7. CREDIT AND INSURANCE

Federal credit and insurance programs are alternatives to direct spending programs as means of achieving a variety of policy objectives. Federal credit programs offer direct loans and loan guarantees to support a wide range of activities including housing, education, business and community development, and exports. At the end of 2006, there were $251 billion in Federal direct loans outstanding and $1,120 billion in loan guarantees. Through its insurance programs, the Federal Government insures bank, thrift, and credit union deposits, guarantees private defined-benefit pensions, and insures against other risks such as natural disasters.

The Federal Government also permits certain privately owned companies, called Government-Sponsored Enterprises (GSEs), to operate under Federal charters for the purpose of enhancing credit availability for targeted sectors. GSEs increase liquidity by guaranteeing and securitizing loans, as well as by providing direct loans. In return for advancing certain social goals and possibly improving economic efficiency, GSEs enjoy various special privileges, such as possible borrowing from Treasury at Treasury's discretion, exemption from State and local income taxation, and favorable regulatory treatments of their securities. These privileges may leave observers with the impression that GSE securities are risk-free. GSEs, however, are not part of the Federal Government, and GSE securities are not federally guaranteed. By law, GSE securities carry a disclaimer of any U.S. obligation.

This chapter discusses the roles of these diverse programs and assesses their effectiveness and efficiency.

- The first section emphasizes the roles of Federal credit and insurance programs in addressing market imperfections that may prevent the private market from efficiently providing credit and insurance. Federal programs are more useful where market imperfections remain serious even though the continued evolution and deepening of financial markets may have in part corrected many of the imperfections.
- The second section interprets the results of the Program Assessment Rating Tool (PART) for credit and insurance programs in relation to their distinguishing features.
- The third section discusses individual credit programs and GSEs intended to support four sectors: housing, education, business and community development, and exports. The discussion focuses on program objectives, recent developments, performance, and future plans for each program.
- In a similar format, the final section reviews Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks.

I. FEDERAL PROGRAMS IN CHANGING FINANCIAL MARKETS

The Federal Role

In most cases, private lending and insurance companies efficiently meet economic demands by allocating resources to their most productive uses. Market imperfections, however, can cause inadequate provision of credit or insurance in some sectors. Federal credit and insurance programs improve economic efficiency if they effectively fill the gaps created by market imperfections. On the other hand, Federal credit and insurance programs that do not effectively address market imperfections can be unnecessary, or can even be counter-productive—they may simply do what the private sector would have done in their absence, or interfere with what the private sector would have done better. Federal credit and insurance programs also help disadvantaged groups. This role alone, however, may not be enough to justify credit and insurance programs; to help disadvantaged groups, direct subsidies are generally more effective and less distortionary.

Relevant market imperfections include insufficient information, limited ability to secure resources, imperfect competition, and externalities. Although these imperfections can cause inefficiencies, the presence of a market imperfection does not mean that Government intervention will be always effective. To be effective, a credit or insurance program should be carefully designed to reduce inefficiencies in the targeted area without causing inefficiencies elsewhere.

Insufficient Information. Financial intermediaries may fail to allocate credit to the most deserving borrowers if there is little objective information about some of the borrowers. Some groups of borrowers, such as start-up businesses and some families, have limited incomes and credit histories. Many creditworthy borrowers belonging to these groups may fail to obtain credit or be forced to pay excessively high interest. For very irregular events, such as natural and man-made disasters, there may not be sufficient information to estimate the probability and magnitude of the loss. This pricing difficulty may prevent insurers from covering those risks at reasonable premiums.

Limited Ability to Secure Resources. The ability of private entities to absorb losses is more limited than that of the Federal Government, which has general taxing authority. For some events potentially involving a very large loss concentrated in a short time period, therefore, Government insurance commanding more resources can be more credible and effective. Such events include massive bank failures and some natural and man-made disasters that can threaten the solvency of private insurers.

Imperfect Competition. Competition can be imperfect in some markets because of barriers to entry or economies of scale. Imperfect competition may result in higher prices of credit and insurance in those markets.

Externalities. Decisions at the individual level are not socially optimal when individuals do not capture the full benefit (positive externalities) or bear the full cost (negative externalities) of their activities. Education, for example, generates positive externalities because the general public benefits from the high productivity and good citizenship of a well-educated person. Pollution, from which other people suffer, is clearly a negative externality. Without Government intervention, people will engage less than socially optimal in activities that generate positive externalities and more in activities that generate negative externalities.

Effects of Changing Financial Markets

Financial markets have become much more efficient through technological advances and financial services deregulation. By facilitating the gathering and processing of information and lowering transaction costs, technological advances have significantly contributed to improving the screening of credit and insurance applicants, enhancing liquidity, refining risk management, and spurring competition. Deregulation, represented by the Riegle-Neal Interstate Banking and Branching Act of 1997 and the Financial Services Modernization Act of 1999, has increased competition and prompted efficiency-improving consolidation by removing geographic and industry barriers.

These changes have reduced market imperfections. The private market now has more information and better technology to process it; it has better means to secure resources; and it is more competitive. As a result, the private market is more willing and able to serve a portion of the population traditionally targeted by Federal programs. The benefits of technological advances and deregulation, however, have been uneven across sectors and populations. To remain effective, therefore, Federal credit and insurance programs need to focus more narrowly on those sectors that have been less affected by financial evolution and those populations that still have difficulty in obtaining credit or insurance from private lenders. The Federal Government also needs to pay more attention to new challenges introduced by financial evolution and other economic developments. Even those changes that are beneficial overall often bring new risks and challenges.

The need for the Federal government to address the information problem has diminished steadily over the years. Nowadays, lenders and insurers have easy access to large databases, powerful computing devices, and sophisticated analytical models. This advancement in communication and information processing technology enables lenders to evaluate risk more objectively and accurately. Also, potential borrowers tend to have access to a much wider array of possible local, national, and global lenders. As a result, most borrowers can easily obtain credit at a fair interest rate reflecting their risk. The improvement, however, may be uneven across sectors. Credit scoring (an automated process that converts relevant borrower characteristics into a numerical score indicating creditworthiness), for example, is considered as a breakthrough in borrower screening. While credit scoring is widely applied to home mortgages and consumer loans, it is applied to a limited extent for small business loans and agricultural loans due to the difficulty of standardizing unique characteristics of small businesses and farmers. It is also possible that banking consolidation adversely affects those borrowers with unique characteristics; small, local banks could serve those borrowers better if they had more borrower-specific information gained through long-term relations. With technological advances such as computer simulation, pricing catastrophe risks has become easier, but it remains much more difficult than pricing more regular events such as automobile accidents. It is still difficult for insurers to estimate with confidence the probability of a major natural disaster occurring. The difficulty may be greater for man-made disasters that lack scientific bases.

Financial evolution has also improved private insurers' ability to deal with catastrophic losses. Using financial derivatives such as options, swaps, and futures, private entities can manage and share various types of risk such as price risk, interest rate risk, credit risk, and even catastrophe-related risk. An insurer can distribute the risk of a natural or man-made catastrophe among a large number of investors through catastrophe-related derivatives. However, the market for catastrophe-related derivatives is still small, and it has not eliminated the difficulty of absorbing catastrophic losses yet. To address this difficulty, reinsurance may be preferred to direct provision of insurance because it involves less intervention.

Imperfect competition is much less likely to justify Federal involvement than was the case only a few years ago due to financial deregulation and improved communication and financing technology. Financial deregulation removed geographic and industry barriers to competition. As a result, major financial holding companies offer both banking and insurance products nationwide. Internet-based financial services have further lowered the cost of financial transactions and reduced the importance of physical location. These developments have been especially beneficial to small and geographically isolated customers who could not afford to bear large transactions costs and otherwise had limited access to financial services. In addition, there are more financing alternatives for both commercial and individual borrowers that used to rely heavily on banks. Venture capital, for example, has become a much more important financing source for small businesses. Finance companies have also become a prominent player both in business and consumer financing.

Problems related to externalities may persist because the price mechanisms that drive the private market by definition ignore the value of externalities. Externalities, however, are a general market failure, rather than a financial market failure. Thus, credit and insurance programs are not necessarily the best means to address externalities, and their effectiveness should be compared with other forms of Government intervention, such as tax incentives and grants. In particular, if a credit program was initially intended to address multiple problems, including externalities, and those other problems have been alleviated, there may be a better way to address any remaining externalities.

Overall, the financial market has become more efficient and safer. Financial evolution and other economic developments, however, are often accompanied by new risks. Federal agencies need to be vigilant to identify and manage new risks to the economy and to the Budget. For example, financial derivatives enable their users either to decrease or to increase risk exposure. If some beneficiaries of Federal programs use financial derivatives to take more risk, the costs of Federal programs, especially insurance programs, can rise sharply. The sheer size of some financial institutions has also created a new risk. While well-diversified institutions are generally safer, even a single failure of a large private institution or a GSE, such as Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, could shake the entire financial market. A more visible risk to the Budget today is posed by the Pension Benefit Guaranty Corporation (PBGC). PBGC has a large shortfall in assets and projected earnings relative to the claims it is already obligated to pay due to unfavorable developments in recent years and to flaws in program structure that the Administration proposes to remedy.

II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) has evaluated 977 Federal programs, including 34 credit programs and seven insurance programs. The PART evaluates programs in four areas (program purpose and design, strategic planning, program management, and program results) and assigns a numerical score (0 to 100) to each category. The overall rating (effective, moderately effective, adequate, ineffective, or results not demonstrated) is determined based on the numerical scores and the availability of reliable data.

The ratings for credit and insurance programs are clustered around the middle; 78 percent of credit and insurance programs (compared with 58 percent for other programs) are rated "adequate" or "moderately effective," while only seven percent (17 percent for other programs) are rated "effective." These results suggest that most credit and insurance programs meet basic standards, but need to improve. In individual categories, credit and insurance programs have scored noticeably low in program purpose and design and high in program results relative to other programs.

Some key features distinguish credit and insurance programs from other programs. Credit and insurance programs are intended to address imperfections in financial markets. They also face various risks, such as uncertain default rates and erratic claim rates. Interpreting PART results in relation to these features should help to identify fundamental problems and to devise effective solutions.

Program Purpose and Design. To be effective, credit and insurance programs should serve those who deserve to be served but are left out by the private market due to market imperfections. Extending credit to those who are not creditworthy, for example, would result in economic inefficiencies and large budget costs. Lending to those who can obtain credit at a reasonable rate in the private market would be unnecessary and might interfere with the market mechanism. To achieve intended outcomes without causing unintended consequences, therefore, credit and insurance programs need to be carefully designed; they should target the

SUMMARY OF PART SCORES

	Purpose and Design	Strategic Planning	Program Management	Program Results
Credit and Insurance Programs				
Average	78.5	74.2	86.0	55.7
Standard Deviation	19.9	24.0	18.4	19.0
All Others Excluding Credit and Insurance Programs				
Average	87.1	75.0	82.2	48.2
Standard Deviation	18.4	24.6	17.9	26.6

intended beneficiaries, and all parties in the transaction should face the correct incentives.

The PART indicates that most credit and insurance programs have clear purposes (not necessarily economically justifiable purposes) and address specific needs. Many credit and insurance programs, however, fail to score high in program design. Some are duplicative of other federal programs or private sources, and some offer inadequate incentive structures.

Strategic Planning. Financial markets have been evolving to serve target populations of Federal programs better and increasingly apply advanced technologies to risk assessments. Credit and insurance programs need to adapt to these new developments quickly. Falling behind, Federal programs can be left with many beneficiaries who do not really need Government help and with those who post greater risk as private entities attract better-risk beneficiaries away from Federal programs.

In subcategories of strategic planning, while most credit and insurance programs effectively execute short-term strategies, they are less effective in pursuing long-term goals that may be more critical in adapting to new developments. Other weaknesses are found in conducting stringent performance evaluation and tying budgets to performance outcomes.

Program Management. Risk management is a critical element of credit and insurance programs. The cashflow is uncertain both for credit and insurance programs. The default rate and the claim rate can turn out to be significantly different than expected. Credit programs also face prepayment and interest rate risks. These risks must be carefully managed to ensure the program cost stays within a reasonable range.

Credit and insurance programs show strengths in basic financial and accounting practices, such as spending funds for intended purposes and controlling routine costs. However, some weaknesses are found in areas that are more critical for effective risk management, such as collecting timely information and using sophisticated financial tools.

Program Results. The main difficulty in evaluating program performance is measuring the net outcome of the program (improvement in the intended outcome net of what would have occurred in the absence of the program). Suppose that an education program is intended to increase the number of college graduates. Although it is straightforward to measure the number of college graduates who were assisted by the program, it is difficult to tell how many of those would not have obtained a college degree without the program's assistance. Credit and insurance programs face an additional difficulty of estimating the program cost accurately. In evaluating programs, the outcome must be weighed against the cost. In the above example, the ultimate measure of effectiveness is not the net number of college graduates produced by the program but the net number per Federal dollar spent on the program. Thus, an inaccurate cost estimate would lead to incorrect program evaluation—an underestimation (overestimation) of the cost would make the program appear unduly effective (ineffective). Results for credit and insurance programs need to be interpreted in conjunction with the accuracy of cost estimation.

Program results, the most important category of performance, are generally weak for credit and insurance programs despite a higher average score than that of other programs. Many credit and insurance programs have difficulty in achieving performance goals and lack objective evidences of program effectiveness. These problems may partly result from the difficulty of measuring net outcomes. With reliable outcome measures, it should be easier to set achievable goals and demonstrate effectiveness.

III. CREDIT IN FOUR SECTORS

Housing Credit Programs and GSEs

Through housing credit programs, the Federal Government promotes homeownership among various target groups, including low-income people, minorities, veterans, and rural residents. Housing GSEs increase liquidity in the mortgage market.

Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase the number of first-time minority homeowners by 5.5 million through 2010. During the first three and a quarter years since the goal was announced, nearly 2.5 million minority families have become homeowners. Through 2006, the Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) helped almost 542,000 of these first-time minority homebuyers through its loan insurance funds, mainly the Mutual Mortgage Insurance (MMI) Fund. FHA mortgage insurance guarantees mortgage loans that provide access to homeownership for people who lack the traditional financial resources or credit history to qualify for a home mortgage in the conventional marketplace. In 2006, FHA endorsed purchase and refinance mortgages for more than 425,000 households. For purchase mortgages, over 79 percent were for first-time homebuyers and about 31 percent were for minority buyers. FHA also endorsed over 76,000 home equity conversion mortgages for elderly homeowners.

