CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 30, 2005

H.R. 3909
Hurricane Check Cashing Relief Act of 2005

As ordered reported by the House Committee on Financial Services on October 27, 2005

SUMMARY

H.R. 3909 would direct the Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA) to indemnify insured financial institutions for any losses resulting from certain uncollectible checks presented by individuals who resided in areas designated as disaster areas after August 25, 2005. This indemnification would apply to checks presented to those institutions from August 25, 2005, through November 15, 2005. Indemnification would be limited to $2,000 per individual. Under the bill, the Federal Reserve would be required to transfer up to $200 million from its surplus to cover the indemnification payments.

CBO estimates that enacting this bill would increase direct spending for indemnification payments by about $120 million over the 2006-2007 period. Those outlays would be initially offset by a transfer of $120 million from the Federal Reserve. Such transfers are recorded in the budget as an increase in revenues. However, monies transferred from the surplus of the Federal Reserve would no longer be invested in securities and would no longer earn interest that otherwise would be transferred to the Treasury—as the Federal Reserve routinely does each year. CBO estimates that the interest earnings forgone would reduce revenues by about $1 million in 2006, $3 million in 2007, and $6 million each year thereafter. Therefore, CBO estimates that net revenues over the 2006-2015 period would increase by $68 million. Thus, enacting this bill would result in a net increase in federal deficits of about $52 million over the 2006-2015 period, with additional revenue losses of about $6 million a year continuing indefinitely thereafter.

H.R. 3909 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the mandate would result in no costs to state, local, or tribal governments. Hence, the mandate would not have costs that exceed the threshold established in that act ($62 million in 2005, adjusted annually for inflation). H.R 3909 contains no new private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3909 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									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
CHANGES IN DIRECT SPENDING										
FDIC and NCUA										
Estimated Budget Authority	30	90	0	0	0	0	0	0	0	0
Estimated Outlays	30	90	0	0	0	0	0	0	0	0
CHANGES IN REVENUES										
Estimated Revenues	29	87	-6	-6	-6	-6	-6	-6	-6	-6

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted before the end of calendar year 2005. We assume that any insured institution in the country could seek reimbursement for uncollectible checks issued by individuals from areas in the states of Alabama, Florida, Louisiana, Mississippi, and Texas that have been declared eligible for any type of disaster assistance since August 25, 2005.

Direct Spending

The amounts paid to indemnify insured depository institutions and credit unions would depend on the volume of uncollectible checks submitted for reimbursement. CBO expects that requests for indemnification would equal the normal volume of uncollectible checks for the portion of the population covered by the bill, plus any extraordinary losses that may have occurred in the wake of Hurricanes Katrina, Rita, and Wilma. Based on industry surveys of check fraud, CBO estimates that indemnification payments could range from $40 million to $200 million, with a midpoint of about $120 million. Given the time needed to issue regulations and process requests, CBO assumes that most of the payments would be made in fiscal year 2007.

CBO expects that insured financial institutions would normally expect to lose about $40 million from bad checks issued over a three-month period from the affected areas. That estimate is based on a 2004 survey by the American Bankers Association on check fraud experienced by banks and savings associations (the data did not include credit unions). The study found that attempted check fraud totaled about $5.5 billion in 2003, but actual losses were less than $700 million (or 13 percent of the attempted fraud) because of various controls and detection measures. Prorating those losses by population—17 percent of the country's population resided in the areas covered by the bill—suggests that the normal level of annual losses for this group totaled about $120 million in 2003. Assuming losses occur evenly throughout the year, losses for a three-month period would have totaled about $30 million in 2003. Adjusting those figures to include credit unions and possible growth in the level of losses from 2003 through 2005 suggests that the normal losses covered by the bill would total about $40 million.

How Hurricane Katrina and other disasters affected the level of attempted fraud and institutions' ability to prevent it are very uncertain. So too is the effect of having a federal indemnification program, which could reduce institutions' incentives to investigate and prosecute check fraud. There are no data available at this time to determine whether costs would reach the $200 million limit in the bill for the Federal Reserve's coverage of agency costs; that amount is five times higher than CBO's estimate of normal losses but lower than CBO's estimate of the region's proportionate share of the routine level of attempted fraud (about $300 million, after adjusting for credit unions and possible growth in attempted fraud). Thus, the agencies' indemnification payments could reach the cap in the bill if there was a significant drop in institutions' ability to stem attempted fraud by individuals from the disaster areas over the designated period.

Revenues

This bill would direct the Federal Reserve banks to transfer up to $200 million from their surplus funds to the FDIC and NCUA to cover the indemnification payments for uncollectible checks or share drafts presented to them by insured banks or credit unions. Transfers from the Federal Reserve System to the Treasury are classified as revenues. Thus, anything that affects the size of the transfers affects federal revenues.

Such transfers originate with the net income of the Federal Reserve System. The Federal Reserve possesses a portfolio of assets that generates a large amount of interest income. Net income of the system represents the amount of the system's earnings less its expenses of operation. Out of its annual net income, the Federal Reserve pays a fixed dividend to its member banks, retains monies for its surplus fund, and voluntarily remits the remaining profits to the U.S. Treasury. The system's surplus fund is a stock of retained earnings accumulated over time and is set by the Federal Reserve each year at a level equal to the paid-in capital of its member banks. The surplus is invested in interest-earning assets and generates some of the income that is in turn remitted to the Treasury in subsequent years.

H.R. 3909 specifies that the amount to be remitted (to cover the indemnification payments) would be paid from the Federal Reserve surplus. The bill also would prohibit the Federal Reserve from replenishing its surplus. Thus, any remittances would be in addition to the amount that CBO has estimated as regular annual transfers of the Federal Reserve's net income to the U.S. Treasury, after payment of dividends and retention of monies for its surplus fund.

CBO estimates that the additional transfer under the bill would increase revenues by \$30 million in fiscal year 2006 and \$90 million in fiscal year 2007. However, the permanent reduction in the surplus of the Federal Reserve would lead to a decrease in investments of the Federal Reserve. This permanent decrease in investments would cause a drop in the investment income that is earned by the Federal Reserve and subsequently sent to the Treasury as revenues. CBO estimates that the revenues from the Federal Reserve would thereby be lowered by \$1 million in fiscal year 2006, \$3 million in 2007, and \$6 million each year thereafter. Thus, CBO estimates that these forgone interest earnings would total \$52 million over the 2006-2015 period, and an additional \$6 million a year after 2015.

Overall Impact for Revenue Transferred from the Federal Reserve Surplus

H.R. 3909's provisions for transferring the Federal Reserve surplus give the appearance of financing the additional outlays of the FDIC and NCUA. This initial outcome is attributable to the fact that the Federal Reserve is treated as a nongovernmental entity for budgetary purposes, with its transfers to the Treasury counted as revenues. The proposal would also reduce future Federal Reserve transfers to the Treasury by an amount equal to the interest earned on the initial \$120 million transfer. Over time, the reduction in these remissions would equal the value of the transfer to the FDIC and NCUA (in present value terms). But much of the loss of Federal Reserve payments occurs outside the budget window of 10 years so that the initial costs of the legislation appear to be partially paid for. In economic terms, however, H.R. 3909 does not provide any new resources to the federal government to pay for the outlays called for by the legislation.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3909 contains an intergovernmental mandate as defined in UMRA. Section 2(d)(1)(E) would preempt any state laws that restrict the ability of the FDIC and the NCUA to recover certain funds. CBO is unaware of any state that has such a law. We estimate that this mandate would result in no costs to state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

This bill contains no new private-sector mandates as defined in UMRA.

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