CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 7, 2014

H.R. 5421
Financial Institution Bankruptcy Act of 2014

As ordered reported by the House Committee on the Judiciary on September 10, 2014

H.R. 5421 would modify the bankruptcy process for certain large financial institutions. Pay-as-you-go procedures apply because enacting the legislation would lower the probability that such an institution would be liquidated by the federal government upon failure, potentially having a small effect on direct spending and revenues. However, CBO expects that failures handled through the bankruptcy code under the bill would not affect the net cash flows of the federal government under current law. Thus, we estimate that H.R. 5421 would have no significant effect on the budget, including discretionary spending, over the next 10 years.

Under current law, the federal government may place certain large and interconnected financial institutions, upon failure, into receivership of the Federal Deposit Insurance Corporation (FDIC). Similar to its historical role as receiver of commercial banks and thrifts, the FDIC may sell the failed institution's assets, merge it with a healthy institution, continue operations through a bridge company, or some combination thereof. Most likely, the receivership will require short-term (and in some cases long-term) financing to quell the liquidity and insolvency concerns that result in the institution's failure. Under current law, such funding is available through the Treasury. While this borrowing must be repaid in full, CBO believes that repayment generally will occur over multiple years. As such, CBO estimates that this authority (also known as Orderly Liquidation Authority, or OLA) will have no net budget effect over time, but will increase deficits in some years. CBO's most recent baseline projects that use of OLA will increase deficits by about $19 billion over the 2015-2024 period. (This projection assumes a low probability that OLA will be triggered in each year. Actual cash flows will be zero in most years and much higher in years when OLA is used.)

H.R. 5421 would establish a separate bankruptcy process for bank holding companies and certain large financial institutions. This process would differ from current law in several ways. First, the court would have the authority to transfer certain property, contracts, and leases of the estate to a bridge company, if necessary to prevent serious adverse effects on the financial stability of the United States (That property could not include unsecured debt or equity, which instead would remain with the estate.) The legislation also would allow for a temporary stay of certain contractual rights tied to the financial condition of the failed institution—for example, collection of collateral, acceleration of debt, or close-out netting of derivatives. Similarly, other leases, contracts, licenses, permits, or registration could not be modified or terminated upon failure, instead transferring to the bridge company.

CBO believes that the changes made by H.R. 5421 would establish a viable alternative to the use of OLA in some circumstances and would increase the probability that a failure would be handled through the bankruptcy code rather than by the FDIC, causing a small change in the FDIC's workload. However, those circumstances are likely to occur when the use of OLA under current law would have generated little to no federal cash flows—for example, the failure of a single entity during a relatively stable economy. More severe situations requiring significant capital or liquidity to proceed probably would continue to be handled by the FDIC under the bill because private debtor-in-possession financing would be difficult to obtain, particularly during economic contractions. Because we expect H.R. 5421 to only affect failures that would otherwise have no budgetary impact under current law, CBO estimates that enacting this legislation would have no significant effect on the federal budget.

H.R. 5421 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

H.R. 5421 would impose a private-sector mandate, as defined in UMRA, on entities that have certain types of contracts with a bank holding company or a large financial institution that has entered the bankruptcy process established under the bill. The bill would limit the contractual rights that those entities have under current law by imposing a temporary stay on actions to terminate or modify such contracts for 48 hours after a bankruptcy petition is filed. The cost of the mandate would amount to any losses sustained by such parties as result of the stay. Because of uncertainty about both the number and size of contracts that would be affected and the amount of losses that would occur as a result of this provision, CBO cannot determine whether the cost of the mandate would exceed the annual threshold established in UMRA for private-sector mandates ($152 million in 2014, adjusted annually for inflation).

The CBO staff contacts for this estimate are Daniel Hoople (for federal costs) and Paige Piper-Bach (for the private-sector impact). The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.