

## 20. CREDIT AND INSURANCE

The Federal Government offers direct loans and loan guarantees to support a wide range of activities including home ownership, education, small business, farming, energy, infrastructure investment, and exports. Also, Government-Sponsored Enterprises (GSEs) operate under Federal charters for the purpose of enhancing credit availability for targeted sectors. Through its insurance programs, the Federal Government insures deposits at depository institutions, guarantees private defined-benefit pensions, and insures against some other risks such as flood and terrorism. Over the last few years, many of these programs have been playing more active roles to address financing difficulties triggered by the recent financial crisis.

This chapter discusses the roles of these diverse programs:

- The first section emphasizes the roles of Federal credit and insurance programs in addressing mar-

ket imperfections that may prevent the private market from efficiently providing credit and insurance.

- The second section discusses individual credit programs and the GSEs. Credit programs are broadly classified into five categories: housing, education, small business and farming, energy and infrastructure, and international lending.
- The third section reviews Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks.
- The last section discusses current issues in credit budgeting. This year, the section is devoted to “fair value” cost estimates for Federal credit programs.

### I. THE FEDERAL ROLE

Credit and insurance markets sometimes fail to function smoothly due to market imperfections. Relevant market imperfections include information failures, monitoring problems, limited ability to secure resources, insufficient competition, externalities, and financial market instability. Federal credit and insurance programs may improve economic efficiency if they effectively fill the gaps created by market imperfections. The presence of a market imperfection, however, does not mean that Government intervention will always be effective. To be effective, a credit or insurance program should be carefully designed to reduce inefficiencies in the targeted area without disturbing efficiently functioning areas. In addition to correcting market failures, Federal credit and insurance programs may provide subsidies to serve other policy purposes, such as reducing inequalities and extending opportunities to disadvantaged regions or segments of the population. The effectiveness of the use of credit assistance should be carefully compared with that of other policy tools, such as grants and tax credits.

**Information Failures.** When lenders have insufficient information about borrowers, they may fail to evaluate the creditworthiness of borrowers accurately. As a result, some creditworthy borrowers may fail to obtain credit at a reasonable interest rate, while some high-risk borrowers obtain credit at an attractive interest rate. The problem becomes more serious when borrowers are much better informed about their own creditworthiness than lenders (asymmetric information). With asymmetric information, raising the interest rate can disproportionately draw high-risk borrowers who care less about the

interest rate (adverse selection). Thus, if adverse selection is likely for a borrower group, lenders may limit the amount of credit to the group instead of raising the interest rate or even exclude the group all together. In this situation, many creditworthy borrowers may fail to obtain credit even at a high interest rate. Ways to deal with this problem in the private sector include equity financing and pledging collateral. Federal credit programs play a crucial role for those populations that are vulnerable to this information failure and do not have effective means to deal with it. Start-up businesses lacking a credit history, for example, are vulnerable to the information failure, but most of them are unable to raise equity publicly and do not have sufficient collateral. Another example is students who have little income, little credit experience, and no collateral to pledge. Without Federal credit assistance, many in these groups may be unable to pursue their entrepreneurial or academic goals. In addition, a moderate subsidy provided by the Government can alleviate adverse selection by attracting more low-risk borrowers, although an excessive subsidy can cause economic inefficiency by attracting many borrowers with unworthy or highly risky projects.

**Monitoring Needs.** Monitoring is a critical part of credit and insurance businesses. Once the price (the interest rate or the insurance premium) is set, borrowers and policyholders may have incentives to engage in risky activities. Insured banks, for example, might take more risk to earn a higher return. Although private lenders and insurers can deter risk-taking through covenants, repricing, and cancellation, Government regulation and su-

pervision can be more effective in some cases, especially where covering a large portion of the target population is important. For a complex business like banking, close examination may be necessary to deter risk-taking. Without legal authority, close examination may be impractical. When it is difficult to prevent risk-taking, private insurers may turn down many applicants and often cancel policies, which is socially undesirable in some cases. To the extent possible, bank failures should be managed to reduce disruption to the financial market. If private-sector pensions were unprotected, many retirees could experience financial hardships and strain other social safety nets.

**Limited Ability to Secure Resources.** The ability of private entities to absorb losses is often more limited than that of the Federal Government. For some events potentially involving a very large loss concentrated in a short time period, therefore, Government insurance can be more reliable. Such events include large bank failures and some natural and man-made disasters that can threaten the solvency of private insurers. In addition, some lenders may have limited funding sources. Small local banks, for example, may have to rely largely on local deposits.

**Insufficient Competition.** Competition can be insufficient in some markets because of barriers to entry or economies of scale. Insufficient competition may result in unduly high 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, in contrast, is a negative externality, from which other people suffer. Without Government intervention, people may engage less than the socially optimal level in activities that generate positive externalities and more in activities that generate negative externalities.

**Financial Market Instability.** Another rationale for Federal intervention is to prevent instability in the financial market. Without deposit insurance, for example, the financial market would be much less stable. When an economic shock impairs the financial structure of many banks, depositors may find it difficult to distinguish between solvent banks and insolvent ones. In this situation, a large number of bank failures might prompt depositors to withdraw deposits from all banks (bank runs). Bank runs would make bank failures contagious and harm the entire economy. Deposit insurance is critical in preventing bank runs.

### Federal Credit Program Management

The objective of Federal credit policies is to support the most efficient use of limited Federal resources by designing programs that maximize progress towards policy goals while minimizing undue risk to the taxpayer. The goal is not to eliminate risk—but to target assistance where it will do the most good, and proactively manage programs within acceptable risk thresholds. Over the last year, the Office of Management and Budget (OMB) has taken steps to support agency management of Federal credit programs. In January 2013, OMB published updates to Federal credit policies to support best practices, generate efficiencies, and identify opportunities for improved targeting of Federal credit assistance.<sup>1</sup> The revised guidance defines objectives of strong credit program management, and provides supplemental materials that outline elements to consider in designing and evaluating management frameworks. It also clarifies guidance on program reviews to emphasize evidence-based proposals to improve efficiency and effectiveness of credit programs. OMB and Treasury have also convened the Federal Credit Policy Council (FCPC). The FCPC is a collaborative forum for agencies to discuss best practices, raise issues relevant to their credit and debt collection activities, and to identify solutions to common problems.

<sup>1</sup> Please see OMB Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables": [http://www.whitehouse.gov/sites/default/files/omb/assets/a129/rev\\_2013/pdf/a-129.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/a129/rev_2013/pdf/a-129.pdf)

## II. CREDIT IN VARIOUS SECTORS

### Housing Credit Programs and GSEs

Through housing credit programs, the Federal Government promotes homeownership and housing among various target groups, including low- and moderate-income people, veterans, and rural residents. Recently, the target market expanded dramatically due to the financial crisis.

The consequences of inflated house prices and loose mortgage underwriting during the housing bubble that peaked in 2007 created perilous conditions for many American homeowners. As broader economic conditions soured and home prices declined, millions of families have been foreclosed upon, millions more find themselves owing more on their homes than their homes are worth, and

many communities have been destabilized. To make matters more difficult, private capital had all but disappeared from the market. Without the unprecedented Federal support provided to the housing market over the last six years, the situation would be far more problematic.

### Federal Housing Administration

The Federal Housing Administration (FHA) guarantees mortgage loans to provide access to homeownership for people who may have difficulty obtaining a conventional mortgage. FHA has been a primary facilitator of mortgage credit for first-time and minority buyers, a pioneer of products such as the 30-year self-amortizing mortgage, and a vehicle to enhance credit for many moderate and low-income households.

### ***FHA and the Mortgage Market***

In the early 2000s, FHA's market presence diminished greatly as low interest rates increased the affordability of mortgage financing and more borrowers used emerging non-prime mortgage products, including subprime and Alt-A mortgages. Many of these products had risky and hard-to-understand features such as low "teaser rates" offered for periods as short as the first two years of the mortgage, high loan-to-value ratios (with some mortgages exceeding the value of the house), and interest-only loans requiring full payoff at a set future date. The Alt-A mortgage made credit easily available by waiving documentation of income or assets. This competition eroded the market share of FHA's single-family loans, reducing it from 9 percent in 2000 to less than 2 percent in 2005.

Starting at the end of 2007, the availability of FHA and Government National Mortgage Association (which supports the secondary market for federally-insured housing loans by guaranteeing securities backed by such mortgages) credit guarantees has been an important factor countering the tightening of private-sector credit. The annual volume of FHA's single-family mortgages soared from \$52 billion in 2006 to \$330 billion in 2009.

FHA's presence has supported the home purchase market and enabled many existing homeowners to re-finance at today's lower rates. If not for such re-financing options, many homeowners would face higher risk of foreclosure due to the less favorable terms of their current mortgages.

While the provision of FHA insurance is serving a valuable role in addressing the needs of the present, the return of conventional financing to the mortgage market—with appropriate safeguards for consumers and investors including proper assessment and disclosure of risk—will broaden both the options available to borrowers and the sources of capital to fund those options. The Administration supports a greater role for non-federally assisted mortgage credit and a reduction toward historical market shares for Federal assistance, while recognizing that FHA will continue to play an important role in the mortgage market going forward.

Following its peak in 2009, FHA's new origination loan volume declined in 2012 to \$213 billion. In line with the volume decrease, the FHA's market share for home purchase loans declined to 19 percent through the first 9 months of calendar year 2013, after peaking at 28 percent in calendar year 2009. Part of this decline is likely due to the increased price of FHA insurance, as discussed in detail below.

### ***FHA's Budget Costs***

Throughout the recent period of stress in the mortgage market and into the Budget's projections for 2014, FHA, like many mortgage market participants, has faced significant financial risk and incurred large costs associated with defaults on loans made prior to the housing bubble's burst. Since 1992 when credit reform accounting began, the net cost of FHA Mutual Mortgage Insurance (MMI) Fund insurance (comprised of nearly all FHA single-family mortgages) has been reestimated and increased by a

total of \$68.4 billion excluding interest, with \$39.3 billion of that reestimate occurring in the last five years due particularly to loans originated from 2006 to 2009. Since that time, however, the quality of FHA loans has increased considerably, as discussed in the section below.

FHA's budget estimates can be volatile and prone to forecast error because default claim rates are sensitive to a variety of dynamics. FHA insurance premium revenues are spread thinly but universally over pools of policyholders, making those inflows generally stable and subject to less forecast error than for mortgage defaults. Mortgage insurance costs, however, are concentrated in the minority of borrowers who default and become claims, with the average per claim cost much larger than the average premium income. Therefore, if claims change by even a small fraction of borrowers (e.g., one percent), net FHA insurance costs will move by a multiple of that change. For other forms of insurance, such as life and health, these changes tend to gradually occur over time, allowing actuaries to anticipate the effects and modify risk and pricing models accordingly. The history of FHA, however, has been spotted with rapid, unanticipated changes in claim costs and recoveries. FHA is vulnerable to "Black Swans," outlier events that are difficult to predict and have deep effect. For FHA, these include the collapse of house prices after the recent housing bubble burst and the emergence of lending practices with very high claim rates, such as the now illegal seller-financed down-payment mortgage.

One of the major benefits of an FHA-insured mortgage is that it provides a homeownership option for borrowers who make only a modest down-payment, but show that they are creditworthy and have sufficient income to afford the house they want to buy. In 2013, over 70 percent of new FHA loans were financed with less than five percent down. The disadvantage to these low down-payment mortgages is that they have little in the way of an equity cushion should house prices decline. When house price declines or stagnation combines with household income loss, limited equity makes mortgage claims more likely, as the market price for a home may not be sufficient to pay off the debt.

FHA has safeguards (such as requiring documented income) to protect it from the worst credit-risk exposure, such as that experienced in the private sector subprime and Alt-A markets. Like many parties with credit-risk, however, FHA has been significantly hurt by house price depreciation.

Influenced by all these factors, FHA recorded a net upward reestimate of \$2.6 billion excluding interest in 2014 in the expected costs of its outstanding loan portfolio of the MMI Fund. Under the provisions of the Federal Credit Reform Act, these subsidy reestimate costs are recorded as mandatory outlays in the year the reestimates are performed and will increase the 2014 budget deficit. According to its annual actuarial analysis, FHA has been below its target minimum capital ratio of 2 percent since 2009. As the housing market recovers, the actuarial review projects that the ratio will again exceed 2 percent by 2016. However, it is important to note that a low capital ratio does not threaten FHA's operations, either for



its existing portfolio or for new books of business. Unlike private lenders, the guarantee on FHA and other Federal loans is backed by the full faith and credit of the Federal Government and is not dependent on capital reserves to honor its commitments.

### ***Policy Responses to Enhance FHA's Risk Management and Capital Reserve***

Since 2008, FHA has increased insurance premiums and tightened underwriting criteria to reduce risk, bolster its capital resources, and encourage the re-entry of private financing into the mortgage market. These steps resulted from analyzing: 1) the ongoing broader housing market stabilization and recovery; 2) the credit risk of specific targeted populations; and 3) FHA MMI Fund capital reserves. This approach balances the goal of rebuilding FHA's capital reserves quickly against the risks of compromising FHA's mission and overcorrecting.