While FHA has been a primary mortgage source for first-time and minority buyers since the 1930s, its loan volume has fallen precipitously in the past four years. This is due in part to lower interest rates that have made uninsured mortgages affordable for more families. Moreover, private lenders—aided by automated underwriting tools that allow them to measure risks more accurately—have expanded lending to people who previously would have had no option but FHA—those with few resources to pay for downpayments and/or weaker credit histories that the private sector considered too risky. The development of new products and underwriting approaches has allowed private lenders to offer loans to more homebuyers. While this is a positive development when the private sector is offering favorable terms, some borrowers either end up paying too much or receiving unfair terms.

As private lenders have expanded their underwriting to cover more borrowers, FHA's business has changed. First, the percentage of FHA-insured mortgages with initial loan-to-value (LTV) ratios of 95 percent or higher has increased substantially, from 62.7 percent in 1995 to 78 percent in 2006. Second, the percentage of FHA loans with downpayment assistance from seller-financed nonprofit organizations has grown rapidly, from 0.3 percent in 1998 to nearly 33 percent in 2006. Recent studies show that these loans are riskier than those made to borrowers who received downpayment assistance from other sources. In 2006, FHA's cumulative default claim rate for its core business is projected to have risen from approximately 10 percent to 12 percent.

The FHA single-family mortgage program was assessed in 2005 using the PART. The assessment found that the program was meeting its statutory objective to serve underserved borrowers while maintaining an adequate capital reserve. However, the program lacked quantifiable annual and long-term performance goals that would measure FHA's ability to achieve its statutory mission. In addition, both the PART and subsequent reports by the General Accountability Office and the Inspector General noted that the program's credit model does not accurately predict losses to the insurance fund, and that despite FHA efforts to deter fraud in the program, it has not demonstrated that these steps have reduced such fraud.

In response to these findings, FHA measured its 2006 performance against new goals, such as the percentage of FHA Single Family loans for first-time and minority homeowners, and exceeded its goals. FHA has also improved the accuracy of its annual actuarial review claim and prepayment estimates. In 2007, it will continue to develop performance goals for fraud detection and prevention.

Proposals for Program Reform

In order to enable FHA to fulfill its mission in today's changing marketplace, the Administration has introduced legislation that will give FHA the ability to respond to current challenges to homeownership among its traditional target borrowers: low and moderate-income first-time homebuyers. FHA has already taken steps, within its current authority, to streamline its paperwork requirements and remove impediments to its use by lenders and buyers. However, additional reforms will enable it to expand homeownership opportunities to its target borrowers on an actuarially sound basis.

To remove two large barriers to homeownership—having limited savings for a downpayment or impaired credit—the Administration again proposes new FHA mortgage products. These products will replace the current flat premium structure with one that varies with the risk of default as indicated by the percentage of downpayment to the loan amount or borrower credit quality. This will create more opportunities for potential homeowners who may face limited mortgage options. For example, first-time buyers with a strong credit record but little savings could finance a higher percent of the purchase than FHA currently allows. Alternatively, a borrower with a poor credit history could qualify for more favorable terms by accumulating savings for a larger downpayment.

This flexible premium structure, which is tiered risk-based pricing, is a way to more fairly price the FHA guarantee to individual borrowers. It creates incentives (lower premium payments) for borrowers to take steps to improve their credit or save more for a downpayment. At the same time it eliminates the current incentive for higher risk borrowers to use FHA because they are undercharged relative to the risk they pose. FHA proposes to base its mortgage insurance premiums upon a borrower's consumer credit score from Fair, Isaac, and Company (FICO), and on the amount and source of downpayment (e.g., the borrower's own resources, relatives, employer, non-profit organization or public agency). Mortgage insurance premiums will be based on FHA's historical experience with similar borrowers. This change will decrease premiums for many of FHA's traditional borrowers, thereby increasing their access to homeownership.

This price structure has many advantages. First, FHA will reflect a borrower's risk via the mortgage insurance premium, not through a higher interest rate as done in the subprime market. With mortgage insurance, borrowers will pay a market rate of interest, and, as a result, will incur lower monthly payments and lower total costs than if they paid a higher mortgage interest rate throughout the life of the loan. Second, by using this pricing structure, FHA will promote price transparency. Each borrower will know why they are paying the premium that they are being charged and will know how to lower their borrowing costs—i.e., by raising their FICO score or their downpayment. Third, risk-based pricing will allow FHA to review the performance of its programs annually in conjunction with the preparation of its credit subsidy estimates and adjust its premiums as necessary to assure the financial soundness of the MMI Fund.

A reformed FHA will adhere to sound management practices that include a new framework of standards and incentives tied to principles of good credit program management. Further, the proposed reforms will better enable FHA to meet its objective of serving first-time and low-income home buyers by managing its risks more effectively.

VA Housing Program

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel to purchase homes as recognition of their service to the Nation. The program substitutes the Federal guarantee for the borrower's down payment. In 2006, VA provided $23.5 billion in guarantees to assist 135,151 borrowers.

Since the main purpose of this program is to help veterans, lending terms are more favorable than loans without a VA guarantee. In particular, VA guarantees zero downpayment loans. VA provided 90,399 zero downpayment loans in 2006.

To help veterans retain their homes and avoid the expense and damage to their credit resulting from foreclosure, VA intervenes aggressively to reduce the likelihood of foreclosures when loans are referred to VA after missing three payments. VA's successful actions resulted in 54 percent of such delinquent loans avoiding foreclosure in 2006.

Rural Housing Service

The U.S. Department of Agriculture's Rural Housing Service (RHS) offers direct and guaranteed loans and grants to help very low- to moderate-income rural residents buy and maintain adequate, affordable housing. The single-family guaranteed loan program guarantees up to 90 percent of a private loan for low- to moderate-income (115 percent of median income or less) rural residents. In 2006, nearly $4.3 billion in assistance was provided by RHS for homeownership loans and loan guarantees; $3.07 billion in guarantees went to more than 31,000 households, of which 30 percent went to very low and low-income families (with income 80 percent or less than median area income).

Additionally in 2006, Hurricane Supplemental loans and guarantees totaling $260 million allowed nearly 2,500 households to obtain homes. In addition, $19 million of low-interest loans and grants was used to repair more than 2,300 homes of families in need. In addition, RHS granted moratoriums on payments, and sheltered survivors in its inventory properties to provide relief.

Historically, RHS has offered both direct and guaranteed homeownership loans. Beginning in 2008, RHS will only offer guaranteed loans. The budget provides no funding for the 502 direct single family housing loan program. The direction of Rural Development's single-family housing mortgage assistance over the last two decades has been towards guaranteed loans. The single-family housing guaranteed loan program was newly authorized in 1990 at $100 million and has grown into a $3 billion plus loan program annually, equaling that of the Veterans Affairs (VA) guaranteed housing loan program. Meanwhile the single-family direct loan program has been stagnant at approximately a $1 billion loan level.

Solely utilizing guarantees for single-family housing mortgage is consistent with the other Federal homeownership programs. In fact, there are no Federal single family direct loan home ownership programs for urban areas. Furthermore, financial markets have become more efficient and increased the reach of mortgage credit to lower credit qualities and incomes. While some rural areas remain isolated from broad credit availability, these areas are shrinking as broadband internet access and correspondent lending grow. Therefore, relying on the private banking industry to provide this service, with a guarantee from the Federal government, is a more efficient way to deliver that assistance.

To replace the loss of assistance to the very low- to low-income rural borrowers still seeking assistance for mortgage credit, the Administration expects to propose legislation to authorize a subsidized guaranteed single-family housing program.

For the already established 502 guarantee programs in 2008, RHS will increase the guarantee fee on new loans to 3 percent from 2 percent. This allows the loans to be less costly for the Government without a significant additional burden to the borrowers, given that they can finance the fee as part of the loan. The guarantee fee for refinance loans remains 0.5 percent. Funding in 2008 is requested at an increased amount of $4.8 billion for purchase loans to compensate for no funding for direct loans.

RHS also offers multifamily housing loans and guarantees to provide rural rental housing, including farm labor housing. The farm labor housing combined grant and loan level will provide $18 million in 2008 for new construction as well as repair and rehabilitation. RHS also expects to be able to guarantee $200 million in multifamily housing construction loans for 2008. RHS will continue to propose funding and legislative changes to address the preservation issues surrounding the over 40-year old program. A long-term initiative has been developed to revitalize the 17,000-property portfolio. During 2008, $28 million will be directed to the revitalization initiative, primarily to assist existing residents in properties leaving the program. No funds are requested for the direct rural rental housing program because fixing the current portfolio is the first priority.

RHS partnered with its multifamily program borrowers and made available all the vacant units in the loan portfolio to house evacuees from Hurricanes Katrina and Rita. Costs were covered by an emergency allotment of rental assistance for a six-month period. Multifamily Programs instituted a number of waivers designed to ease the regulatory burden for housing evacuees on an emergency basis. RHS housed over 3,000 families in RHS-financed housing

Government-Sponsored Enterprises in the Housing Market

Homeownership has long been recognized as an important part of the American economy and part of the American dream. However, it has not always been within reach for the average American. During the Great Depression, housing markets were in turmoil. A typical mortgage required a downpayment of around 50 percent and a balloon payment of principal within a few years. Limitations in financial and communication technology and restrictions on financial institutions made it difficult for surplus funds in one part of the country to be shifted to other parts of the country to finance residential housing. Starting in 1932, the Congress responded by creating a series of entities and programs that together promoted the development of long-term, amortizing mortgages and facilitated the movement of capital to support housing finance.

A key element of this response was the creation of the Federal Housing Administration in 1934. Another element was the establishment of several entities designed to develop secondary mortgage markets and to facilitate the movement of capital into housing finance. These entities, known today as Government-Sponsored Enterprises (GSEs), were chartered by the Congress with a public mission, and endowed with certain benefits that give them competitive advantages when compared with fully private companies.

The Federal Home Loan Bank System, created in 1932, is comprised of twelve individual banks with shared liabilities. Together they lend money to financial institutions—mainly banks and thrifts—that are involved in mortgage financing to varying degrees, and they also finance some mortgages on their own balance sheets. The Federal National Mortgage Association, or Fannie Mae, created in 1938, and the Federal Home Loan Mortgage Corporation, or Freddie Mac, created in 1970, were established to support the stability and liquidity of a secondary market for residential mortgage loans. Together these three GSEs currently are involved, in one form or another, with nearly one half of the $10-plus trillion residential mortgages outstanding in the U.S. today. Their market share peaked at 54 percent in 2003, after which management and internal control problems started to surface.

As with other financial institutions, the Congress also established regulatory regimes to ensure the safety and soundness of the housing GSEs. The Office of Federal Housing Enterprise Oversight (OFHEO), established in 1992 as an independent agency within the Department of Housing and Urban Development, oversees Fannie Mae and Freddie Mac. The Federal Housing Finance Board (FHFB), established in 1989, oversees the Federal Home Loan Bank system. Numerous reports and studies have pointed to various shortcomings with the current regulatory structure for the housing GSEs. The Administration is proposing to strengthen this structure and combine OFHEO and FHFB into a new regulator.

Mission

The mission of the housing GSEs is to support certain aspects of the U.S. mortgage market. Fannie Mae and Freddie Mac's mission is to promote affordable housing, respond to private capital markets, and provide liquidity and stability to the secondary mortgage market. Currently, they engage in two major lines of business.

1. Credit Guarantee Business—Fannie Mae and Freddie Mac guarantee the timely payment of principal and interest on mortgage-backed securities (MBS). They create MBS by either buying and pooling whole mortgages or by entering into swap arrangements with mortgage originators. Over time these MBS held by the public have averaged about one-quarter of the U.S. mortgage market.

2. Mortgage Investment Business—Fannie Mae and Freddie Mac manage retained mortgage portfolios composed of their own MBS, MBS issued by others, and whole mortgages. As of June 30, 2006, these retained mortgages totaled $1.4 trillion. Given Fannie Mae and Freddie Mac's serious accounting, internal control, risk management, and systems problems, the growth of these portfolios is temporarily constrained through consent agreements with OFHEO.

The mission of the Federal Home Loan Bank System is broadly defined as housing finance, and the System also has specific requirements to support affordable housing. The Federal Home Loan Banks have not grown mortgage asset portfolios as large as Fannie Mae or Freddie Mac. Their principal business remains lending to regulated depository institutions and insurance companies engaged in residential mortgage finance to varying degrees.

Risks That GSEs Face and Cause

Like other financial institutions, the GSEs face a full range of risks, including market (interest rate) risk, credit risk, and operational risk. Several of the Federal Home Loan Banks and Fannie Mae have faced serious market risks due to inadequate hedging. More recently, Fannie Mae and Freddie Mac have faced serious operational risk. Due to earnings manipulation, poor accounting systems, lack of proper controls, lack of proper risk management, and misapplication of accounting principles, earnings at Fannie Mae were misstated by $6.3 billion through June of 2004, and at Freddie Mac by $5.0 billion through December of 2002.

The GSEs also pose risks to the financial system. Systemic risk is the risk that unanticipated problems at a financial institution or group of institutions could lead to problems more widely in the financial system or economy—the risk that a small problem could multiply to a point where it could jeopardize the country's economic well-being. The particular systemic risk posed by the GSEs is the risk that a miscalculation, failure of controls, or other unexpected event at one company could unsettle not only the mortgage and mortgage finance markets but other vital parts of the financial system and economy. To understand this risk, one must understand the interdependencies among the GSEs and other market participants in the financial system and the lack of market discipline imposed on the GSEs because investors perceive that the GSEs are implicitly backed by the U.S. Government.

The GSEs are among the largest borrowers in the world. As of September 2006 their combined debt and guaranteed MBS totaled $5.2 trillion, higher than the total publicly held debt of the United States. The investors in GSE debt include thousands of banks, institutional investors such as insurance companies, pension funds, and foreign governments, and millions of individuals through mutual funds and 401k investments. Based on the prices paid by these investors, they act as if the Federal Government guarantees GSE debt. In fact, there is no such guarantee or Federal backing of GSE debt.

