CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 23, 2004

H.R. 2179
Securities Fraud Deterrence and Investor Restitution Act of 2004

As ordered reported by the House Committee on Financial Services on February 25, 2004

SUMMARY

H.R. 2179 would increase the maximum amount of civil penalties assessed for violating securities laws and regulations and would direct the Securities and Exchange Commission (SEC) to use such penalty collections to compensate victims of such violations. The SEC also would be authorized to use those collections to compensate private debt collectors for collecting such penalties and could spend any remaining penalty collections on investor education programs. Finally, the bill would direct the SEC to make several amendments and updates to securities laws pertaining to the investment industry.

CBO estimates that enacting S. 2179 would increase revenues by about $720 million in 2004, $15.1 billion over the 2004-2009 period, and $29.5 billion over the 2004-2014 period; it would increase direct spending by about $1 billion in 2004, $17 billion over the 2004-2009 period, and $33 billion over the 2004-2014 period. The net budgetary impact of the bill would be a decrease in the deficit of about $460 million in 2004, a net increase in deficits of $320 million over the 2004-2009 period, and a net increase in deficits of about $1.9 billion over the 2004-2014 period. Budget deficits would increase under H.R. 2179 because penalties currently being collected by the SEC (but unspent under current law) would be spent under the bill. Implementing the bill would not have a significant effect on spending subject to appropriation.

H.R. 2179 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the resulting costs would not be significant and would not exceed the threshold established in UMRA ($60 million in 2004, adjusted annually for inflation).

H.R. 2179 would impose private-sector mandates as defined in UMRA on certain companies, associations, and individuals involved in the securities industry. Based on information

provided by industry and government sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates ($120 million in 2004, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2179 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Billions of Dollars										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
CHANGES IN REVENUES											
Estimated Revenues	0.7	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
CHANGES IN DIRECT SPENDING											
Estimated Budget Authority	1.0	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Estimated Outlays	0.3	2.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
CHANGES IN DEFICITS											
Estimated Net Increase in the Deficits	-0.5	-0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3

NOTE: Components may not sum to totals because of rounding.

BASIS OF ESTIMATE

CBO estimates that S. 2179 would increase the annual level of penalties imposed by the SEC approximately tenfold. The bill would authorize the SEC to spend all penalties collected under current law—as well as the new higher collections generated by the bill. Thus the net budgetary impact of the bill would be the spending of amounts collected under the current penalty structure. Under current law, these amounts are deposited in the Treasury and are not available for spending.

CBO estimates that the net budgetary impact of the bill would be a decrease in the deficit of about $460 million in 2004, a net increase in deficits of $320 million over the 2004-2009 period, and a net increase in deficits of about $1.9 billion over the 2004-2014 period.

Revenues

Section 3 would increase maximum civil penalties for violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. Such violations include insider trading and fraud and deceit in the offer, purchase, or sale of securities. According to the SEC, collections of such penalties were about $250 million in 2003 and about $230 million for the first half of 2004. The bill would increase the maximum penalty by roughly tenfold, depending on the severity of the violation. For example, the maximum penalty for violations of the Securities Act of 1933 for individuals would increase from $100,000 to $1 million.

Based on information regarding collections in 2003 and 2004 provided by the SEC, CBO estimates that enacting S. 2179 would increase revenues by about $720 million in 2004, $15.1 billion over the 2004-2008 period, and $29.5 billion over the 2004-2014 period. This estimate does not assume any significant decline in the number of violations. The increase in collections could be much higher or lower considering that the amount of penalties varies widely from year to year.

Direct Spending

Section 8 of the S. 2179 would direct the SEC to place all civil penalties it collects into disgorgement funds to compensate victims of violations of securities laws and regulations. If the victim of a violation cannot be identified or located, or the amounts remaining are too small to merit distribution, the SEC could request that the penalty collections be used to fund investor education programs administered by a nonprofit or government organization. In addition, section 7 of the bill would authorize the SEC to contract with private firms to collect penalties assessed for violations of securities laws and regulations and to compensate the private firms using the amounts they recover. Under current law, the SEC is not authorized to spend penalty collections.