To increase FHA's capital resources and to encourage the return of large-scale private mortgage financing, there have been five premium increases since 2008. In 2013, FHA implemented another increase of 0.1 percentage points in annual premiums. With this increase, upfront fees on home purchase guarantees will be 1.75 percent and annual fees will be 1.35 percent for most guarantees. For a typical borrower, the cumulative increases since 2008 are 0.25 percentage points in the upfront premium and 0.85 percentage points in annual premiums. As a result of these premium increases and other risk management practices taken by FHA, as well as the improved economic and housing sector forecast, FHA's MMI subsidy rate is estimated to be minus 9.03 percent in 2015, resulting in discretionary receipts estimated to exceed \$10 billion.

Also during 2013, FHA took the following steps to bolster financial performance, in addition to the premium increase.

1. Reversed a policy to cancel required premium payments after borrowers achieve an amortized loan-to-value ratio of 78 percent. Under the previous practice borrowers paid premiums for only about ten years even though FHA's 100 percent insurance guarantee remains in effect for up to 30 years. This change applies only to new loans.
2. Revised its loss mitigation program to target deeper levels of payment relief for struggling borrowers, allowing more families to retain their homes and avoid foreclosure.
3. Expanded the use of home short-sales, which provide opportunities for distressed borrowers for whom home retention is not feasible to transition to new housing without going through foreclosure.
4. Limited initial loan disbursements and required financial assessments and, where appropriate, cash set-asides to increase compliance with property in-

surance and tax requirements for HECM reverse mortgages.

To increase FHA support of credit during the financial crisis and its aftermath, temporary higher loan limits were enacted in 2008. These limits capped the size of FHA mortgages at the lesser of \$729,750 or 125 percent of area median house price. These limits expired at the end of calendar year 2013. The permanent limits now in effect are the lesser of \$625,500 or 115 percent of area median price.

In 2010, FHA implemented new loan-to-value and credit score requirements. FHA's minimum credit score was raised to 580 for borrowers making low down-payments of less than 10 percent (loan-to-value ratios above 90 percent). Other borrowers, having the security of possessing a high amount of home equity relative to low down-payment borrowers, remain eligible for FHA assistance with a credit score as low as 500. FHA also is reducing allowable seller concessions from 6 percent of property value to 3 percent or \$6,000, whichever is higher but no higher than 6 percent. This conforms closer to industry standards and reduces potential house price over-valuation.

In addition to the single-family mortgage insurance provided through the MMI program, FHA's General Insurance and Special Risk Insurance (GISRI) loan guarantee programs continue to facilitate the construction, rehabilitation, or refinancing of tens of thousands of apartments and hospital beds in multifamily housing and healthcare facilities each year. Annual loan volumes in these programs have exploded over the last several years, from less than \$5 billion in 2008 to more than \$24 billion in 2013 as private market alternatives to FHA financing largely disappeared and low interest rates drove up refinancing activity. However, GISRI loan volume is projected to decline to \$21 billion in 2015 as private financing options increase and rising interest rates reduce refinancing volume, especially in the multifamily rental market.

### **VA Housing Program**

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel in purchasing homes in recognition of their service to the Nation. The housing program effectively substitutes the Federal guarantee for the borrower's down payment, making the lending terms more favorable than loans without a VA guarantee. VA does not guarantee the entire mortgage loan to veterans, but provides a 100 percent guarantee on the first 25 percent of losses upon default. VA provided 162,327 zero down payment loans and 203,174 fee-exempt loans to veterans with service-connected disabilities in 2013. The number of loans VA guaranteed remained at a high level in 2013, as the tightened credit markets continued to make the VA housing program more attractive to eligible homebuyers. Additionally, the continued historically low interest rate environment of 2013 allowed 187,885 Veteran borrowers to lower the interest rate on their home mortgages through refinancing. VA provided almost \$135 billion in guarantees to assist 600,023 borrowers in 2013, compared with \$120 billion and 542,036 borrowers in 2012.

VA, in cooperation with VA-guaranteed loan servicers, also assists borrowers through home retention options and alternatives to foreclosure. VA intervenes when needed to help veterans and service members avoid foreclosure through loan modifications, special forbearances, repayment plans, and acquired loans; as well as assistance to complete compromise sales or deeds-in-lieu of foreclosure. These joint efforts helped resolve nearly 80 percent of defaulted VA-guaranteed loans in 2013.

### **Rural Housing Service**

The Rural Housing Service (RHS) at the U.S. Department of Agriculture (USDA) offers direct and guaranteed loans to help very-low- to moderate-income rural residents buy and maintain adequate, affordable housing. RHS housing loans and loan guarantees differ from other Federal housing loan programs in that they are means-tested, making them more accessible to low-income, rural residents. For the direct loan program, approximately 40 percent of borrowers earn less than 50 percent of their area's median income; the remainder earn between 50 percent and 80 percent (maximum for the program) of area median income. The single family housing guaranteed loan program is designed to provide home loan guarantees for moderate-income rural residents whose incomes are between 80 percent and 115 percent (maximum for the program) of area median income.

The 2015 Budget continues to reflect a re-focusing of USDA single family housing assistance programs to improve effectiveness by providing single family housing assistance primarily through loan guarantees. Within its \$24 billion loan level, the Budget expects RHS to provide at least \$5.7 billion in loans for low-income rural borrowers, which will provide 50,000 new homeownership opportunities to that income group. Overall, the program could potentially provide 171,000 new homeownership opportunities to low- to moderate-income rural residents in 2015.

For the single family housing guarantees, the Budget continues to include an annual and an up-front fee structure, as FHA does. This fee structure serves to reduce the overall subsidy cost of the loans without adding significant burden to the borrowers. The Budget also proposes to make USDA's guaranteed home loan program a direct endorsement program, which is consistent with VA and FHA guaranteed home loan programs. This change will make RHS more efficient and allow the single family housing staff to refocus on other unmet needs. For USDA's single family housing direct loan program, the Budget provides a reduced loan level of \$360 million for 2015. This decision reflects that with a \$24 billion loan level for the single family housing guarantees and interest rates near their lowest levels in decades, demand for the direct loans should be waning, and hence the focus should be on the guarantee program.

For USDA's multifamily housing portfolio, the Budget focuses primarily on portfolio management. The Budget fully funds this rehabilitation effort by providing \$29.8 million for the multifamily housing revitalization activities, which include loan modifications, grants, zero percent loans, and soft second loans as well as some funding

for traditional multifamily housing direct loans to allow USDA to better address its inventory property. These activities allow borrowers to restructure their debt so that they can effectively rehabilitate properties within the portfolio in order for them to continue to supply decent, safe, affordable rental housing to the low- and very-low-income population in rural America. The Budget also proposes to codify these activities into permanent law. In addition, rental assistance grants, which supplement tenant rental payments to the property owners and are vital to the proper underwriting of the multifamily housing direct loan portfolio, are funded at \$1.089 billion, which is sufficient to renew outstanding contracts. The rental assistance grant funding assumes a \$20 million savings from a new \$50 minimum tenant rent contribution requirement, similar to the ones that are already in place for HUD programs that provide rental subsidies. The Budget also provides \$150 million in guaranteed multifamily housing loans and \$16 million in budget authority for the Farm Labor Housing grants and loans program. The combined 2015 Budget request in the rural development multifamily housing portfolio reflects the Administration's support for the poorest rural tenant population base.

### **Government-Sponsored Enterprises in the Housing Market**

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. Fannie Mae's and Freddie Mac's public missions were later broadened to promote affordable housing.

Growing stress and losses in the mortgage markets in 2007 and 2008 seriously eroded the capital of Fannie Mae and Freddie Mac, and responsive legislation enacted in July 2008 strengthened GSE regulation and provided the Treasury Department with authorities to bolster the GSEs' financial condition. In September 2008, reacting to growing GSE losses and uncertainty that threatened to paralyze the mortgage markets, the GSEs' independent regulator, the Federal Housing Finance Agency, put Fannie Mae and Freddie Mac under Federal conservatorship, and Treasury began to exercise its authorities to provide assistance to stabilize the GSEs. The Budget continues to reflect the GSEs as non-budgetary entities in keeping with their temporary status in conservatorship. However, all of the current Federal assistance being provided to Fannie Mae and Freddie Mac, including capital provided by Treasury through the Senior Preferred Stock Purchase Agreements (PSPA), is shown on-budget, and discussed below.

The Federal Home Loan Bank (FHLB) 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 using their own funds. Recent financial market conditions have led to strong net interest income for the FHLBs, but several banks have

experienced significant losses on their investments in private-label mortgage-backed securities. These securities constitute 2.5 percent of their total portfolio. Strict collateral requirements, superior lien priority, and joint debt issuances backed by the entire system have helped the FHLBs remain solvent, and stronger regulatory oversight has led to growth in FHLB system-wide capital from just above the regulatory ratio of 4 percent in 2008 to 6 percent in 2013.

Together these three GSEs currently are involved, in one form or another, with approximately half of the \$11 trillion residential mortgages outstanding in the U.S. today. Their share of outstanding residential mortgage debt peaked at 55 percent in 2003. Subsequently, originations of subprime and non-traditional mortgages led to a surge of private-label Mortgage-Backed Securities (MBS), reducing the three GSEs' market share to a low of 47 percent in 2006. Recent disruptions in the financial market, however, have led to a resurgence of their market share. The combined market share of the three GSEs was about 5 percent as of September 30, 2013.

### **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 provide liquidity and stability to the secondary mortgage market and to promote affordable housing. 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 pooling mortgages acquired through either purchase from or swap arrangements with mortgage originators. Over time these MBS held by the public have averaged about one-quarter of the U.S. mortgage market, and as of November 30, 2013, they totaled \$4.1 trillion.
2. **Mortgage Investment Business**—Fannie Mae and Freddie Mac manage retained mortgage portfolios composed of their own MBS, MBS issued by others, and individual mortgages. The GSEs finance the purchase of these portfolio assets through debt issued in the credit markets. As of November 30, 2013, these retained mortgages, financed largely by GSE debt, totaled \$962 billion. As a term of their PSPA contracts with Treasury, the combined investment portfolios of Fannie Mae and Freddie Mac were limited to no more than \$1.8 trillion as of December 31, 2009, and this limitation was directed to decline by 10 percent each year. To accelerate the return of private capital to the mortgage markets and the wind-down of the GSEs, Treasury revised the PSPA terms in August 2012, setting the effective portfolio limitation at \$1.1 trillion as of December 31, 2013, and accelerating the reduction in this limitation to 15 percent each year until December 31, 2018, when

the combined limitation will be fixed at \$500 billion (\$250 billion for each company).

As of November 30, 2013, the combined debt and guaranteed MBS of Fannie Mae and Freddie Mac totaled \$5.1 trillion.

The mission of the FHLB System is broadly defined as promoting housing finance, and the System also has specific requirements to support affordable housing. Its principal business remains lending (secured by mortgages and financed by System debt issuances) to regulated depository institutions and insurance companies engaged in residential mortgage finance. Historically, investors in GSE debt have included thousands of banks, institutional investors such as insurance companies, pension funds, foreign governments and millions of individuals through mutual funds and 401k investments.

### **Regulatory Reform**

The 2008 Housing and Economic Recovery Act (HERA) reformed and strengthened the GSEs' safety and soundness regulator by creating the Federal Housing Finance Agency (FHFA), a new independent regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The FHFA authorities consolidate and expand upon the regulatory and supervisory roles of what were previously three distinct regulatory bodies: the Federal Housing Finance Board as the FHLB's overseer; the Office of Federal Housing Enterprise Oversight as the safety and soundness regulator of the other GSEs; and HUD as their public mission overseer. FHFA was given substantial authority and discretion to influence the size and composition of Fannie Mae and Freddie Mac investment portfolios through the establishment of housing goals, through monitoring GSE compliance with those goals, and through capital requirements.

FHFA is required to issue housing goals, such as for purchases of single-family mortgages provided to low-income families, for each of the regulated enterprises, including the FHLBs, with respect to single family and multi-family mortgages and has the authority to require a corrective "housing plan" if an enterprise does not meet its goals and statutory reporting requirements, and in some instances impose civil money penalties. In August of 2009, FHFA promulgated a final rule adjusting the overall 2009 housing goals downward based on a finding that current market conditions had reduced the share of loans that qualify under the goals. However, HERA mandated dramatic revisions to the housing goals, which were implemented the following year. The revised goals for 2010 and 2011 provided for a retrospective and market-based analysis of the GSEs' contributions toward the goals by expressing the goals as a share of the GSEs' total portfolio purchase activity. The revised goals for Fannie Mae and Freddie Mac comprise four single-family goals and one multifamily special affordability goal. The housing goals for 2012 through 2014, promulgated on November 13, 2012, establish revised benchmarks but maintain the structural changes implemented for 2010 and 2011. FHFA has determined that both Fannie Mae and Freddie



Mac exceeded the 2012 benchmark levels on all of the single-family and multifamily goals. However, FHFA also noted that both Fannie Mae and Freddie Mac lagged market performance in 2012, which FHFA views as a relevant measure for evaluating the companies' performance in years when the market levels are higher than the benchmark levels.

The expanded authorities of FHFA also include the ability to place any of the regulated enterprises into conservatorship or receivership based on a finding of undercapitalization or a number of other factors.