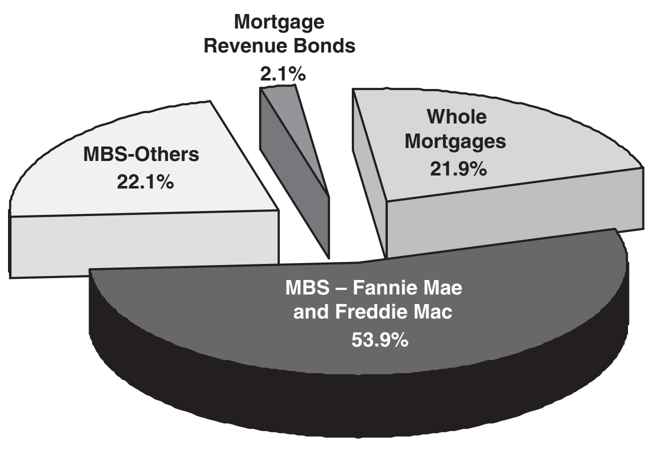
Because investors act as if there is an "implicit guarantee" by the Federal Government to back GSE debt, investors on average lend their money to the GSEs at interest rates roughly 30 to 40 basis points less ($300–$400 less per year for every $100,000 borrowed) than to other highly rated privately held companies. In addition, investors do not demand the same financial disclosures as for other privately owned companies. Neither Fannie Mae nor Freddie Mac currently file quarterly earnings reports with the Securities and Exchange Commission, though Fannie Mae is required to and Freddie Mac volunteered to. Yet there has been no significant impact on the pricing of GSE debt securities. This lack of market discipline facilitates the growth of the GSE asset portfolios, thereby increasing systemic risk.

Retained Asset Portfolios Have Significantly Grown While Achieving Little for the GSEs' Housing Mission

Fannie Mae and Freddie Mac have used their funding advantage to amass large retained asset portfolios. Together these GSEs have more than $1.5 trillion in debt outstanding, almost entirely for the purpose of funding these portfolios. From 1990 through 2005, the GSEs' competitive funding advantage enabled them to increase their portfolios of mortgage assets ten-fold, which far exceeds the growth of the overall mortgage market. Due to the risks associated with the portfolios, the Administration is proposing that the new regulatory structure empower the regulator to address and mitigate these risks.

As chart 7–1 shows, almost 54 percent of Fannie Mae and Freddie Mac's combined retained mortgage portfolio at the end of 2005 was comprised of holdings of their own guaranteed MBS, which could easily be sold.

Chart 7-1. Fannie Mae and Freddie Mac Combined Retained Mortgage Portfolios Year-End 2005



Source: Office of Federal Housing Enterprise Oversight.

The function of these portfolio holdings is largely to increase profits, not facilitate affordable housing. In 1992, the Congress broadened Fannie Mae and Freddie Mac's mission to include promoting affordable housing. To measure this performance, the Congress mandated that HUD establish three affordable housing goal targets that Fannie Mae and Freddie Mac must meet each year. HUD has also implemented home purchase subgoals to encourage homeownership opportunities for first-time homeowners and minority homeowners. Given that Fannie Mae and Freddie Mac have a mission to help more families achieve homeownership as well as to expand rental opportunities, their retained portfolios should be tied to that mission. However, currently only about 30 percent of Fannie Mae and Freddie Mac's retained portfolio holdings would be eligible to qualify for any of the affordable housing goals. About half of the MBS issued by others and whole loans qualify toward their affordable housing goals. Their performance under the housing goals over time indicate that Fannie

Mae and Freddie Mac should be doing more to help mission-targeted families achieve homeownership or acquire affordable rental housing.

Debt Issuance Subject to Treasury Approval

Fannie Mae and Freddie Mac fund their portfolios by issuing debt, and the U.S. Department of the Treasury has the responsibility to review and approve these GSEs' debt-issuances. The Treasury Department's debt approval authority is contained in Fannie Mae's and Freddie Mac's Charter Acts, and the Department has approved Fannie Mae and Freddie Mac's debt on a regular basis. Treasury is developing a more formalized approach to their debt approval authority. As part of that approach, Treasury is developing new debt approval procedures to enhance the clarity, transparency, standardization, and documentation of Fannie Mae's and Freddie Mac's debt issuances.

Thin Capital Cushions Need Reform

The risks of the GSEs' large portfolios are exacerbated because they are not required to hold cushions of capital against potential losses comparable to the capital requirements for other large financial institutions. Where commercial banks that are part of a financial holding company must hold a 5 percent capital-to-total assets cushion, Fannie Mae and Freddie Mac's requirement is half that, while FHLB's is 4 percent. The risk-based capital requirements for the GSEs also differ dramatically from those applicable to commercial banks. This highlights an important shortcoming of the statutory framework governing Federal oversight of the GSEs. The minimum capital and risk-based capital rules for the GSEs were written into law in 1992. Much has changed since then with regard to financial risk analysis, risk modeling, and capital requirements for comparable financial institutions. The reforms proposed by the Administration would repeal the statutory risk-based capital stress test, and would provide the new GSE regulator with the authority and flexibility to establish new risk-based capital requirements for the GSEs to help ensure that they operate with sufficient capital and reserves to support the risks that arise in the operations and management of each enterprise. A world-class regulator needs the flexibility and authority to change both the risk-based and minimum capital requirements without undue restriction in response to changing conditions.

Although the GSEs' mortgage investments are of relatively low default risk, other types of risk in the GSEs' asset portfolios are substantial. Mortgage portfolios carry considerable interest-rate risk, partly because of the risk that homeowners may prepay their mortgages through refinancing or home sales. This risk can be mitigated—for example, through purchase of interest-rate hedges—but the GSEs protect themselves against only some of the interest rate risk of their portfolios. Moreover, hedges are imperfect because predicting interest-rate movements and mortgage refinancing activity is difficult. As GSE asset portfolios have grown in size, the GSEs' participation in the market for hedging instruments has become dominant enough to cause interest rate spikes in the event that a GSE needs to make large and sudden adjustments to its hedging position.

New Activities and Technological Development Require Oversight

Over the last decade, Fannie Mae and Freddie Mac have begun engaging in a wide range of new activities that were not anticipated when their charters were written. To address these changes, HUD developed a new activity review initiative under its general regulatory authority. HUD has reviewed a number of business initiatives at Fannie Mae and Freddie Mac, including international activities; partnership offices; senior housing; skilled nursing facilities; employer assisted housing plans; third party real-estate-owned programs; Commercial Mortgage-Backed Securities (CMBS); Asset-Backed Securities (ABS); multifamily variable-rate bond certificates; and whole loan REMICs. HUD concluded that some of these activities were not authorized. For example, HUD's review of the GSEs' Commercial MBS programs resulted in OFHEO seeking Freddie Mac's divestiture of certain CMBS holdings, and HUD ordered Fannie Mae to end its third party Real-Estate-Owned program based on its review. In 2007, HUD will complete a Financial Activities Review that will provide a baseline of information on Fannie Mae's and Freddie Mac's business and program activities. As part of this review, HUD will examine specific transactions to determine whether they are consistent with Fannie Mae's and Freddie Mac's charter authorities. The Administration proposes to move this authority to the new regulator.

Because of their enormous presence in the secondary market, Fannie Mae and Freddie Mac are able to exert significant leverage in the *primary* mortgage market. First, their unparalleled size in the residential mortgage market gives the GSEs a unique level of access to market information. The applicability of that information to the management of mortgage risk gives them a competitive edge in the development of new technology that can change relationships between primary market participants as well as the distribution of economic returns between the primary and secondary markets. Second, their funding advantage enables the GSEs to borrow at reduced rates in order to make investments in new areas at below-market prices, thus discouraging competition while gaining experience in those areas.

Through the development and delivery of new technology to the industry and by leveraging their funding advantage, there is potential for the GSEs to expand their business beyond the limitations of their Charter Acts, which prohibits both Fannie Mae and Freddie Mac from originating mortgages. Loan origination is the central function of the primary mortgage market, and the GSEs' charter acts clearly restrict them to the secondary mortgage market. However, technological advancements have blurred the line that defines where the primary market ends and the secondary market begins. A new level of clarity is required to establish the permissible activities under the Enterprises' charter acts, including the development of intellectual property.

New Regulatory Authority

The Administration continues to support broad reform of the GSE supervisory system. In particular, the Administration supports establishing a new regulator for all three of the housing GSEs that would combine safety and soundness authority with oversight of their respective housing missions. The new regulator must have enhanced powers comparable to those of other world-class financial regulators, including, among others, the ability to put a GSE into receivership should it fail, authority to establish and adjust appropriate capital standards, and new product authority. A new regulator must also have clear authority to address and mitigate the risks posed by the GSEs' retained portfolios. Finally, a new regulatory structure must ensure that the GSEs are adhering to their affordable housing mission.

Education Credit Programs

The Federal Government guarantees loans through intermediary agencies and makes direct loans to students to encourage postsecondary education enrollment. The Student Loan Marketing Association (Sallie Mae), created in 1972 as a GSE to develop the secondary market for guaranteed student loans, was privatized in 2004.

The Department of Education helps finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Student Loan (Direct Loan) program. Eligible institutions of higher education may participate in one or both programs. Loans are available to students regardless of income. However, borrowers with low family incomes are eligible for loans with additional interest subsidies. For low-income borrowers, the Federal Government subsidizes loan interest costs while borrowers are in school, during a six-month grace period after graduation, and during certain deferment periods.

The FFEL program provides loans through an administrative structure involving over 3,600 lenders, 35 State and private guaranty agencies, and over 5,000 participating schools. In the FFEL program, banks and other eligible lenders loan private capital to students and parents, guaranty agencies insure the loans, and the Federal Government reinsures the loans against borrower default. Lenders bear three percent of the default risk, and the Federal Government is responsible for the remainder. The Department also makes administrative payments to guaranty agencies and, at certain times, pays interest subsidies on behalf of borrowers to lenders.

The William D. Ford Direct Student Loan program was authorized by the Student Loan Reform Act of 1993. Under the Direct Loan program, the Federal Government provides loan capital directly to nearly 1,100 schools, which then disburse loan funds to students. The program offers a variety of flexible repayment plans including income-contingent repayment, under which annual repayment amounts vary based on the income of the borrower and payments can be made over 25 years with any residual balances forgiven.

In 2006, the Congress passed reconciliation legislation reducing excess subsidies in the FFEL program and helping to make both programs more effective. The reforms included a reduction in the percentage of Federal guarantee provided against default in recognition of the strong repayment record for student loans today and an elimination of unnecessary and costly loan subsidy provisions that allowed some loan holders to have exorbitant financial returns on loans funded through tax-exempt securities. In recognition of the fact that federal subsidies remain higher than necessary to ensure that loans are available to students in this profitable and competitive market, the 2008 Budget proposes to reduce interest subsidies paid to FFEL lenders by 50 basis points. The 2008 Budget also proposes to reduce default insurance from 97 percent to 95 percent, and increase the origination fee lenders pay on consolidation loans. To rationalize federal subsidies to guaranty agencies, the Administration proposes to shift the basis of account maintenance fee payments from the balance of loans guaranteed to a cost-per-unit formula, and reduce the amount guaranty agencies can retain on the defaulted loans they collect. These savings will be used to provide significant benefits to students such as raising the Pell Grant maximum award to $5,400, increasing Academic Competitiveness Grant awards by 50 percent, and offering higher loan limits.

Business and Rural Development Credit Programs and GSEs

The Federal Government guarantees small business loans to promote entrepreneurship. The Government also offers direct loans and loan guarantees to farmers who may have difficulty obtaining credit elsewhere and to rural communities that need to develop and maintain infrastructure. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

Small Business Administration

The Small Business Administration (SBA) helps entrepreneurs start, sustain, and grow small businesses. As a "gap lender" SBA works to supplement market lending and provide access to credit where private lenders are reluctant to do so without a Government guarantee. Additionally, SBA helps home and business-owners, as well as renters, cover the uninsured costs of recovery from disasters through its direct loan program.

The 2008 Budget requests $464 million, including administrative funds, for SBA to leverage more than $29 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support $17.5 billion in guaranteed loans while the 504

Certified Development Company program will support $7.5 billion in guaranteed loans for fixed-asset financing. SBA will supplement the capital of Small Business Investment Companies (SBICs) with $3 billion in long-term, guaranteed loans for venture capital investments in small businesses. At the end of 2006, the outstanding balance of business loans totaled $67 billion.

SBA seeks to target assistance more effectively to credit-worthy borrowers who would not be well-served by the commercial markets in the absence of a Government guarantee to cover defaults. SBA is actively encouraging financial institutions to increase lending to start-up firms, low-income entrepreneurs, and borrowers in search of financing below $150,000. SBA's outreach for the 7(a) program has been successful: Average loan size has decreased from about $230,000 in 2001 to $152,000 in 2006, while the annual number of new loans has grown from 43,000 to over 90,000 during the same time period.

During the past few years, SBA has implemented several initiatives to streamline operations by increasingly delegating responsibilities to lenders and centralizing operations while managing and mitigating risk. In 2003, SBA implemented a state-of-the-art Lender Loan Monitoring System (LLMS) under the newly formed Office of Lender Oversight. This office uses LLMS to evaluate individual SBA lenders by tracking the expected risk of SBA guaranteed loans in their portfolios relative to expected performance of those loans. The office employs a variety of analytical techniques to ensure sound financial management by SBA and to hold lending partners accountable for performance. These techniques include portfolio performance analysis, selected lender risk reviews, credit scoring to compare lenders' performance, and industry concentration analysis. Starting in FY 2004, SBA began consolidating its loan making, servicing and liquidating functions from 69 District Offices into several combined centers. Consolidation has reduced costs, increased timeliness of processing, and standardized how loans are handled. In 2006, SBA completed the elimination of its several billion dollar backlog of loan liquidations resulting from defaulted guarantees. In 2007, SBA is working with contractor support to identify additional processes that could be reengineered to reduce costs, improve quality, and expedite processing.

To address major challenges in making and disbursing loans resulting from the 2005 Gulf Coast hurricanes, SBA initiated the Accelerated Disaster Response Initiative to identify and implement process improvements to quicken the delivery of disaster assistance. As a result of customer feedback and analysis of best business practices, SBA piloted a case management approach. Using case management, in which a team of SBA staff work with a borrower from initial application through loan disbursement, SBA can better serve disaster applicants and monitor the processing of loans. SBA has also implemented numerous productivity metrics to track the status of loans in processing and identify areas that require management intervention or additional resources.

