to terminate and net those contracts until the end of the 24-hour grace period. The FDIC does not expect that a recordkeeping rule under the bill would require institutions to collect new information. Rather, the FDIC anticipates that institutions would have to ensure that certain data that they already collect (and record) on QFCs are organized in a manner that would be accessible to the FDIC. Consequently, CBO expects that the direct costs of the mandate would not exceed the threshold established in UMRA.

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