### ***Conservatorship***

On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorship. This action was taken in response to the GSEs' declining capital adequacy and to support the safety and soundness of the GSEs, given the role they played in the secondary mortgage market and the potential impact of their failure on broader financial markets. HERA provides that as conservator FHFA may take any action that is necessary to return Fannie Mae and Freddie Mac to a sound and solvent condition and to preserve and conserve the assets of each firm. As conservator, FHFA has assumed the powers of the Board and shareholders at Fannie Mae and Freddie Mac. FHFA has appointed new Directors and CEOs that are responsible for the day-to-day operations of the two firms. While in conservatorship, FHFA expects Fannie Mae and Freddie Mac to continue to fulfill their core statutory purposes, including their support for affordable housing discussed above.

### ***Department of Treasury GSE Support Programs under HERA***

On September 7, 2008, the U.S. Treasury launched three programs to provide temporary financial support to the GSEs under the temporary authority provided in HERA. These authorities expired on December 31, 2009.

#### ***1. PSPAs with Fannie Mae and Freddie Mac***

Treasury entered into agreements with Fannie Mae and Freddie Mac to make investments in senior preferred stock in each GSE in order to ensure that each company maintains a positive net worth. In exchange for the substantial funding commitment, the Treasury received \$1 billion in senior preferred stock for each GSE and warrants to purchase up to a 79.9 percent share of common stock at a nominal price. The initial agreements established funding commitments for up to \$100 billion in each of these GSEs. On February 18, 2009, Treasury announced that the funding commitments for these agreements would be increased to \$200 billion for each GSE. On December 24, 2009, Treasury announced that the funding commitments in the purchase agreements would be modified to the greater of \$200 billion or \$200 billion plus cumulative net worth deficits experienced during 2010-2012, less any surplus remaining as of December 31, 2012. Based on the financial results reported by each company as of December 31, 2012, the cumulative funding commitment

for Fannie Mae and Freddie Mac was set at \$445.5 billion. In total, as of December 31, 2013, \$187.5 billion has been invested in the GSEs, and the liquidation preference of the senior preferred stock held by Treasury has increased accordingly. The agreements also require that Fannie Mae and Freddie Mac pay quarterly dividends to Treasury. Prior to calendar year 2013, the quarterly dividend amount was based on an annual rate of 10 percent of the liquidation preference of Treasury's senior preferred stock. Amendments to the PSPAs effected on August 17<sup>th</sup>, 2012, replace the 10 percent dividend with an amount equivalent to the GSE's positive net worth above a capital reserve amount. The capital reserve amount for each company was set at \$3.0 billion for calendar year 2013, and declines by \$600 million at the beginning of each calendar year thereafter until it reaches zero. Through December 31, 2013, the GSEs have paid a total of \$185.2 billion in dividends payments to Treasury on the senior preferred stock. The Budget estimates additional dividend receipts of \$181.5 billion from January 1, 2014, through FY 2024. The cumulative budgetary impact of the PSPA agreements from the first PSPA purchase through FY 2024 is estimated to be a net return to taxpayers of \$179.2 billion. The Temporary Payroll Tax Cut Continuation Act of 2011 signed into law on December 23, 2011, required that the GSEs increase their fees by an average of at least 0.10 percentage points above the average guarantee fee imposed in 2011. Revenues generated by this fee increase are remitted directly to the Treasury for deficit reduction and are not included in the PSPA amounts. The Budget estimates resulting deficit reductions from this fee of \$32.8 billion from FY 2012 through FY 2024.

#### ***2. GSE MBS Purchase Programs***

Treasury initiated a temporary program during the financial crisis to purchase MBS issued by Fannie Mae and Freddie Mac, which carry the GSEs' standard guarantee against default. The purpose of the program was to promote liquidity in the mortgage market and, thereby, affordable homeownership by stabilizing the interest rate spreads between mortgage rates and corresponding rates on Treasury securities. Treasury purchased \$226 billion in MBS from September 2008 to December 31, 2009, when the statutory authority for this program expired. In March of 2011, Treasury announced that it would begin selling off up to \$10 billion of its MBS holdings per month, subject to market conditions. Treasury sold the last of its MBS holdings in March 2012. The MBS purchase program generated \$11.9 billion in net budgetary savings, calculated on a net present value basis as required by the Federal Credit Reform Act.

#### ***3. GSE Credit Facility***

Treasury promulgated the terms of a temporary secured credit facility available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The facility was intended to serve as an ultimate liquidity backstop to the GSEs if necessary. No loans were needed or issued

through December 31, 2009, when Treasury's HERA purchase authority expired.

#### 4. *State Housing Finance Agency Programs*

In December 2009, Treasury initiated two additional purchase programs under HERA authority to support state and local Housing Financing Agencies (HFAs). Under the New Issue Bond Program (NIBP), Treasury purchased \$15.3 billion in securities of Fannie Mae and Freddie Mac comprised of new HFA housing issuances. The Temporary Credit and Liquidity Program (TCLP) provides HFAs with credit and liquidity facilities supporting up to \$8.2 billion in existing HFA bonds. Treasury's statutory authority to enter into new obligations for these programs expired on December 31, 2009. Due to uncertainties and strain throughout the housing sector and the widening of spreads in the tax-exempt market, HFAs experienced challenges in issuing new bonds to fund new mortgage lending and faced difficulties in renewing required liquidity facilities on non-punitive terms. In response, Treasury has provided extensions to the NIBP and TCLP agreements. In November 2011, Treasury extended the contractual deadline for HFAs to use existing NIBP funds to December 31, 2012. By that date, State and local HFAs had used \$13.2 billion to finance single and multi-family mortgages, and the remainder had been returned to Treasury. In late 2012, Treasury granted three-year extensions to the TCLP agreements for six HFAs in order to give these HFAs additional time to reduce their TCLP balances. The revised agreements will expire by December 2015. As of November 30, 2013, the remaining balance of TCLP backed bonds had decreased to \$1.7 billion.

#### ***Recent GSE Role in Administration Initiatives to Relieve the Foreclosure Crisis***

While under conservatorship, Fannie Mae and Freddie Mac have continued to play a leading role in Government and private market initiatives to prevent homeowners who can no longer afford to make their mortgage payments from losing their homes. In March 2009, the Administration announced its Making Home Affordable (MHA) program, which includes the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP).

Fannie Mae and Freddie Mac are participating in HAMP both for mortgages they own or guarantee and as the Treasury Department's contractual financial agents. Under HAMP, investors, lenders, servicers, and borrowers receive incentive payments to reduce eligible homeowners' monthly payments to affordable levels. The incentive payments for the modification of loans not held by the GSEs are paid by Treasury's TARP fund, while the incentive payments for the modification of loans held by the GSEs are paid by the GSEs. As of November 30, 2013, more than 2.1 million trial modifications have been initiated, resulting in almost 1.3 million permanent mortgage modifications. HAMP has also encouraged the mortgage industry to adopt similar programs that have helped mil-

lions more at no cost to the taxpayer. In May of 2013, the Administration announced a two year extension of HAMP to December 31, 2015 to align with extended deadlines for HARP and other programs for homeowners with loans owned or guaranteed by Fannie Mae and Freddie Mac. For more information on HAMP, see the Financial Stabilization Efforts and their Budgetary Effects chapter of this volume.

Fannie Mae and Freddie Mac are also integral to HARP. Under the program, borrowers with a mortgage that is owned by Fannie Mae or Freddie Mac and who are current on their loan payments may be eligible to refinance their mortgage to take advantage of the current low interest rate environment regardless of their current loan-to-value (LTV) ratio. Prior to HARP, the LTV limit of 80 percent for conforming purchase mortgages without a credit enhancement such as private mortgage insurance also applied to refinancing of mortgages owned by the GSEs. Borrowers whose home values had dropped such that their LTVs had increased above 80 percent could not take advantage of the refinance opportunity. On October 24, 2011, FHFA announced that the HARP program would be enhanced by lowering the fees charged by Fannie Mae and Freddie Mac on these refinancings, streamlining the application process, and removing the previous LTV cap of 125 percent. These changes coupled with record low mortgage interest rates have contributed to an increase in HARP loan volumes; more than 800,000 HARP refinancings were completed from January through October of 2013 alone and almost 3 million refinancings have been completed since the program's inception. In April of 2013, FHFA announced a two year extension of HARP to December 31, 2015.

#### ***Future of the GSEs***

The Administration is committed to working with the Congress to reform the housing finance system to prevent future crises, protect taxpayers, and preserve affordable access to mortgages—including the 30-year fixed rate mortgage. The Administration also continues to support a dedicated budget-neutral mechanism to fund affordable housing programs, similar to the Housing Trust Fund enacted in the Housing and Economic Recovery Act of 2008, which would have been funded by assessments on the GSEs but has not been capitalized due to their conservatorship.

While the Administration and Congress continue to evaluate long-term housing finance reform, meaningful steps have already been taken to reduce the role of the GSEs. Temporary GSE conforming loan limits of up to \$729,750 expired on September 30, 2011, and the allowable investment portfolios of Fannie Mae and Freddie Mac will continue to be reduced by 15 percent each year, according to the terms of Treasury's PSPA agreements with the enterprises as amended in August 2012. In 2013, Fannie Mae and Freddie Mac initiated a series of credit risk-sharing transactions with private market participants that add an additional layer of private loss coverage, further limiting taxpayer exposure to credit losses from the GSEs and potentially providing a model for



future reforms. Increases in the guarantee fees charged by Fannie Mae and Freddie Mac are also enhancing the price-competitiveness of non-GSE mortgages.

### **Education Credit Programs**

Historically, the Department of Education (ED) helped 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. In March 2010, President Obama signed the Student Aid and Fiscal Responsibility Act (SAFRA) into law which ended the FFEL program and used the \$67 billion in savings estimated by CBO to increase Pell Grants and provide more beneficial student loan repayment terms. On July 1, 2010, ED became the sole originator of Federal student loans through the Direct Loan program, and despite significant technical challenges, ED made all loans on time and without disruption.

The Direct Loan program was authorized by the Student Loan Reform Act of 1993. Under the program, the Federal Government provides loan capital directly to over 5,500 domestic and foreign schools, which then disburse loan funds to students. Loans are available to students regardless of income. However, borrowers with low and moderate family incomes are eligible for loans with more generous terms. For those loans, the Federal Government provides many other benefits, including not charging interest while undergraduate borrowers are in school and during certain deferment periods.

In 2013 President Obama signed the Bipartisan Student Loan Certainty Act which amended the Higher Education Act of 1965 to establish interest rates for new direct student loans made on or after July 1, 2013. Interest rates on Direct Loans would be set at a variable interest rate that would be determined annually but would be fixed for the life of the loan. Interest rates for Federal Direct Stafford Loans, Federal Direct Unsubsidized Stafford Loans, and Federal Direct PLUS Loans would be set by: (1) indexing the interest rate to the rate of ten-year Treasury notes; and (2) adding the indexed rate to a specific base percent for each type of loan. The Act also set specific caps for each type of direct student loan. For Federal Direct Stafford Loans and Federal Direct Unsubsidized Stafford Loans issued to undergraduate students, the Act set the rate at 2.05 percentage points above to the Treasury 10-year note rate with a cap of 8.25 percent. For Federal Direct Unsubsidized Stafford Loans issued to graduate or professional students, the rate is 3.6 percentage points above the Treasury rate and capped at 9.5 percent. Finally, for Federal Direct PLUS Loans issued to parents and graduate/professional students, the rate is 4.6 percentage points above the Treasury rate and capped at 10.5 percent.

The program offers a variety of flexible repayment plans including income-based 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 October 2011, the Administration announced a "Pay As You Earn" (PAYE) initiative to accelerate these benefits for current and fu-

ture college students who have student loans. Under the plan, eligible borrowers have their loan payments set at no more than 10 percent of their discretionary incomes and would have balances forgiven after 20 years. This plan became available to certain eligible borrowers in December 2012. The 2015 Budget proposes to extend similar benefits to all student borrowers, regardless of when they borrowed, while reforming the PAYE terms to ensure that it is well-targeted and provides safeguard against rising tuition at high-cost institutions. In addition, the Budget proposes to create an expanded, modernized Perkins Loan program providing \$8.5 billion in loan volume annually. Instead of being serviced by the colleges, loans would be serviced by ED along with other Federal loans. The savings from this proposal would be appropriated to the Pell Grant program.

### **Small Business and Farm Credit Programs and GSEs**

The Government offers direct loans and loan guarantees to small businesses and farmers, who may have difficulty obtaining credit elsewhere. It also provides guarantees of debt issued by certain investment funds that invest in small businesses. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

#### **Loans to Small Businesses**

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 at a reasonable price without a Government guarantee. SBA also helps home- and business-owners, as well as renters, cover the uninsured costs of recovery from disasters through its direct loan program. At the end of 2013, SBA's outstanding balance of direct and guaranteed loans totaled approximately \$110 billion.