By 2008, SBA expects to implement an Internet-based loan application system that will facilitate the collection of data from disaster victims and speed processing. This investment complements investments that SBA made through 2006 in the Disaster Credit Management System.

The Budget proposes to build upon the success of the zero-subsidy 7(a) program by making the Microloan program self-financing through modest increases to the interest rate paid by program intermediaries. The Administration is also proposing authorizing legislation to enable the secondary market guarantee (SMG) program to charge nominal fees on lenders seeking to pool loans; fees are expected to be less than or comparable to fees in other secondary market programs and will help stabilize the program from the need to make frequent administrative changes.

USDA Rural Infrastructure and Business Development Programs

USDA provides grants, loans, and loan guarantees to communities for constructing facilities such as health-care clinics, day-care centers, and water systems. Direct loans are available at lower interest rates for the poorest communities. These programs have very low default rates. The cost associated with them is due primarily to subsidized interest rates that are below the prevailing Treasury rates.

The program level for the Water and Wastewater (W&W) treatment facility loan and grant program in this Budget is $1.5 billion. These funds are available to communities of 10,000 or fewer residents. The Budget reflects a significant change in the method for determining the interest rate charged on such loans, from a three-tiered structure (poverty, intermediate, and market) depending on community income to an interest rate that is 60 percent of the market rate not to exceed five percent. This change is expected to reduce the loan repayment costs substantially for most communities, at a lower loan to grant ratio. The Community Facility Program is targeted to rural communities with fewer than 20,000 residents. It will have a program level of $512 million in 2008.

USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, including cooperatives, and to increase employment and diversify the rural economy. In 2008, USDA proposes to provide $1 billion in loan guarantees to rural businesses that serve communities of 50,000 or less. USDA also provides rural business loans through the Intermediary Relending Program (IRP), which provides loan funds at a one percent interest rate to an intermediary, such as a State or local government agency that, in turn, provides funds for economic and community development projects in rural areas. Overall, USDA expects to retain or create 38,795 jobs in 2008 through its Business and Industry guarantee and the IRP loan programs.

Electric and Telecommunications Loans

USDA's Rural Utilities Service (RUS) programs provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband, and also provide grants for distance learning and telemedicine (DLT).

The Budget includes $4.1 billion in direct electric loans for distribution, transmission, and modification of existing generation facilities, $690 million in direct telecommunications loans, $300 million in broadband loans, and $25 million in DLT grants.

Since 1992, RUS electric loans have been used primarily to finance transmission, distribution, and upgrades to generation facilities. During this time, generation has been deregulated and has become a more commercial operation. With the increased needs for all aspects of electricity provision and to ensure adequate funding for rural areas, RUS loans will continue to focus on transmission, distribution, and upgrading generation facilities. Construction of new generation facilities should be financed through the commercial market.

The Rural Telephone Bank successfully dissolved in FY2006. All stock was redeemed during 2006. Loans approved in prior years, but not disbursed are still available for borrowers.

Loans to Farmers

The Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed on aiding beginning and socially disadvantaged farmers. FSA offers operating loans and ownership loans, both of which may be either direct or guaranteed loans. Operating loans provide credit to farmers and ranchers for annual production expenses and purchases of livestock, machinery, and equipment. Farm ownership loans assist producers in acquiring and developing their farming or ranching operations. As a condition of eligibility for direct loans, borrowers must be unable to obtain private credit at reasonable rates and terms. As FSA is the "lender of last resort," default rates on FSA direct loans are generally higher than those on private-sector loans. However, in recent years the loss rate has decreased to 2.9 percent in 2006, compared to 3.1 percent in 2005. FSA-guaranteed farm loans are made to more creditworthy borrowers who have access to private credit markets. Because the private loan originators must retain 10 percent of the risk, they exercise care in examining the repayment ability of borrowers. As a result, losses on guaranteed farm loans remain low with default rates of 0.4 percent in 2006, as compared to 0.45 percent in 2005. The subsidy rates for these programs have been fluctuating over the past several years. These fluctuations are mainly due to the interest component of the subsidy rate.

In 2006, FSA provided loans and loan guarantees to approximately 27,730 family farmers totaling $3.15 billion. The number of loans provided by these programs has fluctuated over the past several years. The average size for farm ownership loans has been increasing. The majority of assistance provided in the operating loan program is to existing FSA farm borrowers. In the farm ownership program, new customers receive the bulk of the benefits furnished. In 2008, FSA proposes to make $3.4 billion in direct and guaranteed loans through discretionary programs.

FSA uses the Farm Business Plan (FBP) to perform financial planning, analysis, and management of the loan portfolio. Several enhancements of the web equity FBP were put into service in 2006. These include a youth loan credit action and availability of additional reports. In 2007, the FBP will be modified to enable credit reports to be ordered on applicants to expedite application processing. FSA is continuing its comprehensive project to streamline all farm loan program regulations, handbooks, and information collections. This is a major effort to streamline the program and reduce the burden for both applicants and the Agency, resulting in an improvement in loan processing efficiencies.

The Farm Credit System and Farmer Mac

The Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (FarmerMac) are Government-Sponsored Enterprises (GSEs) that enhance credit availability for the agricultural sector. The FCS provides production, equipment, and mortgage lending to farmers and ranchers, aquatic producers, their cooperatives, related businesses, and rural homeowners, while Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

The Farm Credit System

The financial condition of the System's banks and associations remain sound. The ratio of capital to assets decreased to 15.7 percent as of September 30, 2006 from 16.8 percent for the same period ended in 2005 as asset growth outpaced capital growth. As of September 30, 2006, capital consisted of $2.2 billion in restricted capital held by the Farm Credit System Insurance Corporation (FCSIC) and $22.0 billion of unrestricted capital—a record level. Nonperforming loans decreased, and earnings increased, although rising short-term interest rates and competitive conditions compressed interest margins. The examinations by the Farm Credit Administration (FCA), the System's Federal regulator, also show the strong financial condition of FCS institutions. As of September 2006, all FCS institutions had one of the top two examination ratings (1 or 2 in a 1–5 scale). Assets grew at a brisk pace (9.5 percent annual rate) over the past four years, while the number of FCS institutions decreased due to consolidation. In September 2002, there were seven banks and 104 associations; by September 2006, there were five banks and 96 associations.

The FCSIC ensures the timely payment of principal and interest on FCS obligations. FCSIC manages the Insurance Fund which supplements the System's capital and the joint and several liability of the System banks. As of September 30, 2006, the assets in the

Insurance Fund totaled $2.243 billion. Of that amount $40 million was allocated to the Allocated Insurance Reserve Accounts (AIRAs). As of September 30, 2006, the Insurance Fund as a percentage of adjusted insured debt was 1.78 percent in the unallocated Insurance Fund and 1.81 percent including the AIRAs. This was below the Secure Base target of 2 percent. During 2006, growth in System debt outpaced the capitalization of the Insurance Fund that occurs through investment earnings and the accrual of premiums.

Over the 12 month period, ending September 30, 2006, the System's loans outstanding grew by $12.6 billion, or 12.3 percent, while over the past three years they grew by $24.6 billion, or 26.9 percent. As required by law, borrowers are also stockholder owners of System banks and associations. As of September 30, 2006, the System had 459,635 stockholders. Loans to young, beginning, and small farmers and ranchers represented 12.3, 19.4, and 29.2 percent, respectively, of the total dollar volume of farm loans outstanding at the end of 2005. The percentage of loans to beginning farmers increased in 2005, while percentages to young and small farmers were slightly lower. Young, beginning, and small farmers are not mutually exclusive groups, and thus, cannot be added across categories. Providing credit and related services to young, beginning, and small farmers and ranchers is a legislative mandate and a high priority for the System.

The System, while continuing to record strong earnings and capital growth, remains exposed to a variety of risks associated with its portfolio concentration on agriculture and rural America. While this sector is currently healthy, it is subject to risk due to rapidly rising farm real estate prices, volatile commodity prices and input costs, uncertainty regarding changes in government farm policy and trade agreements, weather-related catastrophes, animal and plant diseases, and off-farm employment opportunities.

Farmer Mac

Farmer Mac was established in 1988 to facilitate a secondary market for farm real estate and rural housing loans. The Farm Credit System Reform Act of 1996 expanded Farmer Mac's role from a guarantor of securities backed by loan pools to a direct purchaser of mortgages, enabling it to form pools to securitize. This change increased Farmer Mac's ability to provide liquidity to agricultural mortgage lenders.

Farmer Mac continues to meet core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, AgVantage bond assets, and real estate owned) as of September 30, 2006, totaled $7.1 billion. That volume represents an increase of 38 percent from program activity at September 30, 2005. Of total program activity, $2.1 billion were on-balance sheet loans and agricultural mortgage-backed securities, and $5.0 billion were off-balance sheet obligations. Total assets were $4.9 billion at the close of the third quarter, with nonprogram investments accounting for $2.7 billion of those assets. Farmer Mac's net income for first three quarters of 2006 was $23.9 million, a decrease of 39 percent from restated amounts for the same period in 2005.

In November 2006, Farmer Mac restated its financial results for 2005 and other periods to remove the impact of accounting for derivatives as hedges against interest rate movements. As a result, there could be significant fluctuation in net income in future periods. However, Farmer Mac does not expect the accounting change to impact its ability to carry out its business plans or have any effect on its business model.

International Credit Programs

Seven Federal agencies—the Department of Agriculture (USDA), the Department of Defense, the Department of State, the Department of the Treasury, the Agency for International Development (USAID), the Export-Import Bank, and the Overseas Private Investment Corporation (OPIC)—provide direct loans, loan guarantees, and insurance to a variety of foreign private and sovereign borrowers. These programs are intended to level the playing field for U.S. exporters, deliver robust support for U.S. manufactured goods, stabilize international financial markets, and promote sustainable development.

Leveling the Playing Field

Federal export credit programs counter subsidies that foreign governments, largely in Europe and Japan, provide their exporters, usually through export credit agencies (ECAs). The U.S. Government has worked since the 1970's to constrain official credit support through a multilateral agreement in the Organization for Economic Cooperation and Development (OECD). This agreement has significantly constrained direct interest rate subsidies and tied-aid grants. Further negotiations resulted in a multilateral agreement that standardized the fees for sovereign lending across all ECAs beginning in April 1999. Fees for non-sovereign lending, however, continue to vary widely across ECAs and markets, thereby providing implicit subsidies.

The Export-Import Bank attempts to "level the playing field" strategically and to fill gaps in the availability of private export credit. The Export-Import Bank provides export credits, in the form of direct loans or loan guarantees, to U.S. exporters who meet basic eligibility criteria and who request the Bank's assistance. USDA's Export Credit Guarantee Programs (also known as GSM programs) similarly help to level the playing field. Like programs of other agricultural exporting nations, GSM programs guarantee payment from countries and entities that want to import U.S. agricultural products but cannot easily obtain credit.

Stabilizing International Financial Markets

In today's global economy, the health and prosperity of the American economy depend importantly on the stability of the global financial system and the economic health of our major trading partners. The United States can contribute to orderly exchange arrangements and a stable system of exchange rates through the International Monetary Fund and through financial support provided by the Exchange Stabilization Fund (ESF).

The ESF may provide "bridge loans" to other countries in times of short-term liquidity problems and financial crises. A loan or credit may not be made for more than six months in any 12-month period unless the President gives the Congress a written statement that unique or emergency circumstances require the loan or credit be for more than six months.

Using Credit to Promote Sustainable Development

Credit is an important tool in U.S. bilateral assistance to promote sustainable development. USAID's Development Credit Authority (DCA) allows USAID to use a variety of credit tools to support its development activities abroad. DCA provides non-sovereign loan guarantees in targeted cases where credit serves more effectively than traditional grant mechanisms to achieve sustainable development. DCA is intended to mobilize host country private capital to finance sustainable development in line with USAID's strategic objectives. Through the use of partial loan guarantees and risk sharing with the private sector, DCA stimulates private-sector lending for financially viable development projects, thereby leveraging host-country capital and strengthening sub-national capital markets in the developing world. While there is clear demand for DCA's facilities in some emerging economies, the utilization rate for these facilities is still very low.

OPIC also supports a mix of development, employment, and export goals by promoting U.S. direct investment in developing countries. OPIC pursues these goals through political risk insurance, direct loans, and guarantee products, which provide finance, as well as associated skills and technology transfers. These programs are intended to create more efficient financial markets, eventually encouraging the private sector to supplant OPIC finance in developing countries. OPIC has also created a number of investment funds that provide equity to local companies with strong development potential.

Ongoing Coordination

International credit programs are coordinated through two groups to ensure consistency in policy design and credit implementation. The Trade Promotion Coordinating Committee (TPCC) works within the Administration to develop a National Export Strategy to make the delivery of trade promotion support more effective and convenient for U.S. exporters.

The Interagency Country Risk Assessment System (ICRAS) standardizes the way in which agencies budget for the cost associated with the risk of international lending. The cost of lending by the agencies is governed by proprietary U.S. Government ratings, which correspond to a set of default estimates over a given maturity. The methodology establishes assumptions about default risks in international lending using averages of international sovereign bond market data. The strength of this method is its link to the market and an annual update that adjusts the default estimates to reflect the most recent risks observed in the market.

Self-Sufficient Export-Import Bank

The Budget estimates that the Bank's export credit support will total $18.7 billion, and will be funded entirely by receipts collected from the Bank's customers. The Bank estimates it will collect $146 million in 2008 in excess of expected losses on transactions authorized in 2008 and prior years. These amounts will be used to: (1) cover the estimated costs for that portion of new authorizations where fees are insufficient to cover expected losses; and (2) to cover administrative expenses.

IV. INSURANCE PROGRAMS

Deposit Insurance

Federal deposit insurance promotes stability in the U.S. financial system. Prior to the establishment of Federal deposit insurance, failures of some depository institutions often caused depositors to lose confidence in the banking system and rush to withdraw deposits. Such sudden withdrawals caused serious disruption to the economy. In 1933, in the midst of the Depression, the system of Federal deposit insurance was established to protect small depositors and prevent bank failures from causing widespread disruption in financial markets. Since its creation, the system has undergone a series of reforms, most recently in 2006.

