CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 3, 2009

H.R. 3795
Over-the-Counter Derivatives Markets Act of 2009

As ordered reported by the House Committee on Financial Services on October 15, 2009

SUMMARY

H.R. 3795 would require certain derivatives transactions to take place on registered exchanges and would place new registration and reporting requirements on entities that trade in or facilitate those transactions. (Derivatives are financial instruments whose values are derived from the value of other assets.) The bill would broaden the authority of the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to regulate entities and activities related to those derivative transactions. H.R. 3795 also would require information regarding transactions in derivatives to be made available to the public.

CBO estimates that implementing the provisions of H.R. 3795 would cost $872 million over the 2010-2014 period, assuming appropriation of the necessary amounts. Enacting H.R. 3795 could affect revenues because of provisions that would affect the regulation of banks by the Federal Reserve and other agencies that regulate banks, but CBO estimates that any such impacts would not be significant. Further, enacting the bill could increase both revenues and direct spending because additional criminal and civil penalties could be imposed for violations of new regulations. CBO expects that any net increases would not be significant because of the small number of violations that would probably occur.

H.R. 3795 would impose intergovernmental and private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), on participants in certain financial markets. Because the costs of complying with some of the mandates would depend on the regulations to be established under the bill, CBO cannot determine whether the aggregate costs of the mandates would exceed the annual thresholds established in UMRA ($69 million for intergovernmental mandates and $139 million for private-sector mandates in 2009, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3795 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					
	2010	2011	2012	2013	2014	2010-2014
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Estimated Authorization Level	54	175	222	225	226	902
Estimated Outlays	40	166	216	224	226	872

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted early in 2010, that the necessary amounts will be appropriated each year, and that spending will follow historical patterns for the activities of CFTC and SEC.

Spending Subject to Appropriation

H.R. 3795 would authorize the CFTC and SEC to regulate entities that trade in or assist the trading of over-the-counter (OTC) derivative instruments, including swaps (contracts that call for an exchange of cash between two participants based on an underlying rate or index, or the performance of an asset.) Under the bill, the CFTC, the SEC, and the banking regulators—the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC)—would be required to develop uniform rules to implement the bill's new requirements.

H.R. 3795 would require swap dealers and certain other participants in swap transactions to register with either the CFTC or the SEC (depending on the nature of the investment underlying the swap) and to comply with new rules related to recordkeeping, reporting, and operating standards designed to protect investors.

Other provisions of the bill would:

- Require the parties to certain swaps to enter into the transaction on a regulated exchange;

- Require certain swap transactions to be settled and cleared through registered clearing organizations;

- Require the CFTC (or its designee) to make aggregated information about swap trading volumes available to the public; and

- Authorize the CFTC and the SEC to establish limits on certain transactions to diminish or prevent excessive speculation and market manipulation.

Based on information from the CFTC, CBO estimates that the agency would add 235 employees by fiscal year 2011 to write regulations and undertake the additional oversight and enforcement activities required by the bill (about a 40 percent increase in staffing levels). In fiscal year 2009, the agency received an appropriation of $146 million for a staff of about 580 employees. Similarly, based on information from the SEC, CBO estimates that the agency would add 450 employees by fiscal year 2011 to undertake similar activities with respect to entities under its jurisdiction (a 12.5 percent increase over current staffing levels). In fiscal year 2009, the SEC received a gross appropriation of $894 million for a staff of about 3,600 employees.

Assuming appropriation of the necessary amounts, CBO estimates that implementing H.R. 3795 would increase spending by $872 million over the 2010-2014 period ($291 million for the CFTC and $581 million for the SEC). That amount would cover the cost of salaries and benefits, overhead, reports, and upgrades to information technology systems.

Offsetting Collections

Under current law, the SEC is authorized to collect fees to register and trade securities; those fees offset amounts appropriated to the agency. Based on information from the SEC, CBO estimates that implementing H.R. 3795 would not have a significant effect on the amount of those collections.

Under current law, the SEC charges a fee on the transactions executed on securities exchanges regulated under the Securities Exchange Act of 1934. H.R. 3795 would establish new exchanges where CBO expects most, if not all, of the swap transactions that would fall under the SEC's jurisdiction would be executed. While the SEC would have regulatory authority over those new exchanges, according to the agency, swap transactions on those exchanges would probably not be subject to the transaction fee provisions of the Securities Exchange Act. Thus, CBO estimates that implementing H.R. 3795 would not significantly affect SEC collections of transaction fees.