The 2015 Budget supports more than \$30 billion in financing for small businesses through the 7(a) General Business Loan program and the 504 Certified Development Company (CDC) program. The 7(a) program will support \$17.5 billion in guaranteed loans that will help small businesses operate and expand. This amount includes an estimated \$15.7 billion in term loans and \$1.8 billion in revolving lines of credit; the latter are expected to support over \$40 billion in total credit assistance through draws and repayments over the life of the commitment. The 504 program will support \$7.5 billion in guaranteed loans for fixed-asset financing, and the Budget also extends an additional \$7.5 billion in no-cost 504 guarantees to allow small businesses to refinance to take advantage of current interest rates and free up resources for expansion. In addition, SBA will supplement the capital of Small Business Investment Corporations (SBICs) with up to \$4 billion in long-term, guaranteed loans to support SBIC financing assistance for venture capital investments in small businesses, including an added focus in 2015 within

the SBIC's Impact Investment Fund to provide support for young manufacturing firms scaling up their first commercial facility. The Budget also supports SBA's disaster direct loan program at its 10-year average volume of \$1.1 billion in loans, and includes \$187 million to administer the program. Of this amount, \$155 million is provided through the Budget Control Act's disaster relief cap adjustment for costs related to Stafford Act (Presidentially-declared) disasters.

For the 2015 Budget, SBA recorded a net downward reestimate of \$780 million in the expected costs of its outstanding loan portfolio, reflecting an improved loan performance forecast, which will decrease the 2014 budget deficit.

Due to improving economic conditions and the 2013 refinements in program cost estimation, the 7(a) program is projected to have zero subsidy cost for 2014. As a result, SBA's fees charged to lenders and borrowers have decreased from recent years. SBA eliminated lender fees on loans of less than \$150,000 in 2014 to promote lending to small businesses that face the greatest constraints on credit access. SBA also took action in 2014 to support veterans by waiving upfront fees on 7(a) Express loans between \$150,000 and \$350,000 for veteran-owned businesses at a minimal cost to taxpayers. The easing of fees for veteran-owned businesses will expand in 2015 by adding a 50 percent upfront fee waiver to non-SBA Express 7(a) loans above \$150,000 to veterans, a group often underserved in credit markets. The 7(a) credit model will undergo continued review throughout 2014 to ensure that it accurately forecasts the 7(a) program's cost to taxpayers.

The Budget also requests \$25 million in direct loans, and \$20 million in technical assistance grant funds for the Microloan program. The Microloan program provides low-interest loan funds to non-profit intermediaries who in turn provide loans of up to \$50,000 to new entrepreneurs.

To help small businesses drive economic recovery and create jobs, the Small Business Jobs Act of 2010 created two new mandatory programs to increase financing assistance to small businesses, administered by the Department of the Treasury.

Treasury's State Small Business Credit Initiative (SSBCI) is designed to support state programs that make new loans or investments to small businesses and small manufacturers. SSBCI offered states and territories (and in certain circumstances, municipalities) the opportunity to apply for Federal funds to finance programs that partner with private lenders to extend new credit to small businesses to create jobs. These funds allow States to create new or build on existing models for small business programs, including collateral support programs, capital access programs, revolving loan and loan guarantee programs, loan participation programs, and State venture capital programs. SSBCI guidelines state that all approved programs must demonstrate a reasonable expectation of minimum overall leverage of \$10 in new private lending for every \$1 in Federal funding. Treasury

is providing approximately \$1.5 billion for SSBCI, which is expected to spur up to \$15 billion in new lending to small businesses. As of September 30, 2013, SSBCI had approved funding for 47 states, 5 territories, 4 municipalities, and the District of Columbia for a total of over \$1.4 billion in obligations, of which \$912 million had already been disbursed. During 2013, Treasury provided technical assistance to States in order to improve program impacts, focusing on elements of good program design, operation, and marketing.

The Budget includes an additional \$1.5 billion for a second round of the State Small Business Credit Initiative. The proposal requires \$1 billion of the funding to be competitively awarded to States best able to target underserved groups, leverage Federal funding and evaluate results. The remaining \$500 million will be allocated to States according to a need-based formula based on economic factors such as job losses and pace of economic recovery.

The second Treasury program created by the Act was the Small Business Lending Fund (SBLF), a dedicated investment fund that encourages lending to small businesses by providing capital to qualified community banks and community development loan funds (CDLFs) with assets of less than \$10 billion. Because participating institutions leverage their capital, the SBLF helps increase lending to small businesses in an amount significantly greater than the total capital provided to participating banks. In addition to expanding the lending capacity of all participants, SBLF creates a strong incentive for banks to increase small business loans by tying the cost of SBLF funding to the growth of their portfolio of small business loans. The initial dividend rate on SBLF funding was capped at 5 percent. If a bank's small business lending increases by 10 percent or more, the rate will fall to as low as 1 percent. Banks that increase their lending by amounts less than 10 percent can benefit from rates set between 2 percent and 5 percent. For participants whose lending does not increase in the first two years, however, the rate will increase to 7 percent. After 4.5 years, the rate on all outstanding SBLF funding will increase to 9 percent. The application period for the program closed in June 2011, with 332 institutions receiving slightly over \$4 billion in funding by the end of 2011. The current reestimated subsidy rate and actual program volume of \$4.03 billion result in projected budget savings of approximately \$25 million, representing a decrease in the original projected subsidy cost of \$1.3 billion. In 2013, Treasury released the results of a study on the Small Business Lending Fund analyzing changes in small business lending by SBLF participants as of June 30, 2013. Among other findings, the study concluded that:

- SBLF participants have, in total, increased their small business lending by \$10.4 billion over a \$36.5 billion baseline;
- Increases in small business lending were widespread, with 92 percent of participants having in-

creased their small business lending over baseline levels; and

- When compared with changes relative to a peer group, SBLF banks have increased business loans outstanding by a median of 48.2 percent over baseline levels, versus a 10.3 percent median increase for the representative peer group.

### 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, while 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. 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. The subsidy rates for the direct programs fluctuate largely because of changes in the interest component of the subsidy rate.

The number of loans provided by these programs has varied over the past several years. In 2013, FSA provided loans and loan guarantees to almost 30,000 family farmers totaling \$3.9 billion. Direct and guaranteed loan programs provided assistance totaling \$1.7 billion to beginning farmers during 2013. Loans for socially disadvantaged farmers totaled \$570 million, of which \$268 million was in the farm ownership program and \$302 million in the farm operating program. The average size of farm ownership loans was consistent over the past two years, with new customers receiving the bulk of the direct loans. In contrast, the majority of assistance provided in the operating loan program is to existing FSA farm borrowers. Overall, demand for FSA loans—both direct and guaranteed—continues to be high. More conservative credit standards in the private sector continue to drive applicants from commercial credit to FSA direct programs. Also, record high land prices, market volatility and uncertainty are driving lenders to request guarantees in situations where they may not have in the past. In the 2015 Budget, FSA proposes to make \$5.6 billion in direct and guaranteed loans through discretionary programs. The Budget also requests funding for the guaranteed conservation loans. The overall loan level for conservation loans is unchanged from the 2014 requested level of \$150 million.

Lending to beginning farmers was strong during 2013. FSA provided direct or guaranteed loans to more than 23,500 beginning farmers. Loans provided under the

Beginning Farmer Down Payment Loan Program represented 29 percent of total direct ownership loans made during the year, substantially less than the previous year. Fifty six percent of direct operating loans were made to beginning farmers, an increase of 23 percent in dollar volume over 2012. Overall, as a percentage of funds available, lending to beginning farmers was 1 percentage point above the 2012 level. Lending to minority and women farmers was a significant portion of overall assistance provided, with \$570 million in loans and loan guarantees provided to more than 7,100 farmers. This represents an increase of 4 percent in the overall number of direct loans to minority and women borrowers. Outreach efforts by FSA field offices to promote and inform beginning and minority farmers about FSA funding have resulted in increased lending to these groups.

FSA continues to evaluate the farm loan programs in order to improve their effectiveness. FSA released a new Microloan program to increase lending to small niche producers and minorities. This program dramatically reduces application procedures for small loans, and implements more flexible eligibility and experience requirements. FSA has also developed a nationwide continuing education program for its loan officers to ensure they remain experts in agricultural lending, and it is transitioning all information technology applications for direct loan servicing into a single, web-based application that will expand on existing capabilities to include all special servicing options. Its implementation will allow FSA to better service its delinquent and financially distressed borrowers.

### The Farm Credit System (Banks and Associations)

The Farm Credit System (FCS or System) is a Government-sponsored enterprise (GSE) composed of a nationwide network of borrower-owned cooperative lending institutions originally authorized by Congress in 1916. The FCS’s mission continues to be providing sound and dependable credit to American farmers, ranchers, producers or harvesters of aquatic products, their cooperatives, and farm-related businesses.

The financial condition of the System’s banks and associations remains fundamentally sound. Between September 30, 2012 and September 30, 2013, the ratio of capital to assets increased from 16.1 percent to 16.5 percent. Capital consisted of \$38.3 billion in unrestricted capital and \$3.4 billion in restricted capital in the Farm Credit Insurance Fund, which is held by the Farm Credit System Insurance Corporation (FCSIC). For the first nine months of calendar year 2013, net income equaled \$3.5 billion compared with \$3.2 billion for the same period of the previous year. The increase in net income resulted primarily from a decrease in provision for loan losses and an increase in net interest income.

Over the 12-month period ending September 30, 2013, nonperforming loans as a percentage of total loans outstanding decreased from 1.53 percent to 1.15 percent, primarily because of an improvement in the credit quality of loans to borrowers in certain agricultural sectors. System assets grew a moderate 5.5 percent during that period as growth in real estate mortgage, production and interme-



diate, energy and water/waste water, and other loans offset declines in loans to cooperatives and communication loans.

Over the same period, the System's loans outstanding grew by \$8.8 billion, or 4.7 percent, while over the past five years they grew by \$36.1 billion, or 22.9 percent. As required by law, borrowers are also stockholder-owners of System banks and associations. As of September 30, 2013, the System had 502,044 stockholders.

The number of FCS institutions continued to decrease because of consolidation. As of September 30, 2013, the System consisted of four banks and 82 associations, compared with seven banks and 104 associations in September 2002. Of the 86 FCS banks and associations, 77 of them had one of the top two examination ratings (1 or 2 on a 1 to 5 scale) and accounted for 98.4 percent of gross System's assets. Eight FCS institutions had a rating of 3, and 1 FCS institution had a rating of 4.

Loans to young, beginning, and small farmers and ranchers represented 11.7 percent, 15.2 percent, and 17.4 percent, respectively, of the total dollar volume of all new farm loans made in 2012. The shares of all three categories were higher than those reported for 2011. Between 2011 and 2012, the increase in the dollar volume of new loans was 18.5 percent for young farmers, 19.2 percent for beginning farmers, and 17.9 percent for small farmers. Young, beginning, and small farmers are not mutually exclusive groups and, thus, cannot be added across categories. Maintaining special policies and programs for the extension of credit to young, beginning, and small farmers and ranchers is a legislative mandate 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 in agriculture and rural America. High grain prices and a weak housing industry put considerable stress on the protein, dairy and ethanol industries, as well as housing related sectors such as timber and nurseries. However, credit conditions in these industries have improved substantially in the past year. The System has maintained its capacity to issue longer-term debt at extremely low yields. The agricultural sector is also subject to future risks such as a farmland price decline, a rise in interest rates, volatile commodity prices, rising production costs, weather-related catastrophes, and long-term environmental risks related to climate change.

The FCSIC, an independent Government-controlled corporation, ensures the timely payment of principal and interest on FCS obligations on which the System banks are jointly and severally liable. On September 30, 2013, the assets in the Insurance Fund totaled \$3.4 billion. As of September 30, 2013, the Insurance Fund as a percentage of adjusted insured debt was 1.99 percent. This was slightly below the statutory secure base amount of 2 percent. During the first nine months of calendar year 2013, outstanding insured System obligations grew by 1.7 percent.

## **Federal Agricultural Mortgage Corporation (Farmer Mac)**

Farmer Mac was established in 1988 as a federally chartered instrumentality of the United States and an institution of the FCS to facilitate a secondary market for farm real estate and rural housing loans. Farmer Mac is not liable for any debt or obligation of the other System institutions, and no other System institutions are liable for any debt or obligation of Farmer Mac. 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. In May 2008, the Food, Conservation and Energy Act of 2008 (2008 Farm Bill) expanded Farmer Mac's program authorities by allowing it to purchase and guarantee securities backed by rural utility loans made by cooperatives.

Farmer Mac continues to meet core capital and regulatory risk-based capital requirements. As of September 30, 2013, Farmer Mac's total outstanding program volume (loans purchased and guaranteed, standby loan purchase commitments, and AgVantage bonds purchased and guaranteed) amounted to \$13.79 billion, which represents an increase of 10.6 percent from the level a year ago. Of total program activity, \$9.7 billion were on-balance-sheet loans and guaranteed securities, and \$4.1 billion were off-balance-sheet obligations. Total assets were \$13.1 billion, with nonprogram investments (including cash and cash equivalents) accounting for \$3.2 billion of those assets. Farmer Mac's net income for the first three quarters of calendar year 2013 was \$59.3 million, a significant increase from the same period in 2012 during which Farmer Mac reported net income of \$34.3 million. Farmer Mac's earnings can be substantially influenced by unrealized fair-value gains and losses. For example, fair-value changes on financial derivatives resulted in an unrealized gain of \$22.5 million for the first three quarters of 2013, compared with unrealized losses \$23.3 million for the same period in 2012 (both pre-tax). Although unrealized fair-value changes experienced on financial derivatives temporarily impact earnings and capital, those changes are not expected to have any permanent effect if the financial derivatives are held to maturity, as is expected.