While the deposit insurance system for banks and thrifts today is generally sound and well managed, inherent weaknesses in the system prompted the Administration to propose, and the Congress to enact, the Deposit Insurance Reform Act (part of the Deficit Reduction Act of 2005) in February 2006. This package of reforms had several effects: it consolidated the Federal Deposit Insurance Corporation's (FDIC) insurance funds (the Bank Insurance Fund and Savings Association Insurance Fund) into a new Deposit Insurance Fund, set new parameters on how the consolidated fund would be managed, adjusted the way that premiums for deposit insurance were calculated to ensure that all banks would pay premiums for Federal insurance on their insured deposits, and allowed for an increase of the coverage limits for Federal deposit insurance. These new authorities allow the FDIC to better manage the Deposit Insurance Fund and help avoid strain on financial institutions by spreading the cost of deposit insurance over time instead of having a potential for sharp premium increases when the economy may be under stress. The FDIC issued several new regulations during 2006 to implement the reforms in 2007.

The FDIC insures deposits in banks and savings associations (thrifts). The National Credit Union Administration (NCUA) insures deposits (shares) in most credit unions (certain credit unions are privately insured). FDIC and NCUA insure deposits up to $100,000 per account. Under the Deposit Insurance Reform Act of 2005, the deposit insurance ceiling for retirement accounts will be increased to $250,000. In addition, beginning in 2010, and every five years thereafter, FDIC and NCUA will have the authority to increase deposit insurance coverage limits for retirement and non-retirement accounts based on inflation if the Boards of the FDIC and NCUA determine such an increase is warranted. As of September 30, 2006, FDIC insured $4.1 trillion of deposits at 8,743 commercial banks and thrifts, and NCUA insured $529 billion of deposits (shares) at 8,462 credit unions.

Current Industry Conditions

The banking and thrift sector has been in the midst of a sustained run of record profits and strong balance sheets. During calendar year 2006, insured banks and thrifts continued to report record-high net earnings, with the industry's two highest-ever quarterly profits reported in the second and third quarters of 2006. In 2005 and 2006, no banks or thrifts failed—the longest period without a failure in the 73-year history of the FDIC. As of September 30, 2006, the FDIC classified 47 institutions with $4 billion in assets as "problem institutions" (institutions with the highest risk ratings), a historical low both in the number of institutions and dollar-value of assets thus classified.

Despite these strong fundamentals, some risks remain. In particular, the residential real estate market has been showing signs of significant weakness in recent months, with several regional markets experiencing slower sales and stagnant or even falling property prices. According to the National Association of Realtors, U.S. median house prices stayed essentially flat during the second half of 2006, after four and half years when growth rates nationwide exceeded five percent. In addition, after the steady series of interest rate hikes by the Federal Reserve in 2005 and 2006, higher short-term interest rates are beginning to squeeze the interest margins of many banks (The interest margin is the difference between the interest rates the banks charge for loans and the interest rates that they pay to depositors).

This tightening has begun to erode the proceeds from banks' core business. Not only are higher interest rates squeezing banks, they are also squeezing borrowers. During the past few years, banks have issued an increasing number of non-traditional mortgages, i.e., loans that have adjustable payment terms that allow borrowers to have lower initial payments, while their overall debt burden stays constant or even increases. Studies have suggested that in the first half of 2006, as many as 30 percent of mortgages issued nationally were non-traditional. Federal regulators, including the Federal Reserve, Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and FDIC, and industry analysts have been vocal in highlighting the spread of non-traditional lending products, and warned lenders and borrowers about the additional risks these products can pose if not properly managed. The regulators have raised these issues in testimony before Congress and in a variety of public forums, including guidance issued to the industry.

The Office of the Comptroller of the Currency has reported that, as competition in lending has intensified, banks have been easing their standards for extending loans to individuals and businesses. This has led to concerns about maintaining credit quality in the nation's lending markets. Separate, but related concerns have arisen in the area of "subprime" lending—loans to consumers with poor credit histories or who belong to groups that may not have previously had access to financing. This segment of the market has seen substantial growth in recent years, providing greater opportunity to these borrowers, but loans to subprime borrowers historically have higher rates of default. Although lenders charge higher rates of interest to subprime borrowers to compensate for the risk of default, with increased competition the spread (or additional interest charged) on subprime lending has fallen and may not fully cover the potential risk.

In order to address some of these potential problems, especially in non-traditional mortgages and easing lending standards, during 2006 the Federal banking regulators (the Board of Governors of the Federal Reserve System, the FDIC, the OCC, and the OTS) issued guidance to banks and thrifts on managing exposure to non-traditional mortgages, and on the appropriate disclosure to consumers of clear and balanced information about the risks of these products. The regulators also issued guidance on commercial real estate which sought to mitigate potential problems with rising concentrations of lending in commercial real estate, an issue of regulatory concern in a number of smaller and mid-sized community banks.

Also worthy of note is the increasing consolidation of the U.S. banking industry in recent years. As banks have merged or been acquired, the largest institutions have accounted for a growing share of total assets—whereas in 1984 depository institutions with over $10 billion in assets accounted for 42 percent of total assets in the industry, by 2004 the share of those institutions had risen to 73 percent. This has enabled larger banks and other institutions to diversify more effectively and obtain financing from the capital markets, but it has also meant that the failure of a single large insured institution could put a significant strain on the resources of the Federal deposit insurance funds.

Recent Changes to Federal Deposit Insurance Funds

Under the Deposit Insurance Reform Act of 2005, the FDIC's Bank Insurance Fund (BIF) and its Savings Association Insurance Fund (SAIF) were merged into the new Deposit Insurance Fund (DIF) in June 2006.

At the end of September 2006, the DIF reserve ratio (ratio of insurance reserves to insured deposits) stood at 1.22 percent—$1.2 billion below the level that would meet the target reserve ratio. Under new authority provided by the passage of the Deposit Insurance Reform Act, the FDIC Board voted to establish a new set of premiums for the industry to recapitalize the DIF. The new premiums range from a minimum of five basis points (five cents per $100 of assessable deposits) up to as high as 43 basis points based on the assessed risk of an institution. The Deposit Insurance Reform Act of 2005 provided depository institutions that had paid deposit insurance premiums prior to 1996 (the last year the FDIC collected premiums) with $4.7 billion in credits toward premiums, most of which will likely be used by 2009. Taking these credits into consideration, the FDIC is expected to collect approximately $1.5 billion in new revenue during fiscal 2007 and 2008 combined.

The National Credit Union Share Insurance Fund (NCUSIF), the Federal fund for credit unions that is analogous to the DIF for banks and thrifts, ended fiscal year 2006 with assets of $6.7 billion and an equity ratio of 1.29 percent, approaching the NCUA-set target ratio of 1.30 percent. Over the past five years, the NCUSIF's equity ratio has gradually risen from about 1.27 percent, reflecting strong performance (and therefore few losses due to failures) in the credit union industry.

Current Regulatory Issues

A number of major regulatory initiatives are currently underway in the banking sector, which are likely to have a significant impact on the banking sector as a whole and, by extension, on the Federal deposit insurance system. For example, the Federal banking regulators (the Federal Reserve, FDIC, OCC and OTS) continue to work on a rulemaking that would implement the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" ("Basel II").

Since equity capital serves as a cushion against potential losses, banks with riskier asset portfolios should hold more equity capital. The original Basel Capital Accord (Basel I) adopted in 1989 is an international accord among financial regulators establishing a uniform capital standard for banks across nations. Under Basel I, bank assets are grouped into a small number of broad risk categories. A bank's regulatory capital requirement is tied to the amount of its asset holdings in each risk category.

During 2006, the Federal banking regulators proposed two separate but related rulemakings to implement the Revised Basel Capital Accord: the "Basel II" framework and an intermediate "Basel 1A" framework.

In the proposed Basel II rule, U.S. regulators are considering requiring the ten or so largest banks (including those that have major international operations, complex financial structures and expertise) to use an advanced internal ratings-based approach to calculate their credit risk capital requirements. The Basel II rulemaking would allow for greater sensitivity to risk in the portfolios banks hold. Rather than grouping assets into broad risk categories, capital requirements would be tied to banks' internal assessments of the likelihood and severity of default losses from the assets they hold. The rules are also intended to allow capital requirements to more accurately account for the benefits or risk-mitigation activities undertaken by banks. The rulemaking would also require banks to hold capital to cover operational risk, which is not covered under the existing (Basel I) requirements.

Implementation of the Basel II standard in Europe is scheduled to begin during 2007, more than a year before U.S. implementation would likely begin, and this delay has led to concerns about a competitive imbalance between U.S. and foreign banks. There are also concerns about competitive imbalance between U.S. banks, and for that reason, banks other than the ten largest U.S. banks would be able to choose between adopting the "Basel II" standard, the current "Basel I" system, and an alternative "Basel 1A" standard.

The "Basel 1A" standard is intended to be more risk-sensitive than Basel I, but easier to implement than Basel II. The "Basel 1A" standard would provide additional risk-sensitivity through use of external credit ratings, and internal risk measures for some types of assets (i.e., loan-to-value ratios for mortgages). This new standard would allow banks to potentially lower their capital requirements and provide small- and mid-sized banks a means to stay competitive with the larger Basel II banks. The regulators are proposing to make the Basel 1A standard optional for banks, meaning that no small or medium-sized bank would be required to change its capital regime.

The proposed text of both rules has been released for public comment, and regulators hope to finalize these rules in the near future.

Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures pension benefits of workers and retirees in covered defined-benefit pension plans sponsored by private-sector employers. PBGC pays benefits, up to a guaranteed level, when a company with an underfunded pension plan meets the legal criteria to transfer its obligations to the pension insurance program. PBGC's claims exposure is the amount by which qualified benefits exceed assets in insured plans. In the near term, the risk of loss stems from financially distressed firms with underfunded plans. In the longer term, loss exposure results from the possibility that healthy firms become distressed and well-funded plans become underfunded due to inadequate contributions, poor investment results, or increased liabilities.

PBGC monitors companies with underfunded plans and acts to protect the interests of the pension insurance program's stakeholders where possible. Under its Early Warning Program, PBGC works with companies to strengthen plan funding or otherwise protect the insurance program from avoidable losses. However, PBGC's authority to prevent undue risks to the insurance program is limited.

As a result of a flawed pension funding system and exposure to losses from financially troubled plan sponsors, PBGC's single-employer program incurred substantial losses from underfunded plan terminations in 2001 through 2006. The table below shows the ten largest plan termination losses in PBGC's history. Nine of the ten have come in the past five years. The program's deficit at 2006 year-end stood at $18.1 billion[1] compared to a $9.7 billion surplus at 2000 year-end.

LARGEST TEN CLAIMS AGAINST THE PBGC'S SINGLE-EMPLOYER INSURANCE PROGRAM, 1975–2006

Top 10 Firms	Fiscal Years of Plan Terminations	Claims (by firm)	Percent of Total Claims (1975–2005)
1. United Airlines	2005	$7,484,348,482	22.90%
2. Bethlehem Steel	2003	3,654,380,116	11.20%
3. US Airways	2003, 2005	2,690,222,805	8.20%
4. LTV Steel *	2002, 2003, 2004	2,136,698,831	6.50%
5. National Steel	2003	1,275,628,286	3.90%
6. Pan American Air	1991, 1992	841,082,434	2.60%
7. Weirton Steel	2004	690,181,783	2.10%
8. Trans World Airlines	2001	668,377,105	2.00%
9. Kaiser Aluminum	2004	600,009,879	1.80%
10. Kemper Insurance	2005	568,417,151	1.70%
Top Ten Total	....	20,609,346,871	63.20%
All Other Total	....	12,017,433,400	36.80%
TOTAL	....	**$32,626,780,271**	**100.00%**

Due to rounding, percentages may not add up to 100 percent.

Data in this table have been calculated on a firm basis and include all plans of each firm.

Values and distributions are subject to change as PBGC completes its reviews and establishes termination dates.

* Does not include 1986 termination of a Republic Steel plan sponsored by LTV.

Sources: PBGC Fiscal Year Closing File (9/30/06), PBGC Case Administration System, and PBGC Participant System (PRISM).

In February 2005 the Administration proposed comprehensive reforms to address structural flaws in the statutory plan funding requirements and in the design of the insurance program. The proposal sought to strengthen funding for workers' defined-benefit pensions; provide more accurate information about pension liabilities and plan underfunding; and enable PBGC to meet its obligations to participants in terminated pension plans. Many of the President's reforms were incorporated into the Deficit Reduction Act (DRA) of 2005, enacted in February 2006, and the Pension Protection Act of 2006 (PPA), enacted in August 2006.

The legislation made significant structural changes to the retirement system. But while the PBGC has sufficient liquidity to meet its obligations for a number of years, neither the single-employer nor multiemployer program has the resources to satisfy fully the agency's long-term obligations to plan participants.

Further reforms are needed to address the $19 billion gap that still exists between PBGC's liabilities and its assets. The Budget reproposes non-enacted premium reforms from the Administration's comprehensive pension reform proposal that were not included in the DRA or the PPA, including:

- Authorizing PBGC's Board of Directors to set the variable premium rate.
- Extending the variable rate premium to a plan's non-vested as well as its vested liabilities.

These reforms will improve PBGC's financial condition and safeguard the future benefits of American workers. The Administration is committed to pension reform that will ultimately restore the PBGC to solvency.

Disaster Insurance

Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP), which is administered by the Federal Emergency Management Agency of the Department of Homeland Security (DHS). Flood insurance is available to homeowners and businesses in communities that have adopted and enforced appropriate flood plain management measures. Coverage is limited to buildings and their contents. By

[1] The 2006 year-end single-employer program deficit of $18.1 billion was less than the $22.8 billion deficit at the end of 2005. The improvement in PBGC's financial condition was driven primarily by the airline relief provisions in the Pension Protection Act of 2006, which resulted in large plans previously classified as probable terminations being changed from the probable classification to the reasonably possible classification in FY 2006. This credit was partially offset by $3.1 billion in financial losses.

the end of 2006, the program had over 5.3 million policies in more than 20,200 communities with over $1 trillion of insurance in force.