Based on information provided by the SEC, CBO estimates that enacting S. 2179 would increase direct spending for compensating victims, funding investor education, and compensating private debt collectors by more than the increase in penalty amounts that would occur under the bill. CBO estimates that spending would increase under the bill by about $1 billion in 2004, $17 billion over the 2004-2009 period, and $33 billion over the 2004-2014 period. The increase in spending could be much higher or lower considering that the amount of penalties collected varies widely from year to year.

Spending Subject to Appropriation

Reviews of Financial Statements. Section 14 would require the SEC to review the most recent financial statements disclosed by the largest 250 reporting issuers. According to the SEC, the agency is already in the process of conducting financial reviews for several issuers and would not require significant additional resources to complete the review required by section 14. Therefore, CBO estimates that implementing this provision would not have a significant effect on spending subject to appropriation.

Investment Industry Regulations. Several provisions in S. 2179 would make changes to regulations involving the investment industry. In particular, the bill would affect rules with regard to mutual fund management, disclosure of potential conflicts of interest by financial professionals, and accessibility of information about registered securities associations. Based on information provided by the SEC, CBO estimates that implementing those changes would not have a significant effect on spending subject to appropriation.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

Section 2 would preempt laws in almost all states by allowing properties otherwise covered by homestead provisions to be seized by federal securities authorities. (Generally, state homestead exemptions protect a certain amount of property from seizure during a bankruptcy or other proceeding.) That preemption constitutes a mandate as defined in UMRA. Although states may incur some costs due to this provision, CBO estimates that such costs would fall significantly below the threshold established in UMRA ($60 million in 2004, adjusted annually for inflation) because most homestead exemptions protect very limited assets. Any costs incurred by states for participating in the federal and state cooperation study established in section 8 or contributing to the relief of victims fund would be voluntary.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 2179 would impose private-sector mandates as defined in UMRA on certain companies, associations, and individuals involved in the securities industry. Based on information provided by industry and government sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates ($120 million in 2004, adjusted annually for inflation).

Prohibition of Certain Distribution and Marketing Fees

Under current law, the Securities and Exchange Commission rule 12b-1 allows mutual funds to assess fees on shareholders for fund marketing, distribution, and certain other costs. The bill would prohibit mutual fund companies from charging any fees under rule 12b-1, except fees for shareholder servicing activities, on mutual funds that are closed to new investors. Based on information from industry experts and government sources, CBO interprets the language of that provision to mean that while marketing and distribution fees would be prohibited, other fees could still be charged, although not under SEC rule 12b-1. According to information from industry and government sources, about 150 mutual funds are closed to new investors, and such funds charge approximately $10 million to $15 million per year in marketing and distribution fees under rule 12b-1. The direct cost of the mandate would be the loss of those fees less the administrative cost to collect them. The cost of the mandate could be significantly higher, however, if the SEC interprets the language differently and prohibits funds from collecting other fees currently collected under rule 12b-1 in promulgating the rules and regulations for this provision.

Access to Information and Corporate Governance

The bill would impose other private-sector mandates regarding additional disclosures, consumer information, and corporate governance. Based on information from industry and government sources, CBO estimates that the direct cost to comply with those mandates would be small. Those mandates would:

- Prohibit companies and individuals from disclosing in certain instances that financial records have been requested by the SEC;
- Require investment advisers and principal underwriters to disclose certain material information to the board of directors of a registered investment company when entering into or renewing a contract or agreement;
- Require a registered securities association to establish and maintain a readily accessible electronic or other process to respond to certain inquiries regarding brokers, including information about the registration and licensing of brokers, and disciplinary actions;
- Require investment advisers to pay fees to cover the cost of systems set up to respond to certain inquiries regarding investment advisers if such a system is established by the SEC; and

- Require the board of directors of a registered investment company to select a lead independent director, unless the chairman of the board is an independent director.

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