## **Energy and Infrastructure Credit Programs**

This Administration is committed to constructing a new foundation for economic growth and job creation, and clean energy is a critical component of that. The general public, as well as individual consumers and owners, benefits from clean energy and well-developed infrastructure. Thus, the Federal Government promotes clean energy and infrastructure development through various credit programs.

### **Credit Programs to Promote Clean and Efficient Energy**

The Department of Energy (DOE) administers two credit programs that serve to reduce emissions and en-

hance energy efficiency: a loan guarantee program to support innovative energy technologies and a direct loan program to support advanced automotive technologies.

The DOE's Title 17 loan guarantee program is authorized to issue loan guarantees for projects that employ innovative technologies to reduce air pollutants or man-made greenhouse gases. The program was first provided \$4 billion in loan volume authority in 2007. The 2009 Consolidated Appropriations Act provided an additional \$47 billion in loan volume authority, allocated as follows: \$18.5 billion for nuclear power facilities, \$2 billion for "front-end" nuclear enrichment activities, \$8 billion for advanced fossil energy technologies, and \$18.5 billion for energy efficiency, renewable energy, and transmission and distribution projects. The 2011 appropriations effectively reduced the available loan volume authority for energy efficiency, renewable energy, and transmission and distribution projects by \$17 billion and provided \$170 million in credit subsidy to support renewable energy or energy efficient end-use energy technologies. Congress has since provided no new loan authority or credit subsidy for DOE's Title 17 program. The President's 2015 Budget requests no new authority as the program will focus on deploying the remaining resources appropriated in prior years.

The American Reinvestment and Recovery Act of 2009 amended the program's authorizing statute to allow loan guarantees on a temporary basis for commercial or advanced renewable energy systems, electric power transmission systems, and leading edge biofuel projects. The Recovery Act initially provided \$6 billion in new budget authority for credit subsidy costs incurred for eligible loan guarantees. After funds were transferred to support the Department of Transportation's "Cash for Clunkers" program in 2009 and \$1.5 billion was rescinded to offset the Education Jobs and Medicaid Assistance Act in 2010, the program had \$2.5 billion available for credit subsidy. Early solicitations for the guarantee program attracted many projects requesting 100 percent guarantees of DOE-supported loans. Consistent with Federal credit policies, loans with 100 percent guarantees in this program are financed by the Federal Financing Bank, and therefore do not involve private sector lenders. The program's "Financial Institutions Partnership Program" solicitation, however, invited private sector lenders to participate whereby DOE provided guarantees for up to 80 percent of loan amounts financed by private sector financial institutions. This structure utilized private sector expertise, expedited the lending/underwriting process, and leveraged the program's funds by sharing project risks with the private sector, while increasing private sector experience with financing new energy technologies. The program also added a new solicitation in 2010 specifically targeting projects in the United States that manufacture renewable energy systems or related components. While the authority for the temporary program to extend new loans expired September 30, 2011, DOE provided loan guarantees to 28 projects totaling over \$16 billion in guaranteed debt including: 12 solar generation, 4 solar manufacturing, 4 wind generation, 3 geothermal, 2 biofuels, and 3 trans-

mission/energy storage projects. Four projects withdrew prior to any disbursement of funds.

The Advanced Technology Vehicle Manufacturing (ATVM) Direct Loan program was created to support the development of advanced technology vehicles and associated components in the United States that would improve vehicle energy efficiency by at least 25 percent relative to a 2005 Corporate Average Fuel Economy standards baseline. In 2009, Congress appropriated \$7.5 billion in credit subsidy costs to support a maximum of \$25 billion in loans under ATVM. The program provides loans to automobile and automobile part manufacturers for the cost of re-equipping, expanding, or establishing manufacturing facilities in the United States, and for other costs associated with engineering integration.

### **Electric and Telecommunications Loans**

Rural Utilities Service (RUS) programs of the United States Department of Agriculture (USDA) provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband, and also provide grants for distance learning and telemedicine (DLT).

The Budget includes \$5 billion in direct loans for electricity distribution, construction of renewable energy facilities, transmission, and carbon capture projects on facilities to replace fossil fuels. The Budget also provides \$690 million in direct telecommunications loans, \$44 million in broadband loans, \$20 million in broadband grants, and \$25 million in DLT grants.

### **USDA Rural Infrastructure and Business Development Programs**

USDA provides grants, loans, and loan guarantees to communities for constructing facilities such as healthcare clinics, police stations, and water systems. Direct loans are available at lower interest rates for the poorest communities. These programs have very low default rates. That coupled with the historically low funding costs for the Government has resulted in negative subsidy rates for these programs.

The program level for the Water and Wastewater treatment facility loan and grant program in the 2015 President's Budget is \$1.5 billion. These funds are available to communities of 10,000 or fewer residents. The Community Facility Program is targeted to rural communities with fewer than 20,000 residents. For 2015, it will have a program level of \$2.2 billion in direct loans and \$21 million in grants.

USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, cooperatives, nonprofits, and farmers in creating new community infrastructure (i.e. educational and healthcare networks) and to diversify the rural economy and employment opportunities. In 2015, USDA proposes to provide \$627 million in loan guarantees and direct loans to entities that serve communities of 25,000 or less through the Intermediary Relending program and to entities that serve communities of 50,000 or less through the Business and Industry guaranteed loan program and the Rural Microentrepreneur

Assistance program. These loans are structured to save or create jobs and stabilize fluctuating rural economies.

The Rural Business Service is also responsible for the Rural Energy for America program through which the Budget proposes \$10 million in funding to support \$52 million in loan guarantees and grants to promote energy efficiencies, renewable energy, and small business development in rural communities.

### **Transportation Infrastructure**

Federal credit programs, offered through the Department of Transportation (DOT), fund critical transportation infrastructure projects, often using innovative financing methods. The two predominant programs are the program authorized by the Transportation Infrastructure Finance and Innovation Act (TIFIA), and the Railroad Rehabilitation and Improvement Financing (RRIF) program.

Established by the Transportation Equity Act of the 21st century (TEA-21) in 1998, the TIFIA program is designed to fill market gaps and leverage substantial private co-investment by providing supplemental and subordinate capital to projects of national or regional significance. Through TIFIA, DOT provides Federal credit assistance to highway, transit, rail, and intermodal projects. The 39 projects that have received TIFIA credit assistance represent over \$55 billion of infrastructure investment in the United States. Government commitments in these partnerships constitute nearly \$15 billion in Federal assistance with a budgetary cost of approximately one billion dollars.

TIFIA can help advance qualified, large-scale projects that otherwise might be delayed or deferred because of size, complexity, or uncertainty over the timing of revenues at a relatively low budgetary cost. Each dollar of subsidy provided for TIFIA can provide approximately \$10 in credit assistance, and leverage an additional \$20 to \$30 in non-Federal transportation infrastructure investment. Prior to the most recent surface transportation reauthorization, MAP-21, the demand for the TIFIA program far exceeded available resources. MAP-21 dramatically increased program resources in an effort to help meet demand, providing \$750 million in 2013 and \$1 billion for the program in 2014. In 2015, the President's Budget continues to build upon prior success by requesting \$1 billion for the TIFIA program. At the requested level, TIFIA could provide approximately \$10 billion in credit support for up to \$30 billion in new infrastructure projects. This funding will accelerate critical transportation improvements and attract private investment by lowering financing costs and mitigating market imperfections.

DOT has also provided direct loans and loan guarantees to railroads since 1976 for facilities maintenance, rehabilitation, acquisitions, and refinancing. Federal assistance was created to provide financial assistance to the financially-challenged portions of the rail industry. However, following railroad deregulation in 1980, the industry's financial condition began to improve, larger railroads were able to access private credit markets, and interest in Federal credit support began to decrease.

Also established by TEA-21 in 1998, the RRIF program provides loans with an interest rate equal to the Treasury rate for similar-term securities. TEA-21 also stipulates that non-Federal sources pay the subsidy cost of the loan, thereby allowing the program to operate without Federal subsidy appropriations. The RRIF program assists projects that improve rail safety, enhance the environment, promote economic development, or enhance the capacity of the national rail network. While refinancing existing debt is an eligible use of RRIF proceeds, capital investment projects that would not occur without a RRIF loan are prioritized.

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) increased the amount of total RRIF assistance available from \$3.5 billion to \$35 billion, and the Rail Safety Improvement Act (RSIA) extended the maximum loan term from 25 to 35 years. Since enactment of TEA-21, over \$1.7 billion in direct loans have been made under the RRIF program.

### **National Infrastructure Bank**

To direct Federal resources for infrastructure to projects that demonstrate the most merit and may be difficult to fund under the current patchwork of Federal programs, the President has called for the creation of an independent, non-partisan National Infrastructure Bank (NIB), led by infrastructure and financial experts. The NIB would offer broad eligibility and unbiased selection for transportation, water, and energy infrastructure projects. Projects would have a clear public benefit, meet rigorous economic, technical and environmental standards, and be backed by a dedicated revenue stream. Geographic, sector, and size considerations would also be taken into account. Interest rates on loans issued by the NIB would be indexed to United States Treasury rates, and the maturity could be extended up to 35 years, giving the NIB the ability to be a "patient" partner side-by-side with State, local, and private co-investors. To maximize leverage from Federal investments, the NIB would finance no more than 50 percent of the total costs of any project.

### **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 private and sovereign borrowers. These programs are intended to level the playing field for U.S. exporters, deliver robust support for U.S. goods and services, stabilize international financial markets, and promote sustainable development.

### **Leveling the Playing Field**

Federal export credit programs counter official financing that foreign governments around the world, largely in Europe and Japan but also increasingly in emerging markets such as China and Brazil, 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). In its current form, this agreement has virtually eliminated direct interest rate subsidies, significantly constrained tied-aid grants, and standardized the fees for corporate and sovereign lending across all OECD ECAs—bringing the all-in costs of OECD export credit financing broadly in line with market levels. In addition to ongoing OECD negotiations, US government efforts resulted in the 2012 creation of the International Working Group (IWG) on export credits. This group includes China and other non-OECD providers of export credits in discussions on a broader framework that would bring common practices to ECAs throughout the world.

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**

Consistent with U.S. obligations in the International Monetary Fund regarding global financial stability, the Exchange Stabilization Fund managed by the Department of the Treasury may provide loans or credits to a foreign entity or government of a foreign country. 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 that 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.

OPIC mobilizes private capital to help solve critical challenges such as renewable energy and infrastructure development, and in doing so, advances U.S. foreign policy. OPIC achieves its mission by providing investors with financing, guarantees, political risk insurance, and support for private equity investment funds. These programs are intended to create more efficient financial markets, eventually encouraging the private sector to supplant OPIC finance in developing countries.

### **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 most agencies that lack sufficient historical experience budget for the cost associated with the risk of international lending. The cost of lending by these 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.

### **Promoting Economic Growth and Poverty Reduction through Debt Sustainability**

The Enhanced Heavily Indebted Poor Countries (HIPC) Initiative reduces the debt of some of the poorest countries with unsustainable debt burdens that are committed to economic reform and poverty reduction.

## **III. INSURANCE PROGRAMS**

### **Deposit Insurance**

Federal deposit insurance promotes stability in the U.S. financial system. Prior to the establishment of Federal deposit insurance, depository institution failures 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 Great Depression, a system of Federal deposit insurance was established to protect de-

positors and to prevent bank failures from causing widespread disruption in financial markets.

Today, the Federal Deposit Insurance Corporation (FDIC) insures deposits in banks and savings associations (thrifts) using the resources available in its Deposit Insurance Fund (DIF). The National Credit Union Administration (NCUA) insures deposits (shares) in most credit unions (certain credit unions are privately insured) through the National Credit Union Share Insurance Fund (SIF). As of September 30, 2013, the FDIC insured \$6 tril-

lion of deposits at 6,891 commercial banks and thrifts, and the NCUA insured \$862 billion of shares at 6,620 credit unions. The expiration of the Transaction Account Guarantee program on December 31, 2012 led to a large one time reduction in FDIC insured deposits as amounts above \$250,000 deposited in domestic noninterest-bearing transaction accounts are no longer insured by FDIC. See the Financial Stabilization Efforts and their Budgetary Effects chapter of the Analytical Perspectives volume of the 2014 President's Budget for more information on the Transaction Account Guarantee program.

### Recent Reforms

Since its creation, the Federal deposit insurance system has undergone many reforms. As a result of the recent crisis, several reforms were enacted to protect both the acute and longer-term integrity of the Federal deposit insurance system. The Helping Families Save Their Homes Act of 2009 (P.L. 111–22) provided NCUA with tools to protect the Share Insurance Fund as well as support to credit union member institutions. Notably, the Helping Families Save Their Homes Act:

- Segregated losses of corporate credit unions into the Temporary Corporate Credit Union Stabilization Fund (TCCUSF), providing a mechanism for assessing losses related to the corporate credit unions to member institutions over an extended period of time;
- Allowed a restoration plan to spread insurance premium assessments over a period of up to eight years if the equity ratio fell below 1.2 percent; and
- Increased the Share Insurance Fund's borrowing authority to \$6 billion.