Prior to the creation of the program in 1968, many factors made it cost prohibitive for private insurance companies alone to make affordable flood insurance available. In response, the NFIP was established to make affordable insurance coverage widely available. The NFIP requires building standards and other mitigation efforts to reduce losses, and operates a flood hazard mapping program to quantify the geographic risk of flooding. These efforts have made substantial progress. However, structures built prior to flood mapping and NFIP floodplain management requirements, which make up 26 percent of the total policies in force, pay less than fully actuarial rates.

DHS is using three strategies to increase the number of flood insurance policies in force: lender compliance, program simplification, and expanded marketing. DHS is educating financial regulators about the mandatory flood insurance requirement for properties that are located in floodplains and have mortgages from federally regulated lenders. These strategies have resulted in policy growth of nearly 14 percent in 2006 with nearly 660,000 new policies. The most significant participation increases were in vulnerable coastal states, such as Mississippi (58 percent, 25,371 policy increase), Texas (30 percent, 140,834 policy increase), Louisiana (25 percent, 98,096 policy increase), and Florida (11 percent, 208,716 policy increase). However, the program has also seen significant growth within some in-land states such as Idaho (24 percent, 1,357 policy increase), based on greater awareness of the need for flood insurance protection.

DHS also has a multi-pronged strategy for reducing future flood damage. The NFIP offers flood mitigation assistance grants to assist flood victims to rebuild to current building codes, including base flood elevations, thereby reducing future flood damage costs. In addition, two grant programs targeted toward repetitive and severe repetitive loss properties not only help owners of high-risk property, but also reduce the disproportionate drain on the National Flood Insurance Fund these properties cause through acquisition, relocation, or elevation. As a result of the 2005 hurricane season, the number of repetitive and severe repetitive loss properties increased significantly, and the Budget proposes to expand the severe repetitive loss grant program to mitigate the future impact of these high-risk properties. DHS is working to ensure that all of the flood mitigation grant programs are closely integrated, resulting in better coordination and communication with State and local governments. Further, through the Community Rating System, DHS adjusts premium rates to encourage community and State mitigation activities beyond those required by the NFIP. These efforts, in addition to the minimum NFIP requirements for floodplain management, save over $1 billion annually in avoided flood damages.

The program's reserve account, which is a cash fund, has sometimes had expenses greater than its revenue, forcing the NFIP to borrow funds from the Treasury in order to meet claims obligations. However, since the program began in 1968 until 2005, the program has repaid all borrowed funds with interest. However, hurricanes Katrina, Rita, and Wilma generated more flood insurance claims than the cumulative number of claims from 1968 to 2004. These three storms resulted in over 234,000 claims with total claims payments expected to be approximately $21 billion. As a result, the Administration and the Congress have increased the borrowing authority to $20.8 billion to date in order to make certain that all claims could be paid.

The catastrophic nature of the 2005 hurricane season has also triggered an examination of the program, and the Administration has worked with the Congress to improve the program, based on the following principles: protecting the NFIP's integrity by covering existing commitments; phasing out subsidized premiums in order to charge fair and actuarially sound premiums; increasing program participation incentives and improving enforcement of mandatory participation in the program; increasing risk awareness by educating property owners; and reducing future risks by implementing and enhancing mitigation measures. Although flood insurance reform was not achieved in 2006, the Administration looks forward to continuing to work with the Congress to enact program reforms that further mitigate the impact of flood damages and losses.

Crop Insurance

Subsidized Federal crop insurance administered by USDA's Risk Management Agency (RMA) assists farmers in managing yield and revenue shortfalls due to bad weather or other natural disasters. The program is a cooperative effort between the Federal Government and the private insurance industry. Private insurance companies sell and service crop insurance policies. These companies rely on reinsurance provided by the Federal Government and also by the commercial reinsurance market to manage their individual risk portfolio. The Federal Government reimburses private companies for a portion of the administrative expenses associated with providing crop insurance and reinsures the private companies for excess insurance losses on all policies. The Federal Government also subsidizes premiums for farmers.

The Budget includes a proposal to implement a participation fee in the Federal crop insurance program. The proposed participation fee would initially be used to fund modernization of the existing information technology (IT) system and would supplement the annual appropriation provided by the Congress. Subsequently, the fee would be shifted to maintenance and would be expected to reduce the annual appropriation. The participation fee would be charged to insurance companies participating in the Federal crop insurance program; based on a rate of about one-half cent per dollar of premium sold, the fee is expected to be sufficient to generate about $15 million annually beginning in 2009. The existing IT system is nearing the end of its useful life and recent years have seen increases in "down-time" resulting from system failures. Over the years, numerous changes have occurred in the Federal crop insurance program; the development of revenue and livestock insurance, for example, has greatly expanded the program and taxed the IT system due to new requirements, such as daily pricing, which were not envisioned when the existing IT system was designed. These new requirements contribute to increased maintenance costs and limit RMA's ability to comply with Congressional mandates pertaining to data reconciliation with the Farm Service Agency. The participation fee will alleviate these problems.

There are various types of insurance programs. The most basic type of coverage is catastrophic coverage (CAT), which compensates the farmer for losses in excess of 50 percent of the individual's average yield at 55 percent of the expected market price. The CAT premium is entirely subsidized, and farmers pay only an administrative fee. Higher levels of coverage, called buy-up coverage, are also available. A premium is charged for buy-up coverage. The premium is determined by the level of coverage selected and varies from crop to crop and county to county. For the 10 principal crops, which account for about 80 percent of total liability, the most recent data shows that over 75 percent of eligible acres participated in the crop insurance program.

RMA offers both yield and revenue-based insurance products. Revenue insurance programs protect against loss of revenue stemming from low prices, poor yields, or a combination of both. These programs extend traditional multi-peril or yield crop insurance by adding price variability to production history.

USDA is continuously trying to develop new products or expand existing products in order to cover more types of crops. In 2006, a Livestock Risk Protection for Lamb pilot was introduced, and Adjusted Gross Revenue-Lite was made available in five additional States. In addition, two new Group Risk Protection risk management tools for pasture, rangeland, and forage protection were approved for the 2007 crop year. These innovative pilot programs are based on vegetation greenness and rainfall indices and were developed to provide livestock producers the ability to purchase insurance protection for losses of forage produced for grazing or harvested for hay. RMA also expanded the Group Risk Income Protection plans for cotton, wheat, and grain sorghum for the 2007 crop year. And, it is expected that the Livestock Gross Margin pilot program will be expanded to include cattle in 2007. RMA is also making substantial improvements to the Florida Fruit Tree pilot program to enhance coverage and make it more effective for loss due to hurricane. RMA continues to pursue a number of avenues to increase program participation among underserved States and commodities by working on declining yield issues and looking at discount programs for good experienced producers who pose less risk.

For more information and additional crop insurance program details, please reference RMA's web site: *(www.rma.usda.gov).*

Insurance Against Security-Related Risks

Terrorism Risk Insurance

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002 (TRIA). The Act was designed to address disruptions in economic activity caused by the withdrawal of many insurance companies from the marketplace for terrorism risk insurance in the aftermath of the terrorist attacks of September 11, 2001. Their withdrawal in the face of great uncertainty as to their risk exposure to future terrorist attacks led to a moratorium on many new construction projects, increasing business costs for the insurance that was available, and substantially shifting risk—from reinsurers to primary insurers, and from insurers to policyholders (e.g., investors, businesses, and property owners). Ultimately, these costs were borne by American workers and communities through decreased development and economic activity.

The Act established a temporary, three-year Federal program that provided a system of shared public and private compensation for insured commercial property and casualty losses arising from acts of terrorism (as defined by the Act). Under the Act, insurance companies offering commercial property and casualty insurance policies were required to make available to their policyholders coverage for losses from acts of terrorism. In the event of a terrorist attack on private businesses and others covered by this program, the Federal Government would initially cover 90 percent of the insured losses above each insurance company's deductible (as specified in the Act). The Act also provided authority for the Department of the Treasury to recoup any Federal payments via surcharges on policyholders in future years. In December 2005, the Congress passed and the President signed the Terrorism Risk Insurance Extension Act, which extended the program for two years, through December 31, 2007, and substantially narrowed the scope of the program.

The 2005 Act significantly reduced taxpayers' exposure by excluding certain lines of insurance from Federal coverage: commercial automobile, burglary and theft, surety, professional liability, and farm owners multiple peril insurance were removed from the program altogether. In addition, the 2005 Act increased insurers' deductibles from 15 percent of direct earned premiums for calendar year 2005 to 17.5 percent in 2006 and 20 percent in 2007. The extension also decreased the Federal co-payment for insured losses above the insurers' deductibles from 90 percent of insured losses in calendar year 2005 and 2006 to 85 percent of insured losses in 2007.

The new legislation also increased the trigger amount for Federal payments, from the original $5 million in aggregate insured losses from an act of terrorism to

$50 million in calendar year 2006 and $100 million in calendar year 2007. TRIA imposes a cap of $100 billion on total insurer losses from terrorist attacks that the Federal program would cover. Under the statute, the Congress would determine the procedures to govern any payments for losses beyond $100 billion in separate legislation.

In addition to the reforms to the scope of the program, the 2005 Act required the President's Working Group on Financial Markets (PWG) to conduct a study on the availability and affordability of terrorism risk coverage under the program and to report the results to the Congress by September 30, 2006. The PWG report found that the program had achieved its goals of supporting the insurance industry post September 11, 2001 and that the market for terrorism risk insurance (in terms of availability and affordability) has improved since September 11, 2001. The TRIA program was never intended to be permanent, but rather was intended to help stabilize the insurance industry during a time of significant transition. It has been successful in providing a temporary transition to allow for greater market development.

Airline War Risk Insurance

After the September 11, 2001 attacks, private insurers cancelled third-party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In addition to a number of short term responses, the Congress also passed the Homeland Security Act of 2002 (P.L. 107–296.) Among other provisions, this Act required the Secretary to provide additional war risk insurance coverage to air carriers insured for Third-Party War Risk Liability as of June 19, 2002, as authorized under existing law. The Continuing Appropriations Act for FY 2007, as amended (P.L. 109–383) further extended the requirement to provide insurance coverage through the duration of the resolution, February 15, 2007, and the program is expected to be continued through at least August 31, 2007. Acting on behalf of the Secretary, the FAA insurance policies made available under this Act cover: (i) hull losses at agreed value; (ii) death, injury, or property loss to passengers or crew, the limit being the same as that of the air carrier's commercial coverage before September 11, 2001; and (iii) third party liability, the limit generally being twice that of such coverage. The Secretary is also authorized to limit an air carrier's third party liability to $100 million, when the Secretary certifies that the loss is from an act of terrorism.

This program provides airlines with financial protection from war risk occurrences, and thus allows airlines to meet the basic requirement for "adequate liability coverage" found in most aircraft leases and in government regulation. Without such coverage, many airlines might be grounded. Currently, aviation war risk insurance coverage is generally available from private insurers, but premiums are significantly higher in the private market. Private insurance is also available for third-party liability and for occurrences involving weapons of mass destruction, albeit to a lesser extent.

Currently 75 air carriers are insured by the Department of Transportation. Coverage for individual carriers ranges from $80 million to $4 billion per carrier, with the median insurance coverage at approximately $1.8 billion per occurrence. Premiums collected by the Government for these policies are deposited into the Aviation Insurance Revolving Fund. In 2006, the Fund earned approximately $169 million in premiums for insurance provided by DOT, and it is anticipated that an additional $99 million in premiums will be earned in 2007. At the end of 2006, the balance in the Aviation Insurance Revolving Fund available for payment of future claims was $742 million. Although no claims have been paid by the Fund since 2001, the balance in the Fund would be inadequate to meet either the coverage limits of the largest policies in force ($4 billion) or to meet a series of large claims in succession. The Federal Government would pay any claims by the airlines that exceed the balance in the Aviation Insurance Revolving Fund. The Administration does not support a straight extension of this program, which crowds out private sector mechanisms for managing risk. The Administration is committed to working with the Congress to reform this program, and to ensure that air carriers more equitably share in the risks associated with this program.

Chart 7-2. Face Value of Federal Credit Outstanding

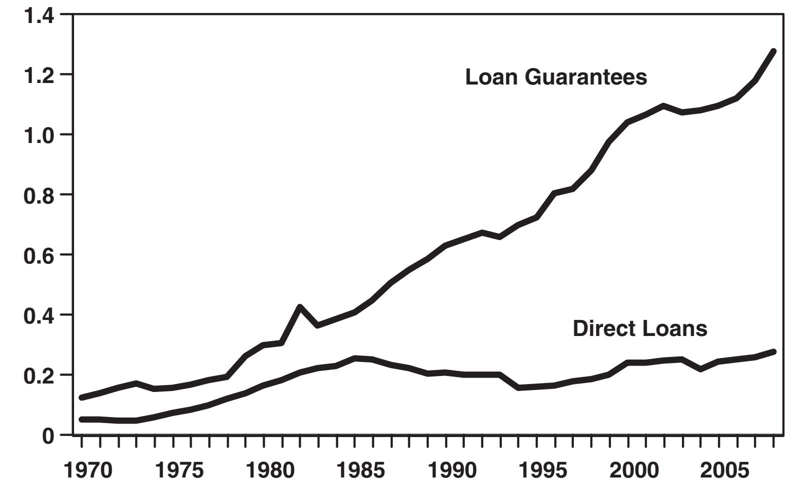


TABLE 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(In billions of dollars)

Program	Outstanding 2005	Estimated Future Costs of 2005 Outstanding [1]	Outstanding 2006	Estimated Future Costs of 2006 Outstanding [1]
Direct Loans: [2]				
Federal Student Loans	113	11	116	16
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	43	9	43	10
Rural Utilities Service and Rural Telephone Bank	34	2	38	2
Housing and Urban Development	12	2	11	3
Export-Import Bank	10	5	7	2
Public Law 480	9	4	8	4
Agency for International Development	8	3	7	3
Commodity Credit Corporation	3	1	2	1
Disaster Assistance	4	1	7	2
VA Mortgage	1	....	1	....
Other Direct Loan Programs	11	3	12	4
Total Direct Loans	247	41	251	47
Guaranteed Loans: [2]				
FHA Mutual Mortgage Insurance Fund	336	2	317	3
VA Mortgage	206	3	211	3
Federal Student Loans	289	31	325	52
FHA General/Special Risk Insurance Fund	90	3	98	1
Small Business [3]	73	2	67	2
Export-Import Bank	36	2	36	2
International Assistance	22	2	22	2
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	30	1	31	....
Commodity Credit Corporation	2	....	3	....
Maritime Administration	3	....	3	....
Air Transportation Stabilization Program	1	1	....	....
Government National Mortgage Association (GNMA) [3]	....	*	....	*
Other Guaranteed Loan Programs	8	1	6	1

TABLE 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS—Continued

(In billions of dollars)

Program	Outstanding 2005	Estimated Future Costs of 2005 Outstanding [1]	Outstanding 2006	Estimated Future Costs of 2006 Outstanding [1]
Total Guaranteed Loans	1,096	48	1,120	66
Total Federal Credit	**1,343**	**89**	**1,371**	**113**

* $500 million or less.
[1] Direct loan future costs are the financing account allowance for subsidy cost and the liquidating account allowance for estimated uncollectible principal and interest. Loan guarantee future costs are estimated liabilities for loan guarantees.
[2] Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as CCC commodity price supports. Defaulted guaranteed loans which become loans receivable are accounted for as direct loans.
[3] GNMA data are excluded from the totals because they are secondary guarantees on loans guaranteed by FHA, VA and RHS. Certain SBA data are excluded from the totals because they are secondary guarantees on SBA's own guaranteed loans.