In addition, the SEC charges a fee to register securities that are traded on securities exchanges. Based on information from the SEC, CBO expects that the agency would treat swaps similar to options that are currently traded on national securities exchanges, which are not charged registration fees by the agency. CBO therefore estimates that implementing H.R. 3795 would not affect collections of SEC registration fees.

Direct Spending and Revenues

Under H.R. 3795, three federal bank regulators—the Federal Reserve, the OCC, and the FDIC—would be responsible for ensuring that banks that act as dealers or participants in swap transactions comply with the provisions in the bill. Based on information from the affected agencies, CBO estimates that the OCC would spend about $4 million a year to implement this bill and would increase fees by a corresponding amount to offset those costs. By contrast, we estimate that enacting the legislation would have a negligible effect on the operations of the FDIC because relatively few of the institutions under its supervision engage in swap transactions. Any increase in FDIC spending would be recovered through insurance premiums paid by insured depository institutions. Thus, CBO estimates that the activities of the OCC and FDIC would have no significant net effect on direct spending over the 2010-2019 period.

Net spending by the Federal Reserve is recorded in the federal budget as a change in revenue. Based on information from the Federal Reserve, CBO expects that the regulatory activities would have no significant effect on the Federal Reserve's workload or budget and thus would have no significant impact on the federal budget.

Enacting H.R. 3795 also could affect both revenues and direct spending because additional criminal and civil penalties could be imposed for violations of new regulations, but we expect that any such increases would not be significant because of the relatively small number of violations likely to occur.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 3795 would impose intergovernmental and private-sector mandates, as defined in UMRA, on participants in swap markets. Because the costs of the mandates would depend on future regulatory actions, CBO cannot determine whether the aggregate costs of complying with them would exceed the annual thresholds established in UMRA ($69 million for intergovernmental mandates and $139 million for private-sector mandates in 2009, adjusted annually for inflation).

Mandates that Apply to Both Public and Private Entities

The bill would impose several requirements on public and private entities such as pension funds, swap dealers, and other participants in swap markets. Specifically, the bill would require participants in swap transactions to clear and trade them on an exchange or through a swap execution facility if possible. If not possible, participants in swap transactions would be required to report information to a repository or to the CFTC. The bill would impose limits on the value of swaps that can be held by an entity (known as "position limits").

Because CBO has limited information about the transactions in the affected markets, the regulations to be established by the CFTC and SEC, and the extent to which those regulations would affect market returns or increase the exposure to risk, we have no basis for estimating the cost of the mandates on public or private-sector entities.

Mandates that Only Apply to Public Entities

Prohibition on investments by small public entities. The bill would impose a mandate on public entities that invest more than $25 million but less than $50 million by prohibiting them from entering into swaps with entities that are not federally regulated. Because CBO has limited information about the extent to which public entities enter into such arrangements, we have no basis for estimating the cost of complying with this mandate.

Preemption of state law. The bill also would preempt state laws that affect the offer, sale, or distribution of swaps. That preemption would be a mandate as defined in UMRA, but it would impose no duty on states that would result in additional spending.

Mandates that Only Apply to Private Entities

The bill would impose new requirements on derivatives clearing organizations (DCOs). In addition to registration requirements, DCOs would be required to designate a compliance officer to report to the CFTC regarding compliance with the provisions of this bill. To the extent that DCOs also act as swap execution facilities, they also would be required to monitor trading to prevent price manipulation and ensure compliance. In addition, to the extent that DCOs also act as swap repositories, they would be required to comply with data collection and maintenance standards prescribed by the CFTC and SEC. Based on information from the CFTC and the SEC, CBO estimates that the costs of complying with those mandates would be minimal.

PREVIOUS CBO ESTIMATE

On February 23, 2009, CBO transmitted an estimate for H.R. 977, the Derivatives Markets Transparency and Accountability Act of 2009, as ordered reported by the House Committee on Agriculture on February 12, 2009. H.R. 977 did not include language that broadened the authority of the Securities and Exchange Commission but included new authorities for the CFTC that are not included in H.R. 3795. The cost estimates reflect those differences.

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