The Dodd-Frank Wall Street Reform and Consumer Protection (Wall Street Reform) Act of 2010 included provisions allowing the FDIC to more effectively and efficiently manage the DIF. The Act authorized the FDIC to set the minimum DIF reserve ratio (ratio of the deposit insurance fund balance to total estimated insured deposits) to 1.35 percent by 2020, up from 1.15 percent. In addition to raising the minimum reserve ratio, the Wall Street Reform Act also:

- Eliminated the FDIC's requirement to rebate premiums when the DIF reserve ratio is between 1.35 and 1.5 percent;
- Gave the FDIC discretion to suspend or limit rebates when the DIF reserve ratio is at least 1.5 percent, effectively removing the 1.5 percent cap on the DIF; and
- Required the FDIC to offset the effect on small insured depository institutions (defined as banks with assets less than \$10 billion) when setting assessments to raise the reserve ratio from 1.15 to 1.35 percent.

In implementing the Wall Street Reform Act, the FDIC issued a final rule setting a long-term (i.e., beyond 2024) reserve ratio target of 2 percent, a goal that FDIC considers necessary to maintain a positive fund balance during economic crises while permitting steady long-term assessment rates that provide transparency and predictability to the banking sector. This rule, coupled with other provisions of the Wall Street Reform Act, will significantly improve the FDIC's capacity to resolve bank failures and maintain financial stability during economic downturns.

The Wall Street Reform Act also permanently increased the insured deposit level to \$250,000 per account at banks or credit unions insured by the FDIC or NCUA.

### Recent Fund Performance

After seven consecutive quarters of negative balances, the DIF balance became positive on June 30, 2011, standing at \$3.9 billion on an accrual basis, then doubling to \$7.8 billion on September 30, 2011. As of September 30, 2013, the DIF fund balance stood at \$40.8 billion. The growth in the DIF balance is a result of fewer bank failures and higher assessment revenue. The reserve ratio on September 30, 2013 was 0.68 percent.

As of September 30, 2013, the number of insured institutions on the FDIC's "problem list" (institutions with the highest risk ratings) totaled 515, which represented a decrease of nearly 42 percent from December 2010. Furthermore, the assets held by problem institutions decreased by more than 55 percent.

The SIF ended September 2013 with assets of \$11.7 billion. The NCUA's equity ratio was 1.31 percent in March 2013. If the equity ratio increases above the normal operating level of 1.30 percent, a distribution is normally paid to member credit unions to reduce the equity ratio to the normal operating level. However, the Helping Families Save Their Homes Act requires that SIF dividends be directed to Treasury for the repayment of any outstanding TCCUSF loans before a distribution can be paid to member credit unions. In March of 2013, NCUA distributed SIF dividends of \$88 million to the TCCUSF. As of September 30, 2013, the TCCUSF had a \$4.7 billion loan outstanding from the Department of the Treasury.

The health of the credit union industry continues to improve. Consequently, the ratio of insured shares in problem institutions to total insured shares decreased to 1.6 percent in September 2013 from a high of 5.7 percent in December 2009. With the improving health of credit unions, NCUA has been steadily reducing SIF loss reserves. As of September 30, 2013, the SIF had set aside \$243.8 million in reserves to cover potential losses, over 75 percent less than the \$1.0 billion set-aside as of September 30, 2011.

### Restoring the Deposit Insurance Funds

Pursuant to the Wall Street Reform Act, the restoration period for the FDIC's DIF reserve ratio to reach 1.35 percent was extended to 2020. (Prior to the Act, the DIF reserve ratio was required to reach the minimum target of 1.15 percent by the end of 2016.) The Budget projects that changes in net provisions for losses coupled with low-

er projected investment income in 2014 will slightly decrease the DIF reserve ratio to 0.64 percent at year-end. From 2015 on, however, it is expected to increase steadily, reaching the statutorily required level of 1.35 percent by 2020. In late 2009, the FDIC Board of Directors adopted a final rule requiring insured institutions to prepay quarterly risk-based assessments for the fourth quarter of CY 2009 and for all of CY 2010, 2011, and 2012. The FDIC collected approximately \$45 billion in prepaid assessments pursuant to this rule. Unlike a special assessment, the prepaid assessments did not immediately affect bank earnings; it was booked as an asset and amortized each quarter by that quarter's assessment charge. This prepaid assessment, coupled with annual assessments on the banking industry, provided the FDIC with ample operating cash flows to effectively and efficiently resolve bank failures during the short period in which the DIF balance was negative. Although the FDIC has authority to borrow up to \$100 billion from Treasury to maintain sufficient DIF balances, the Budget does not anticipate FDIC utilizing their borrowing authority because the DIF is projected to maintain positive operating cash flows over the entire 10-year budget horizon.

While the NCUA has successfully restored the reserve ratio of the SIF to the required level, NCUA continues to seek compensation from the parties that created and sold troubled assets to the failed corporate credit unions. As of December 31, 2013, NCUA's gross recoveries from securities underwriters total more than \$1.75 billion, helping to minimize losses and future assessments on federally in-

sured credit unions. These recoveries have also accelerated repayment of the TCCUSF's outstanding U.S. Treasury borrowings.

### Budget Outlook

The Budget estimates DIF net outlays of -\$92.9 billion (i.e. net inflows into the fund) over the 10-year budget window. As a result of updated economic assumptions and technical changes to OMB's forecasting model, the projected inflows between 2014 and 2023 are lower than the 2014 Mid-Session Review (MSR) projection by approximately \$5.8 billion. The latest public data on the banking industry led to a downward revision to bank failure estimates, which are consistent with long-term, historical averages in terms of failed bank assets as a percentage of GDP. With the lower bank failure projection, the Budget projects much lower FDIC premiums necessary to reach the minimum Wall Street Reform Act DIF reserve ratio of 1.35 percent.

### Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures the pension benefits of workers and retirees in covered defined-benefit pension plans. PBGC pays benefits, up to a guaranteed level, when a company's plan closes without enough assets to pay future benefits. 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 un-

**Table 20-1. TOP 10 FIRMS PRESENTING CLAIMS (1975-2013)**

Single-Employer Program

Firm	Fiscal Year(s) of Plan Termination(s)	Claims (by firm)	Percent of Total Claims (1975-2013)
1 United Airlines	2005	\$7,304,186,216	15.01%
2 Delphi	2009	6,387,327,984	13.13%
3 Bethlehem Steel	2003	3,702,771,655	7.61%
4 US Airways	2003, 2005	2,723,720,013	5.60%
5 LTV Steel*	2002, 2003, 2004	2,134,985,884	4.39%
6 Delta Air Lines	2006	1,720,156,504	3.53%
7 National Steel	2003	1,319,009,117	2.71%
8 Pan American Air	1991, 1992	841,082,434	1.73%
9 Trans World Airlines	2001	668,377,106	1.37%
10 Weirton Steel	2004	640,480,970	1.32%
Top 10 Total		\$27,442,097,883	56.39%
All Other Total		\$21,219,218,191	43.61%
TOTAL		\$48,661,316,074	100.00%

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

Sources: PBGC Fiscal Year Closing File (9/30/13), PBGC Case Management System, and PBGC Participant System (PRISM).

Due to rounding of individual items, numbers and percentages may not add up to totals.

Data in this table have been calculated on a firm basis and, except as noted, include all trustee plans of each firm.

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



derfunded 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. Most private insurers can diversify or reinsure their catastrophic risks as well as flexibly price these risks. Unlike private insurers, PBGC cannot deny insurance coverage or adjust premiums according to risk. Both types of PBGC premiums—the flat rate (a per person charge paid by all plans) and the variable rate (paid by some underfunded plans) are set in statute. CBO and others have noted that the premium rates are far lower than what a private financial institution would charge for insuring the same risk.

Claims against PBGC's insurance programs are highly variable. One large pension plan termination may result in a larger claim against PBGC than the termination of many smaller plans. Future results will continue to depend largely on the termination of a limited number of very large plans.

PBGC operates two legally distinct insurance programs: one for single employer plans and another for multiemployer plans. Single employer plans generally provide benefits to the employees of one employer. When an underfunded single employer plan terminates, usually through bankruptcy, PBGC becomes trustee of the plan, applies legal limits on payouts, and pays benefits. The amount of benefit paid is determined after taking into account (a) the benefit that a beneficiary had accrued in the terminated plan, (b) the availability of assets from the terminated plan to cover benefits, and (c) the legal maximum benefit level set in statute. In 2013, the maximum annual payment guaranteed under the single-employer program was \$55,841 for a retiree aged 65.

PBGC's single-employer program has incurred substantial losses from underfunded plan terminations. Table 20-1 shows the ten largest plan termination losses in PBGC's history. Nine of the ten happened since 2001.

Multiemployer plans are collectively bargained pension plans maintained by more than one unrelated employer, usually within the same or related industries, and one or more labor unions. PBGC's role in the multiemployer program is more like that of a re-insurer; if a company sponsoring a multiemployer plan fails, its liabilities are assumed by the other employers in the collective bargaining agreement, not by PBGC, although those employers can withdraw from a plan for an exit fee. PBGC becomes responsible for insurance coverage when the plan runs out of money to pay benefits at the statutorily guaranteed level, which usually occurs after all contributing employers have withdrawn from the plan, leaving the plan without a source of income. PBGC provides insolvent multiem-

ployer plans with financial assistance in the form of loans sufficient to pay guaranteed benefits and administrative expenses. Benefits under the multiemployer program are calculated based on the benefit a participant would have received under the insolvent plan, subject to the legal multiemployer maximum set in statute. The maximum guaranteed amount depends on the participant's years of service. In 2013, for example, the maximum annual payment for a participant with 30 years of service was \$12,870.

As of September 30, 2013, the single-employer and multi-employer programs reported deficits of \$27.4 billion and \$8.3 billion, respectively. Although PBGC will be able to pay benefits for years to come, it is still projected to be unable to meet its long-term obligations under current law. PBGC estimates its long-term loss exposure to reasonably possible terminations (e.g., underfunded plans sponsored by companies with credit ratings below investment grade) at approximately \$329 billion. For 2013, exposure was concentrated in the following sectors: manufacturing (primarily automobile/auto parts and primary and fabricated metals), transportation (primarily airlines), services, and wholesale and retail trade.

The Congress has raised premiums twice since 2012. The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (MAP-21), signed on July 6, 2012, increased PBGC premiums for both single-employer and multiemployer plans. The Bipartisan Budget Act, signed on December 26, 2013, raised single-employer premiums. Flat-rate premiums for single-employer plans will be increased to \$64 by 2016, and will be indexed to inflation thereafter. Variable-rate premiums will also increase, and will also be indexed to inflation for the first time. Rates are expected to increase to \$29 per \$1000 of underfunding by 2016. The variable-rate premium will be capped in filing year 2013 at \$400 times the number of plan participants; the cap increases to \$500 by 2016, and is indexed thereafter. Flat-rate premiums for multiemployer plans were increased to \$12 for 2013, and will be indexed thereafter.

While this legislation brings in much-needed resources to improve PBGC's financial condition, rates remain much lower than what a private financial institution would charge for insuring the same risk. Any further premium increases need to be carefully crafted to avoid worsening PBGC's financial condition and harming workers' retirement security by driving healthy plans that pose little risk of presenting a claim to PBGC out of the system.

To address these concerns, the 2015 Budget proposes to give the PBGC Board the authority to adjust premiums in both the single and multi-employer programs to better account for the risk that different sponsors pose. In the multiemployer program, these premium increases are crucial to improving solvency but will not be sufficient to address the complex challenges facing these plans. The Administration looks forward to working with Congress to develop a more comprehensive solution. This proposal is estimated to save \$20 billion over the next decade.

Consistent with previous Administration proposals, the Board would be required to consult with stakeholders prior to setting a new premium schedule and to es-

establish a hardship waiver and other limitations on plan-specific premium increases. PBGC would be directed to try to make the premiums counter-cyclical and any increase would be phased in gradually. In determining the new premium rates, the Board would consider a number of factors, including a plan's risk of losses to PBGC and the amount of a plan's underfunding.

## 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 enforce appropriate floodplain management measures. Coverage is limited to buildings and their contents. By the end of 2013, the program had over 5.5 million policies in more than 22,200 communities with over \$1.3 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, to combine a program of insurance with flood mitigation measures to reduce the nation's risk of loss from flood, and to minimize Federal disaster-assistance expenditures. The NFIP requires building standards and other mitigation efforts to reduce losses, and operates a flood hazard mapping program to quantify geographic variation in the risk of flooding. These efforts have made substantial progress. However, structures built prior to flood mapping and NFIP floodplain management requirements, which make up 21.5 percent of the total policies in force, currently pay less than fully actuarial rates.

A major DHS goal is to have property owners be compensated for flood losses through flood insurance, rather than through taxpayer-funded disaster assistance. The agency's marketing strategy aims to increase the number of Americans insured against flood losses and improve retention of policies among existing customers. The strategy includes:

1. Providing financial incentives to the private insurers that sell and service flood policies for the Federal Government to expand the flood insurance business.
2. Conducting the national marketing and advertising campaign, FloodSmart, which uses TV, radio, print and online advertising, direct mailings, and public relations activities to help overcome denial and resistance and increase demand.
3. Fostering lender compliance with flood insurance requirements through training, guidance materials,

and regular communication with lending regulators and the lending community.

4. Conducting NFIP training for insurance agents via instructor-led seminars, online training modules, and other vehicles.
5. Seek opportunities to simplify and clarify NFIP processes and products to make it easier for agents to sell and for consumers to buy.