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2006 [1]

(Budget authority and outlays, in millions of dollars)

Program	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
DIRECT LOANS:												
Agriculture:												
Agriculture credit insurance fund	2	–31	23	....	331	–656	921	10	–701	–147	–2	–14
Farm storage facility loans	....	....	....	....	....	....	–1	–7	–8	7	–1	....
Apple loans	....	....	....	....	....	....	–2	1	....	*	*	*
Emergency boll weevil loan	....	....	....	....	....	....	....	1	*	*	3	....
Distance learning and telemedicine	....	....	....	....	....	....	1	–1	–1	1	7	....
Rural electrification and telecommunications loans	–37	84	....	–39	....	–17	–42	101	265	143	–197	....
Rural telephone bank	....	10	....	–9	....	–1	....	–3	–7	–6	–17	....
Rural housing insurance fund	46	–73	....	71	....	19	–29	–435	–64	–200	109	....
Rural economic development loans	....	1	....	–1	*	....	–1	–1	....	–2	*	....
Rural development loan program	....	....	....	–6	....	....	–1	–3	....	–3	–2	....
Rural community advancement program [2]	....	8	....	5	....	37	3	–1	–84	–34	–73	....
P.L. 480	–37	–1	....	....	....	–23	65	–348	33	–43	–239	–26
P.L. 480 Title I food for progress credits	–38	....	....	....	....	....	....	–112	–44	....	....	....
Commerce:												
Fisheries finance	....	....	....	....	....	–19	–1	–3	....	1	–15	–12
Defense:												
Military housing improvement fund	....	....	....	....	....	....	....	....	....	*	–4	–1
Education:												
Federal direct student loan program: [3]												
Volume reestimate	....	....	....	22	....	–6	....	43	....	....	....	....
Other technical reestimate	3	–83	172	–383	–2,158	560	....	3,678	1,999	855	2,827	2,674
College housing and academic facilities loans	....	....	....	....	....	–1	....	....	....	....	....	11
Homeland Security:												
Disaster assistance	....	....	....	....	47	36	–7	–6	*	4	*	*
Interior:												
Bureau of Reclamation loans	....	....	....	....	3	3	–9	–14	....	17	1	*
Bureau of Indian Affairs direct loans	....	....	....	1	5	–1	–1	2	*	*	*	1
Assistance to American Samoa	....	....	....	....	....	....	....	....	*	*	....	2
State												
Repatriation loans	....	....	....	....	....	....	....	....	....	....	....	–4
Transportation:												
High priority corridor loans	....	....	–3	....	....	....	....	....	....	....	....	....
Alameda corridor loan	....	....	....	....	–58	....	....	....	–12	....	....	....
Transportation infrastructure finance and innovation	....	....	....	....	....	18	....	....	....	3	–11	7
Railroad rehabilitation and improvement program	....	....	....	....	....	....	....	....	–5	–14	–11	–1
Treasury:												
Community development financial institutions fund	....	....	....	....	1	....	....	*	–1	*	–1	1
Veterans Affairs:												
Veterans housing benefit program fund	76	–72	465	–111	–52	–107	–697	17	–178	987	–44	–76
Native American veteran housing	....	....	....	....	....	....	....	–3	*	*	*	1
Vocational Rehabilitation Loans	....	....	....	....	....	....	....	*	*	*	–1	1
Environmental Protection Agency:												
Abatement, control and compliance	....	....	....	....	....	3	–1	*	–3	*	*	*
International Assistance Programs:												
Foreign military financing	....	13	4	1	152	–166	119	–397	–64	–41	–7	–6
U.S. Agency for International Development:												
Micro and small enterprise development	....	....	....	....	....	....	*	....	*	....	....	....
Overseas Private Investment Corporation:												
OPIC direct loans	....	....	....	....	....	....	....	–4	–21	3	–7	72
Debt reduction	....	....	....	....	36	–4	....	*	–47	–104	54	–3
Small Business Administration:												
Business loans	....	....	....	....	....	1	–2	1	25	....	–16	–4
Disaster loans	....	....	–193	246	–398	–282	–14	266	589	196	61	258
Other Independent Agencies:												
Export-Import Bank direct loans	37	....	....	....	–177	157	117	–640	–305	111	–257	–227
Federal Communications Commission	....	....	4,592	980	–1,501	–804	92	346	380	732	–24	11
LOAN GUARANTEES:												
Agriculture:												
Agriculture credit insurance fund	12	–51	96	....	–31	205	40	–36	–33	–22	–162	20

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2006 [1]—Continued

(Budget authority and outlays, in millions of dollars)

Program	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Agriculture resource conservation demonstration	....	....	....	....	....	2	....	1	–1	*	*	....
Commodity Credit Corporation export guarantees	–426	343	....	....	....	–1,410	....	–13	–230	–205	–366	–232
Rural development insurance fund	....	–3	....	....	....	....	....	....	....	....	34	....
Rural housing insurance fund	7	–10	....	109	....	152	–56	32	50	66	44	....
Rural community advancement program [2]	....	–10	....	41	....	63	17	91	15	29	–64	....
Commerce:												
Fisheries finance	....	....	–2	....	....	–3	–1	3	*	1	*	1
Emergency steel guaranteed loans	....	....	....	....	....	....	....	50	*	3	–75	–13
Emergency oil and gas guaranteed loans	....	....	....	....	....	*	*	*	*	*	–1	*
Defense:												
Military housing improvement fund	....	....	....	....	....	....	....	....	–3	–1	–3	–5
Defense export loan guarantee	....	....	....	....	....	....	....	....	....	–5	....	....
Arms initiative guaranteed loan program	....	....	....	....	....	....	....	....	....	....	....	20
Education:												
Federal family education loan program: [3]												
Volume reestimate	535	99	....	–13	–60	–42	....	277	....	....	....	....
Other technical reestimate	60	....	....	–140	667	–3,484	....	–2,483	–3,278	1,348	6,837	–3,399
Health and Human Services:												
Heath center loan guarantees	....	....	....	....	3	....	*	*	....	1	*	*
Health education assistance loans	....	....	....	....	....	....	....	–5	–37	–33	–18	–20
Housing and Urban Development:												
Indian housing loan guarantee	....	....	....	....	....	–6	*	–1	*	–3	–1	*
Title VI Indian guarantees	....	....	....	....	....	....	....	–1	1	4	*	–4
Community development loan guarantees	....	....	....	....	....	....	....	....	19	–10	–2	4
FHA-mutual mortgage insurance	....	–340	....	3,789	....	2,413	–1,308	1,100	5,947	1,979	2,842	636
FHA-general and special risk	–110	–25	743	79	....	–217	–403	77	352	507	238	–1,254
Interior:												
Bureau of Indian Affairs guaranteed loans	....	31	....	....	....	–14	–1	–2	–2	*	15	5
Transportation:												
Maritime guaranteed loans (Title XI)	....	....	....	–71	30	–15	187	27	–16	4	–76	–11
Minority business resource center	....	....	....	....	....	....	1	....	*	*	....	*
Treasury:												
Air transportation stabilization program	....	....	....	....	....	....	....	113	–199	292	–109	–38
Veterans Affairs:												
Veterans housing benefit fund program	334	–706	38	492	229	–770	–163	–184	–1,515	–462	–842	–525
International Assistance Programs:												
U.S. Agency for International Development:												
Development credit authority	....	....	....	....	....	....	–1	....	1	–3	–2	2
Micro and small enterprise development	....	....	....	....	....	....	....	....	2	–2	....	–3
Urban and environmental credit	–7	....	–14	....	....	....	–4	–15	48	–2	–5	–11
Assistance to the new independent states of the former Soviet Union	....	....	....	....	....	....	–34	....	....	....	....	....
Loan Guarantees to Israel	....	....	....	....	....	....	....	....	–76	–111	188	34
Loan Guarantees to Egypt	....	....	....	....	....	....	....	....	....	....	7	14
Overseas Private Investment Corporation:												
OPIC guaranteed loans	....	....	....	....	....	....	5	77	60	–212	–21	–149
Small Business Administration:												
Business loans	257	–16	–279	–545	–235	–528	–226	304	1,750	1,034	–390	–268
Other Independent Agencies:												
Export-Import Bank guarantees	13	....	....	....	–191	–1,520	–417	–2,042	–1,133	–655	–1,164	–579
Total	727	–832	5,642	4,518	–3,641	–6,427	–1,854	–142	3,468	6,008	9,037	–3,111

* Less than $500,000.
[1] Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.
[2] Includes rural water and waste disposal, rural community facilities, and rural business and industry programs.
[3] Volume reestimates in mandatory programs represent a change in volume of loans disbursed in the prior years.

Table 7–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2006-2008

(In millions of dollars)

Agency and Program	2006 Actual			2007 Estimate			2008 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	8.03	80	989	9.47	94	995	9.88	97	977
Farm storage facility loans	–0.62	–1	111	0.25	....	74	1.12	1	93
Rural community advancement program	5.90	83	1,406	9.00	90	1,009	....	....	....
Rural electrification and telecommunications loans	–0.50	–31	6,080	–0.71	–38	5,377	–0.51	–24	4,790
Distance learning, telemedicine, and broadband program	2.14	7	333	1.94	22	1,155	2.15	6	300
Rural water and waste disposal	....	....	....	....	....	....	14.20	153	1,080
Rural community facility	....	....	....	....	....	....	5.55	17	302
Rural housing assistance grants	46.76	2	4	47.82	4	8	....	....	....
Farm labor	44.59	9	20	47.95	5	10	43.26	6	14
Multifamily housing revitalization	46.76	1	2	47.82	1	2	....	....	....
Rural housing insurance fund	14.57	199	1,357	13.22	195	1,463	17.23	7	39
Rural development loan fund	43.02	15	34	44.07	15	33	42.89	14	34
Rural economic development loans	19.97	5	25	21.84	5	23	22.59	7	33
Public law 480 title I direct credit and food for progress	67.92	27	39	....	....	....	....	....	....
Commerce:									
Fisheries finance	–3.34	–4	138	–6.21	–5	75	–10.58	–1	8
Defense—Military:									
Defense family housing improvement fund	2.56	2	78	28.40	251	883	26.38	61	233
Education:									
College housing and academic facilities loans	....	....	15	57.72	179	310	....	....	....
Federal direct student loan program	4.98	1,807	36,305	2.43	474	19,503	2.35	509	21,636
Health and Human Services:									
State grants and demonstrations	100.00	140	140	100.00	1	1	....	....	....
Homeland Security:									
Disaster assistance direct loan	75.00	953	1,271	1.18	....	25	1.73	....	25
Housing and Urban Development:									
FHA-mutual mortgage insurance	....	....	3	....	....	50	....	....	50
State:									
Repatriation loans	64.99	1	1	60.14	1	1	60.22	1	1
Transportation:									
Federal-aid highways	8.50	4	42	5.05	121	2,400	5.00	79	1,581
Railroad rehabilitation and improvement program	....	....	155	....	....	200	....	....	600
Treasury:									
Community development financial institutions fund	37.47	....	1	37.47	1	3	37.52	1	2
Veterans Affairs:									
Housing	2.27	3	163	5.25	18	335	3.86	20	539
Native American veteran housing loan	–13.79	–1	4	–13.46	–1	4	–14.48	–1	4
General operating expenses	1.59	....	3	2.00	....	3	2.16	....	3
International Assistance Programs:									
Debt restructuring	....	29	....	....	84	....	....	255	....
Overseas Private Investment Corporation	3.63	7	193	2.74	10	350	3.22	16	500
Small Business Administration:									
Disaster loans	14.64	1,286	8,785	17.73	471	2,659	16.27	173	1,064
Business loans	7.17	1	20	10.21	1	10	....	....	25
Export-Import Bank of the United States:									
Export-Import Bank loans	1.79	1	56	34.00	17	50	33.01	17	50
Total	**N/A**	**4,625**	**57,773**	**N/A**	**2,016**	**37,011**	**N/A**	**1,414**	**33,983**

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.
N/A = Not applicable.