While these strategies have resulted in steady policy growth over recent years, the growth slowed somewhat since 2009 due to the severe downturn in the economy. After a slight decline in 2012, the program grew by 16,000 policies in 2013.

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 particular, flood mitigation assistance grants 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. DHS is working to ensure that the flood mitigation grant program is 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.

Due to the catastrophic nature of flooding, with Hurricanes Katrina and Sandy as notable examples, insured flood damages far exceeded premium revenue in some years and depleted the program's reserve account, which is a cash fund. On those occasions, the NFIP exercises its borrowing authority through the Treasury to meet flood insurance claim obligations. While the program needed appropriations in the early 1980s to repay the funds borrowed during the 1970's, it was able to repay all borrowed funds with interest using only premium dollars between 1986 and 2004. In 2005, however, Hurricanes Katrina, Rita, and Wilma generated more flood insurance claims than the cumulative number of claims from 1968 to 2004. Hurricane Sandy in 2012 also generated significant flood insurance claims. As a result, the Administration and Congress have increased the borrowing authority to \$30.4 billion. The program's debt is currently \$24 billion.

The catastrophic nature of the 2005 hurricane season also triggered an examination of the program, and the Administration worked with Congress to improve the program. On July 6, 2012, the Biggert Waters Flood Insurance Reform Act of 2012 was signed into law. In addition to re-authorizing the NFIP for 5 years, the bill also requires the NFIP generally to move to full risk-based premium rates and strengthens the NFIP financially and operationally.

In 2013, the NFIP began phasing in risk-based premiums for certain properties, as required by the law.

### 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 co-operative 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 2015 Budget continues to propose policies that are similar to those included in the 2013 and 2014 Budget and recommended to the Joint Committee for Deficit Reduction:

1. Lower the cap for the crop insurance companies' return on retained premium to 12 percent,
2. Lower the cap on the companies' administrative expense reimbursement to \$0.9 billion, adjusted annually for inflation,
3. Lower the subsidy for producer premiums by 3 percentage points for policies where the Government subsidizes more than 50 percent of the premium, and
4. Reduce premium subsidy by 4 percentage points for revenue coverage that is tied to upward price movements at harvest time.

The most basic type of crop insurance 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", 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 2013, the 10 principal crops, (barley, corn, cotton, grain sorghum, peanuts, potatoes, rice, soybeans, tobacco, and wheat) accounted for over 85 percent of total liability, and approximately 86 percent of the total U.S. planted acres of the 10 crops were covered by crop insurance. 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 the two. These programs extend traditional multi-peril or yield crop insurance by adding price variability to production history.

The pilot Rainfall Index and Vegetation Index plans of insurance are pilot area plans of insurance that insure against a decline in an index value covering Pasture, Rangeland, and Forage. These pilot programs meet the needs of livestock producers who purchase insurance for protection from losses of forage produced for grazing or harvested for hay. In 2013, there were 26,679 vegetation and rainfall policies sold, covering over 54 million acres of pasture, rangeland and forage. There was over \$1 billion in liability, and through January 2014 nearly \$159 million in indemnities paid to livestock producers who purchased coverage.

RMA is continuously working to develop new products and to expand or improve existing products in order to cover more agricultural commodities. Under the 508(h) authorities and procedures, RMA may advance payment of up to 50 percent of expected reasonable research and development costs for FCIC Board approved Concept Proposals prior to the complete submission of the policy or plan of insurance under 508(h) authorities. In 2013, two new privately developed crop insurance programs, Downed Rice Endorsement and Machine Harvested Cucumbers, were approved under the authorities provided by section 508(h) of the Federal Crop Insurance Act and were made available to producers for the 2014 crop year. Five other privately developed products were approved for expansion to producers in additional states and counties: APH Olive, Camelina, Pulse Crop Revenue, Fresh Market Beans and Louisiana Sweet Potato. There are three additional privately developed products currently under the FCIC Board of Directors review process along with four Concept Proposals the FCIC Board has approved for reimbursement of a portion of research and development expenses that are targeted to be available to producers in 2015.

Lastly, RMA contracts for the development of new or improved programs subject to FCIC Board approval. One new program, for Tart Cherries, was developed and approved by the FCIC Board for sale to producers beginning with the 2014 crop year, and another program, the Area Risk Protection Insurance for Rice, was approved but will not be available until the 2015 crop year."

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

### Insurance against Security-Related Risks

#### Terrorism Risk Insurance

The Terrorism Risk Insurance Program (TRIP) was authorized under P.L. 107-297 to help ensure the continued availability of property and casualty insurance following the terrorist attacks of September 11, 2001. TRIP's initial three-year authorization enabled the Federal Government to establish a system of shared public and private compensation for insured property and casualty losses arising from certified acts of foreign terrorism. In 2005, Congress passed a two-year extension (P.L. 109-144), which narrowed the Government's role by increas-



ing the private sector's share of losses, reducing lines of insurance covered by the program, and adding a threshold event amount triggering Federal payments.

In 2007, Congress enacted a further seven-year extension of TRIP and expanded the program to include losses from domestic as well as foreign acts of terrorism (P.L. 110-318). For all seven extension years, TRIP maintains a private insurer deductible of 20 percent of the prior year's direct earned premiums, an insurer co-payment of 15 percent of insured losses of up to \$100 billion above the deductible, and a \$100 million minimum event cost triggering Federal coverage. The 2007 extension also requires Treasury to recoup 133 percent of all Federal payments made under the program up to \$27.5 billion, and accelerates deadlines for recoupment of any Federal payments made before September 30, 2017. The current authorization expires on December 31, 2014.

The Budget baseline includes the estimated Federal cost of providing terrorism risk insurance through the expiration of the program on December 31, 2014. Using market data synthesized through a proprietary model, the Budget projects annual outlays and recoupment for TRIP. While the Budget does not forecast any specific triggering events, the estimates for this account represent the weighted average of TRIP payments over a full range of possible scenarios, most of which include no notional terrorist attacks (and therefore no TRIP payments), and some of which include notional terrorist attacks of varying magnitudes. On this basis, the Budget projects net spending of \$230 million over the 2015-2019 period and \$300 million over the 2015-2024 period.

In order to preserve the long-term availability and affordability of property and casualty insurance for terrorism risk, the Budget proposes to extend the Terrorism Risk Insurance Program and to implement programmatic

reforms to limit taxpayer exposure and achieve cost neutrality. The Administration will work with Congress to identify appropriate adjustments to program terms to achieve budget neutrality and, over the longer term, full transition of the program to the private sector. Building on previously enacted reforms to the program, this extension may include changes to the size of the deductible, the threshold for a certified terrorist event, or the loss-sharing percentages for the Government and covered firms after the deductible is exceeded.

### **Airline War Risk Insurance**

The aviation war risk insurance program expires on September 30, 2014. In the months following the attacks of September 11, 2001, Congress enacted legislation requiring the Secretary of Transportation to expand insurance provided to U.S. air carriers for war and terrorism risks to include hull loss, passenger loss of life, and third party liability, but established limits on the amount of premiums the Secretary could charge. As a result, the program does not collect enough premiums to cover its potential risk. With the goal of utilizing private capacity to manage aviation war risk, the Administration proposes to reform the program, beginning in 2015, by only covering losses resulting from the use of nuclear, bio-chemical, and radioactive (NBCR) attacks and providing a backstop that would trigger FAA full war risk insurance in the event of a widespread cancellation of coverage by the private insurance market. Air carriers would be free to negotiate the charge for commercial war risk coverage in the private insurance market. FAA would offer NBCR coverage, and air carriers would pay premiums to FAA for this coverage. Most foreign air carriers currently obtain most of their war risk insurance from commercial insurers.

## **IV. FAIR VALUE BUDGETING FOR CREDIT PROGRAMS**

Accurate cost and revenue estimates support a sound budget—one that shows the fiscal position of the Federal Government and allocates limited resources across competing needs. Cost estimation is challenging for Federal credit programs because loans and loan guarantees create obligations for uncertain cash flows that can extend far into the future.

The Federal Credit Reform Act of 1990 (FCRA) greatly improved the accuracy of cost estimates for credit programs by reflecting the estimated lifetime costs of loans and loan guarantees up front on a net present value basis, requiring policy officials to budget for those lifetime costs when making programmatic decisions. Any change to FCRA should be consistent with the original goals of credit reform, to provide better information on the budgetary costs of credit programs and improve resource allocation by placing them on a comparable basis to other credit programs and other forms of Federal spending.

Some analysts have argued that credit programs impose costs on taxpayers that are not reflected under FCRA, in particular, costs related to uncertainty. As an alternative, they have proposed to require that the budget

use "fair value" estimates for credit programs. In practice, this would mean discounting credit program cash flows using a market interest rate, instead of the interest rate on U.S. government debt, which would generally increase the cost of these programs.

While fair value analysis may offer some useful insights and help inform decision-making for specific programs, fair value budgeting would have drawbacks that far exceed its advantages. Fair value would create significant inconsistencies across the Federal budget, making it more difficult to compare the costs of credit programs to each other or to other forms of Federal spending, and it would make Federal budgeting less transparent by introducing a wedge between cost estimates and estimated deficit effects for the same program. It would also incorporate costs not relevant to the Federal government, generally overstating the uncertainty premium that is relevant for Federal government decision-making. Finally, fair value would impose significant implementation costs and challenges and could introduce more noise and distortion than valuable information into credit estimates.

## Estimating Costs under FCRA and Fair Value

Since the enactment of FCRA, cost estimates for Federal credit programs—whether loan guarantees or direct lending—equal the present value of expected cash flows to and from the Government over the life of the loan, excluding administrative costs. For example, the cost of a direct loan is the sum of disbursements minus the present value of estimated repayments after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries. Likewise, the cost of a loan guarantee equals the present value of expected claims minus the present value of payments to the Government including fees, penalties, and recoveries. Expected cash flows are discounted by Treasury rates of comparable maturity.

FCRA significantly improved budgeting for credit programs by putting estimates for loans and loan guarantees on the same footing as most other programs, eliminating a systematic bias against direct loans and in favor of loan guarantees. Before FCRA, the budget reflected the cash flows of loans and loan guarantees in the years that the cash flows occurred. The cost of new direct loans was greatly overstated relative to both loan guarantees and non-credit programs—appropriations were required for the full face value of loans and did not consider expected repayment over time. In contrast, new loan guarantees appeared free, and there was no requirement to set aside a reserve to cover anticipated losses. Under FCRA, loan guarantees and direct loans are both scored on the basis of their total expected lifetime costs to the Government. In addition to putting credit assistance on the same basis, FCRA placed the cost of credit programs on a comparable basis to most other forms of Federal spending, allowing for an efficient allocation of resources across competing needs.

FCRA estimates have been fairly accurate overall, although not always on a program-by-program basis. Net lifetime re-estimates of subsidy cost for credit programs over the 21 years that FCRA has been in place are \$17 billion upward—less than one percent of the face value of the loans and guarantees made under FCRA.

Proponents of fair value budgeting do not necessarily question the accuracy of FCRA cost estimates in measuring expected cost to the Federal government. Rather, they argue that expected cost is an incomplete measure of total cost and that budget estimates should also include an additional uncertainty premium. For this reason, proponents of fair value budgeting argue for discounting the cash flow costs of credit programs using market interest rates, instead of Treasury rates. Federal credit programs produce uncertain cash flows that are subject to default, prepayment, and other risks. In contrast, market interest rates are generally higher than Treasury rates, in part because they do include this uncertainty premium. (Market rates also differ from Treasury rates for other reasons; see the box below: “Differences between FCRA and Fair Value Estimates.” Moreover, under fair value, discount rates would need to be derived from available market data, and would vary across programs and in some cases by individual loan.)

## Problems with Fair Value Budgeting

*Consistency.* Any change to credit budgeting should maintain FCRA’s accomplishments in providing better information on the budgetary costs of credit programs and placing credit programs on a comparable basis to other forms of Federal spending. In contrast, fair value budgeting would make it more difficult to compare the costs of credit programs and other types of Federal spending.

Uncertainty is not unique to credit programs. The costs of virtually all mandatory programs, in particular all of the major social insurance programs such as Social Security, Medicare, and Unemployment Insurance, are uncertain and, in some cases, strongly correlated with economic conditions. Revenue estimates are uncertain and also correlated with the business cycle. The uncertainty premium is not budgeted for any of these programs, although their market prices (the premium that a private insurer would charge to insure against unemployment, for example) would be higher than the expected cost. Compared with the uncertainty associated with the deficit impact of mandatory programs and tax collections, the uncertainty in the outcome of credit programs is small. Scoring an uncertainty premium only for credit programs could distort decision making, placing a thumb on the scale against credit assistance.

Some fair value proponents argue that fair value budgeting for credit programs would improve consistency because the costs of most other government activities, consisting of grants, transfers, and purchases from the private sector, are calculated on the basis of market prices. This claim is mistaken. Estimates in these cases are based on accounting costs, that is, cash flows; in many cases, but not always, the accounting cost is the same as the market price paid by other buyers of the same goods and services in the private market. There is no occasion in which the Government chooses the market price over the accounting cost for the budgeting purpose when the accounting cost differs from the market price. For example, no one would propose that budget estimates for Medicare should reflect average prices paid by private insurers, as opposed to the actual Medicare fee schedule.