Table 7–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2006-2008

(In millions of dollars)

Agency and Program	2006 Actual			2007 Estimate			2008 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	3.12	67	2,147	2.39	65	2,624	2.54	62	2,450
Commodity Credit Corporation export loans	4.88	71	1,453	3.00	61	1,990	2.63	63	2,440
Rural community advancement program	3.99	38	933	4.02	48	1,197			
Rural water and waste disposal							–0.82	–1	75
Rural community facility							3.68	8	210
Rural housing insurance fund	1.29	41	3,173	1.26	62	4,998	0.57	29	5,049
Rural business and industry							4.32	43	1,000
Rural business investment	7.72	2	24						
Renewable energy	6.45	2	24	6.49	10	154	9.69	19	195
Education:									
Federal family education loan	12.74	17,274	135,576	6.65	5,860	88,062	3.88	3,861	99,481
Energy:									
Title 17 innovative technology loan guarantee program									9,000
Health and Human Services:									
Health resources and services	3.50		2	3.42		8			
Housing and Urban Development:									
Indian housing loan guarantee fund	2.42	5	190	2.35	5	251	2.42	6	367
Native Hawaiian Housing Loan Guarantee Fund				2.35	1	43	2.42	1	41
Native American housing block grant	12.26	2	13	11.99	2	17	12.12	2	17
Community development loan guarantees	2.20	5	220	2.17	3	136	2.20	1	45
FHA-mutual mortgage insurance	–1.70	–880	51,783	–0.37	–164	44,418	–0.83	–680	81,996
FHA-general and special risk	–1.74	–504	28,702	–2.01	–413	20,499	–2.54	–242	9,514
Interior:									
Indian guaranteed loan	4.75	5	117	6.45	5	87	6.52	5	86
Transportation:									
Minority business resource center program	1.85		2	1.82		18	2.03		18
Federal-aid highways				3.90	8	200	5.90	12	200
Railroad rehabilitation and improvement program									100
Maritime guaranteed loan (title XI)				5.93	4	67			
Veterans Affairs:									
Housing	–0.32	–73	23,500	–0.36	–102	28,260	–0.37	–108	29,104
International Assistance Programs:									
Loan guarantees to Israel						1,000			1,000
Development credit authority	3.66	6	159	5.45	6	110	6.03	21	348
Overseas Private Investment Corporation	–1.96	–13	661	–1.22	–12	950	–0.78	–8	950
Small Business Administration:									
Business loans			19,936			28,000			28,000
Export-Import Bank of the United States:									
Export-Import Bank loans	1.16	141	12,094	0.06	10	15,860	–1.95	–367	18,714
Total	**N/A**	**16,189**	**280,709**	**N/A**	**5,459**	**238,949**	**N/A**	**2,727**	**290,400**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS									
GNMA:									
Guarantees of mortgage-backed securities loan guarantee	–0.23	–188	81,739	–0.21	–181	86,000	–0.27	–209	77,400
SBA:									
Secondary market guarantee			3,633			12,000			12,000
Total, secondary guaranteed loan commitments	**N/A**	**–188**	**85,372**	**N/A**	**–181**	**98,000**	**N/A**	**–209**	**89,400**

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.
N/A = Not applicable.

Table 7–5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES

(In billions of dollars)

	Actual								Estimate	
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Direct Loans:										
Obligations	38.4	37.1	39.1	43.7	45.4	42.0	56.3	57.8	37.0	34.0
Disbursements	37.7	35.5	37.1	39.6	39.7	38.7	50.6	46.6	31.4	32.9
New subsidy budget authority	1.6	(0.4)	0.3	*	0.7	0.4	2.1	4.7	2.0	1.4
Reestimated subsidy budget authority [1]	1.0	(4.4)	(1.8)	0.5	2.9	2.6	3.8	3.1	3.6	....
Total subsidy budget authority	2.6	(4.8)	(1.5)	0.5	3.5	3.0	6.0	7.8	5.5	1.4
Loan guarantees:										
Commitments [2]	252.4	192.6	256.4	303.7	345.9	300.6	248.5	280.7	239.0	290.4
Lender disbursements [2]	224.7	180.8	212.9	271.4	331.3	279.9	221.6	256.0	210.1	256.0
New subsidy budget authority	*	3.6	2.3	2.9	3.8	7.3	10.1	17.2	5.2	2.4
Reestimated subsidy budget authority [1]	4.3	0.3	(7.1)	(2.4)	(3.5)	2.0	3.5	7.0	(6.8)	....
Total subsidy budget authority	4.3	3.9	(4.8)	0.5	0.3	9.3	13.6	24.2	(1.6)	2.4

* Less than $50 million.
[1] Includes interest on reestimate.
[2] To avoid double-counting, totals exclude GNMA secondary guarantees of loans that are guaranteed by FHA, VA, and RHS, and SBA's guarantee of 7(a) loans sold in the secondary market.

Table 7–6. DIRECT LOAN WRITEOFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural credit insurance fund	45	78	70	0.67	1.21	1.15
Commodity Credit Corporation fund	....	....	–1	....	....	–0.05
Rural community advancement program	9	4	4	0.10	0.04	0.03
Rural electrification and telecommunications loans	9	....	....	0.02	....	....
Rural development insurance fund	1	1	1	0.05	0.05	0.06
Rural housing insurance fund	90	99	112	0.36	0.40	0.45
Rural development loan fund	3	2	1	0.69	0.45	0.21
Debt restructuring	130	....	....	24.95	....	....
Commerce:						
Economic development revolving fund	1	1	....	10.00	14.28	....
Education:						
Student financial assistance	14	14	....	4.33	4.34	....
Perkins loan assets	....	....	54	....	....	....
Housing and Urban Development:						
Revolving fund (liquidating programs)	....	1	1	....	16.66	25.00
Guarantees of mortgage-backed securities	4	24	20	40.00	342.85	285.71
Interior:						
Indian direct loan	....	1	1	....	4.34	5.00
Labor:						
Pension benefit guaranty corporation fund	87	93	93	....	....	....
Veterans Affairs:						
Veterans housing benefit program	31	3	3	3.07	0.33	0.25
International Assistance Programs:						
Debt restructuring	....	2	29	....	0.81	12.03
Overseas Private Investment Corporation	15	6	15	2.41	0.82	1.78
Small Business Administration:						
Disaster loans	107	33	61	2.93	0.48	0.85
Business loans	2	2	2	1.09	1.11	1.28
Other Independent Agencies:						
Debt reduction (ExIm Bank)	776	58	107	73.34	19.07	42.29
Export-Import Bank	1,112	36	36	12.43	0.58	0.67
Spectrum auction program	....	50	150	....	11.70	41.89
Tennessee Valley Authority fund	1	1	1	2.08	1.92	1.72
Total, direct loan writeoffs	2,437	509	760	1.11	0.22	0.32
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural credit insurance fund	37	48	48	0.35	0.47	0.45
Commodity Credit Corporation export loans	24	52	61	0.97	1.72	1.91
Rural community advancement program	115	135	158	2.44	3.01	3.41
Rural housing insurance fund	249	107	242	1.69	0.68	1.52
Commerce:						
Fisheries finance	4	....	....	12.50	....	....
Defense—Military:						
Procurement of ammunition, Army	11	15	....	42.30	78.94	....
Family housing improvement fund	....	7	7	....	1.40	1.43
Education:						
Federal family education loans	5,614	6,962	7,671	1.94	2.14	2.12
Health and Human Services:						
Health education assistance loans	16	24	21	0.93	1.74	1.92
Health center loan guarantees	....	1	....	....	2.63	....
Housing and Urban Development:						
Indian housing loan guarantee	1	1	1	0.52	0.27	0.17
Native American housing block grant	....	2	2	....	2.40	2.17
FHA—Mutual mortgage insurance	5,381	5,722	6,250	1.60	1.80	1.98
FHA—General and special risk	1,034	1,535	1,767	1.15	1.57	1.78

Table 7–6. DIRECT LOAN WRITEOFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Interior:						
Indian guaranteed loans	1	5	5	0.31	1.57	1.47
Transportation:						
Maritime guaranteed loans (Title XI)	....	35	32	....	1.19	1.16
Veterans Affairs:						
Veterans housing benefit program	2,207	5,792	5,382	1.07	2.74	2.36
International Assistance Programs:						
Micro and small enterprise development	1	....	1	7.14	....	16.66
Urban and environmental credit program	32	11	12	1.93	0.72	0.86
Development credit authority	....	2	2	....	0.98	0.73
Overseas Private Investment Corporation	118	200	55	3.28	4.94	1.22
Small Business Administration:						
Business loans	1,200	1,141	1,151	1.63	1.69	1.60
Other Independent Agencies:						
Export-Import Bank	217	225	225	0.60	0.61	0.58
Total, guaranteed loan terminations for default	16,262	22,022	23,093	1.07	1.43	1.44
Total, direct loan writeoffs and guaranteed loan terminations	18,699	22,531	23,853	1.08	1.28	1.30
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural credit insurance fund	3	5	7	5.76	7.81	10.00
Commerce:						
Fisheries finance	5	....	....	13.88	....	....
Education:						
Federal family education loans	990	1,121	1,185	4.40	4.57	4.70
Housing and Urban Development:						
FHA—Mutual mortgage insurance	....	9	1	....	2.25	1.69
FHA—General and special risk	276	25	22	6.23	0.51	0.35
Interior:						
Indian guaranteed loans	1	2	2	7.69	11.11	10.00
Treasury:						
Air transportation stabilization guaranteed loans	39	54	....	31.20	72.00	....
International Assistance Programs:						
Overseas Private Investment Corporation	1	8	11	0.46	2.29	2.98
Small Business Administration:						
Business loans	1,012	281	279	19.04	5.52	5.35
Pollution control equipment	8	....	....	40.00	....	....
Other Independent Agencies:						
Export-Import Bank	4	....	....	3.41	....	....
Total, writeoffs of loans receivable	2,339	1,505	1,507	6.18	3.85	3.72

[1] Average of loans outstanding for the year.

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS [1]

(In millions of dollars)

Agency and Program	2006 Actual	2007 Estimate	2008 Estimate
DIRECT LOAN OBLIGATIONS			
Agriculture:			
Agricultural credit insurance fund	936	933	917
P.L. 480	39	......	......
Commerce:			
Fisheries finance	138	75	8
Education:			
Historically black college and university capital financing	208	216	......
Homeland Security:			
Disaster assistance	1,270	25	25
Housing and Urban Development:			
FHA-general and special risk	50	50	50
FHA-mutual mortgage insurance	50	50	50
State:			
Repatriation loans	1	1	1
Transportation:			
Railroad rehabilitation and improvement direct loans	......	......	600
Treasury:			
Community development financial institutions fund	11	8	6
Veterans Affairs:			
Vocational rehabilitation	3	3	3
Native American loans	30	30	......
Small Business Administration:			
Business loans	20	10	25
Total, limitations on direct loan obligations	2,756	1,401	1,685
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural credit insurance fund	2,147	2,622	2,450
Energy:			
Title 17 innovative technology loan guarantees	......	......	9,000
Housing and Urban Development:			
Indian housing loan guarantee fund	116	158	367
Title VI Indian Federal guarantees	17	17	17
Native Hawaiian Housing Loan Guarantee Fund	36	36	41
Community development loan guarantees	135	136	......
FHA-general and special risk	35,000	35,000	35,000
FHA-mutual mortgage insurance	185,000	185,000	185,000
Interior:			
Indian guaranteed and insured loans	117	87	86
Transportation:			
Minority business resource center	18	18	18
Railroad rehabilitation and improvement loan guarantees	......	......	100
International Assistance Programs:			
Development credit authority	700	......	700
Small Business Administration:			
Business loans	19,936	28,000	28,000
Total, limitations on loan guarantee commitments	243,222	251,074	260,779
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS			
Housing and Urban Development:			
Guarantees of mortgage-backed securities	200,000	100,000	100,000
Small Business Administration:			
Secondary market guarantees	12,000	12,000	12,000

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS [1]—Continued

(In millions of dollars)

Agency and Program	2006 Actual	2007 Estimate	2008 Estimate
Total, limitations on secondary guaranteed loan commitments	212,000	112,000	112,000

[1] Data represents loan level limitations enacted or proposed to be enacted in appropriation acts. For information on actual and estimated loan levels supportable by new subsidy budget authority requested, see Tables 7–3 and 7–4.

Table 7–8. FACE VALUE OF GOVERNMENT-SPONSORED LENDING [1]

(In billions of dollars)

	Outstanding	
	2005	2006
Government Sponsored Enterprises		
Fannie Mae [2]	N/A	N/A
Freddie Mac [3]	N/A	N/A
Federal Home Loan Banks	574	621
Farm Credit System	92	105
Total	**N/A**	**N/A**

N/A = Not available.

[1] Net of purchases of federally guaranteed loans.

[2] Financial data for Fannie Mae is not presented here because following a restatement of financial data for 2001–2004, audited financial results for 2005 and 2006 have not been released.

[3] Financial data for Freddie Mac is not presented here because following the release of previous earnings restatements, audited financial statements for 2005 and 2006 have not been released.

Table 7–9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) [1]

(In millions of dollars)

Enterprise	2006
LENDING	
Federal National Mortgage Association: [2]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [3]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	3,642
Outstandings	28,763
Farm credit banks:	
Net change	9,383
Outstandings	76,185
Federal Agricultural Mortgage Corporation:	
Net change	1,933
Outstandings	7,059
Federal Home Loan Banks: [4]	
Net change	21,302
Outstandings	743,855
Less guaranteed loans purchased by:	
Federal National Mortgage Association: [2]	
Net change	N/A
Outstandings	N/A
Other:	
Net change	N/A
Outstandings	N/A
BORROWING	
Federal National Mortgage Association: [2]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [3]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	4,381
Outstandings	32,847
Farm credit banks:	
Net change	13,015
Outstandings	94,376
Federal Agricultural Mortgage Corporation:	
Net change	623
Outstandings	4,554
Federal Home Loan Banks: [4]	
Net change	39,094
Outstandings	944,039

Table 7–9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) [1]—Continued

(In millions of dollars)

Enterprise	2006
DEDUCTIONS [5]	
Less borrowing from other GSEs: [5]	
Net change	N/A
Outstandings	N/A
Less purchase of Federal debt securities: [5]	
Net change	N/A
Outstandings	N/A
Federal National Mortgage Association: [5]	
Net change	N/A
Outstandings	N/A
Other: [5]	
Net change	N/A
Outstandings	N/A

N/A = Not available.

[1] The estimates of borrowing and lending were developed by the GSEs based on certain assumptions that are subject to periodic review and revision and do not represent official GSE forecasts of future activity, nor are they reviewed by the President. The data for all years include programs of mortgage-backed securities. In cases where a GSE owns securities issued by the same GSE, including mortgage-backed securities, the borrowing and lending data for that GSE are adjusted to remove double-counting.

[2] Financial data for Fannie Mae is not presented here because following a restatement of financial data for 2001–2004, audited financial results for 2006 have not been released.

[3] Financial data for Freddie Mac is not presented here because following the release of previous earnings restatements, audited financial statements for 2006 have not been released.

[4] The net change in borrowings is derived from the difference in borrowings between 2006 and the Federal Home Loan Banks' audited financial statements of 2005.

[5] Totals and subtotals have not been calculated because a substantial portion of the total is unavailable as described above.