*Transparency.* The primary role of the budget is to reflect the fiscal position of the Federal Government. Where FCRA cost estimates and budgetary accounting tie the cost of credit programs to actual cash flows, fair value cost estimates could cause an imbalance because the cost estimate for a program would exceed the expected cost to the Government. Under fair value cost estimates, the cost estimate and estimated deficit impact of the same program would be different from one another, raising concerns about consistency and transparency.<sup>2</sup> Moreover, if one were to attempt to address the consistency issues discussed above by applying fair value principles across the Federal government, the costs in terms of transparency would be magnified because there would be even larger systematic divergences between budgetary cost estimates and expected

<sup>2</sup> A full accounting of costs under fair value should result in the same net deficit impact as under FCRA—so while legislators would be scored higher costs for the uncertainty premium, the actual cost to Government would be lower by the amount of the premium.

deficit effects. Put simply, it would no longer be possible to subtract estimated outlays from estimated revenues and arrive at the expected path for budget deficits and debt.

Equally important, fair value cost estimates include factors that are often unobservable or extremely difficult to compute—including the premium that a private actor would demand to compensate for uncertainty of future performance. The Government typically intervenes to improve efficiency in inefficient markets, where either comparable products do not exist or their prices are distorted. Many federal loans are targeted to borrowers who cannot get credit elsewhere and for whom, in most cases, no private market comparable product exists. Given these complexities, fair value budgeting would sometimes require guessing at comparable market rates without reliable references to generate or validate assumptions.

Moreover, even if data and information were available, estimating fair value costs requires advanced financial knowledge and sophisticated modeling techniques. Attempting to isolate the elements of fair value that are relevant to the Government would require judgment. Reasonable analysts would arrive at very different results. The lack of objectivity would further reduce transparency and consistency across programs and contrasts with the comparatively straightforward principles of FCRA budgeting.

FCRA costs reflect estimated cash flows, including expected risks. For example, assume an initial FCRA cost estimate suggested a \$2 million cost for a \$100 million loan program, the original fair value cost estimate was \$10 million for the same program, and actual lifetime costs proved to be \$4 million. Under FCRA, the change in cost is recognized through reestimates where program costs are updated for actual experience and changes in future expectation on an annual basis. Ultimately, one can trace back the change in cost to the actual transactions with the public under FCRA, and that actual experience can feed into future estimates as appropriate. In contrast, fair value cost estimates include factors that can never be observed, even after the fact—including how the market would price specific contract terms, expected losses, and the risk premium for uncertainty. Because fair value includes market price assumptions that are not tied to actual cashflows, there is no way to validate these assumptions and feed them into improved estimates of future costs.

**Accuracy.** Even if one accepts that credit program budget estimates should attempt to incorporate costs related to uncertainty, fair value estimates may not be an improvement on FCRA estimates. Many of the factors reflected in fair value pricing are irrelevant or less relevant to taxpayers than to private investors. Most important, the Federal government has greater ability to diversify risk (across activities, individuals, and generations) than any private actor. Thus, the uncertainty premium incorporated in market interest rates will generally overstate the true cost of uncertainty to Federal taxpayers. Such factors include the liquidity premium, which may be large when dealing with assets that do not trade in well-functioning liquid markets and which is less relevant to taxpayers, because the Government can easily borrow in the Treasury securities market with minimal transac-

tion costs. (See the box below: “Differences between FCRA and Fair Value Estimates.”) Overall, there is no guarantee that fair value estimates will consistently improve on traditional estimates, even judged by the criteria used by fair-value proponents.

### **Implementation Costs and Challenges of Fair Value**

In addition to the conceptual issues discussed above, practical implementation issues represent a major barrier to fair value budgeting. Due to the difficulties and complexities involved in its implementation, fair value budgeting could prove extremely costly, with little long-term benefit in terms of more accurate cost information and efficient resource allocation. Depending on the nature of a fair value proposal, it could require a significant investment in OMB, Treasury, and Federal credit agency resources to implement, or it could divert limited administrative resources from management and oversight of affected programs.

Methods for estimating fair value would need to be explored and developed, along with guidance to ensure consistent and appropriate application across programs. While the components of market prices may be estimated, the degree of accuracy can vary widely. Guidance would also need to be developed to account for actual costs over time to ensure transparency and accuracy in the costs of outstanding loans and guarantees and the effects of policy changes on program costs. However, it is not clear that it is possible to develop guidance that could overcome the inherent problems identified above.

In implementing current FCRA requirements, some Federal credit programs have faced significant administrative challenges in hiring staff with the right technical skill sets, and developing critical management infrastructure, including financial accounting systems, monitoring, and modeling capabilities. Fair value would place much greater demands on agencies in all of these areas. For some of these programs, greater investment in preparing FCRA estimates might do more to improve cost measurement than investment in preparing fair value estimates.

The Troubled Asset Relief Program (TARP) implemented a risk-adjusted cost estimate, similar to fair value, based on the direction in the Economic Emergency Stabilization Act of 2008. The Act provided Treasury permanent indefinite budget authority to fund administrative costs, in contrast to the funding for administrative expenses of most other credit programs, which are annually appropriated and constrained by the discretionary caps. Implementation has been extremely resource-intensive, requiring large investments in private sector financial advisors, datasets, and systems. Agencies with limited administrative resources may not be able to support necessary investments for accurate fair value estimates, or doing so could draw resources away from mitigating risks and costs that otherwise may be within the agency's ability to control. Ultimately, the lifetime cost to Government under TARP is expected to be far lower than originally estimated, as premiums for market risk are returned to Treasury through downward re-estimates over time, raising the question of the value of the original fair value estimates.



## Summary

Fair value cost estimates for Federal credit programs contain some elements that might be useful for benefit-cost analysis. Using fair value cost estimates in the budget, however, would represent a step backward from the methods in use today. Budget estimates for credit programs are more informative when they show the direct cost to the Government in an accurate and transparent manner, comparable to costing methodologies used for other federal programs, as opposed to other definitions of cost that depend on unobservable values. It is conceptually difficult to identify the uncertainty premium relevant to taxpayers, which differs in many cases from the uncer-

tainty premium for private investors. Apart from conceptual issues, it would also be very costly and difficult to estimate fair value costs due to the paucity of historical data and limited relevance of market information.

For the purpose of improving the accuracy and transparency of budget estimates, it might be more effective and practical to explore improvements to FCRA estimates, like better modeling of interest rate and prepayment options, rather than exploring alternative measures. Alternatives to fair value budgeting to inform decision-making for credit programs should be evaluated—including greater investment in improving FCRA cost estimates, and strengthened cost-benefit analyses at the program level.

### DIFFERENCES BETWEEN FCRA AND FAIR VALUE ESTIMATES

Some of the factors incorporated in fair value estimates are irrelevant or less relevant for the Federal government. Decomposing the difference between FCRA and fair value estimates can shed light on which factors are not equally relevant to taxpayers and private investors. (For a more detailed discussion, see pages 393-395 and 397-398 of the 2013 *Analytical Perspectives*.)

*Time Preference (incorporated in both FCRA and fair value estimates).* Time preference reflects the higher value that people give to money received now than to money received in the future. This factor is fully incorporated in both Treasury rates and comparable market rates.

*Expected Loss from Default (incorporated in both FCRA and fair value estimates).* Comparable market rates reflect the expected loss from default. Although Treasury rates do not reflect the expected loss from default, FCRA budgeting fully accounts for it by deducting expected amounts of default from future cash flows.

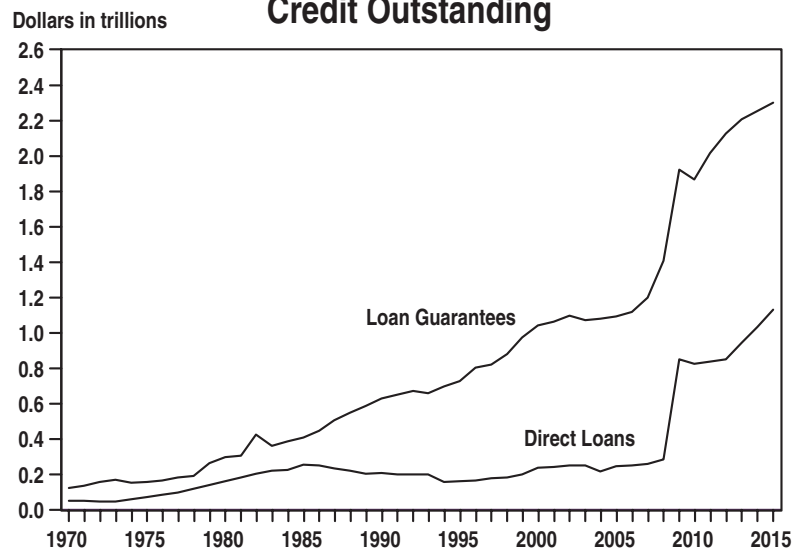
*Uncertainty Premium (raises fair value costs relative to FCRA costs in most cases).* The uncertainty premium, an extra expected return that investors demand as compensation for uncertain returns, is the crux of the debate over fair value estimates. While the expected losses associated with defaults are incorporated into both FCRA and fair value estimates, the additional uncertainty premium associated with variance in the loss rate is reflected in the comparable market rate but not in the Treasury rate because Treasury securities are considered to be free of default risk. Uncertainty about the loss rate may matter to taxpayers. However, uncertainty can be reduced or eliminated through diversification across assets and spreading among a large number of individuals. A possibility of a low return on an asset doesn't really increase risk if it can be offset by a high return on another asset, and uncertainty faced by each individual becomes insignificant when moderate uncertainty is spread among a large number of individuals. While the Federal government cannot completely diversify risk, it generally has greater ability to diversify (across activities, individuals, and generations) than any private actor. For this reason, the uncertainty premium relevant to taxpayers is generally lower than the uncertainty premium relevant to private investors, which is the premium incorporated in fair value estimates. The exact portion of the uncertainty premium relevant to taxpayers is complex to determine and may vary across programs.

*Liquidity Premium (raises fair value costs relative to FCRA costs).* To hold an illiquid asset, investors have to sacrifice the flexibility to sell it quickly or accept a below-market price in doing so. Thus, they demand a higher interest rate, a "liquidity premium," if an asset is less liquid. The difference between comparable market rates and Treasury rates reflects a liquidity premium because most private assets are less liquid than Treasury securities, which trade in the most liquid market. This component is irrelevant to taxpayers. Even though a Federal loan itself may be illiquid, the illiquidity of the loan does not restrict other activities of the Government which can easily borrow in the Treasury securities market at a minimal transaction cost. The Government and hence taxpayers benefit from the high liquidity of the Treasury securities market without incurring an extra cost.

*Tax Differential (raises fair value costs relative to FCRA costs).* Interest income from Treasury securities is exempt from State income tax. This tax advantage results in a higher spread between Treasuries and private interest rates; investors in private loans will demand a higher before-tax return to compensate for the impact that State taxes have on their after-tax return. The Treasuries' tax advantage lowers the cost to the Government of financing direct loans. But that same tax advantage results in lost tax revenue at the State level, which may ultimately have to be made up by taxpayers. Thus, unlike the liquidity premium, this may not be a costless benefit. The extent to which it matters to taxpayers, however, is hard to determine.

*Administrative Costs (included in fair value estimates; treated separately under current budget practices).* Lending involves various administrative costs, related to loan processing, servicing, and debt collection, that are necessary to preserve the value of the loan portfolio. Since the Government cannot avoid these costs, this component is relevant to taxpayers. However, consistent with all other Federal administrative costs, administrative costs of running credit programs are provided on a cash basis, separate from the credit subsidy. Private lenders would build essential costs into their pricing. Administrative expenses would need to be estimated and removed from market rates for fair value estimates, which may be difficult. Data on private lender administrative costs is not readily available. Although administrative costs are relevant to both private investors and taxpayers, the amounts may not be the same for a variety of reasons, including different cost structures, levels of service and technical assistance. On the Federal side, it may also be difficult to tease out what costs are "essential" to the value of the loan, and which costs are discretionary policy choices given program goals.

**Chart 20-1. Face Value of Federal  
Credit Outstanding**



**Table 20-2. ESTIMATED FUTURE COST OF OUTSTANDING DIRECT LOANS AND LOAN GUARANTEES**

(In billions of dollars)

Program	Outstanding 2012	Estimated Future Costs of 2012 Outstanding <sup>1</sup>	Outstanding 2013	Estimated Future Costs of 2013 Outstanding <sup>1</sup>
<b>Direct Loans:<sup>2</sup></b>				
Federal Student Loans .....	510	-17	623	-54
Education Temporary Student Loan Purchase Authority .....	95	-14	90	-13
Farm Service Agency, Rural Development, Rural Housing .....	53	10	53	6
Rural Utilities Service and Rural Telephone Bank .....	52	2	54	2
Troubled Asset Relief Program (TARP) <sup>3</sup> .....	40	24	18	6
State Housing Finance Authority Direct Loans .....	14	1	9	1
Export-Import Bank .....	13	2	18	2
Advance Technology Vehicle Manufacturing, Title 17 Loans .....	12	2	14	2
Housing and Urban Development .....	10	8	11	7
Disaster Assistance .....	8	2	8	2
Transportation Infrastructure Finance and Innovation Act Loans .....	5	*	7	*
Small Business Lending Fund (SBLF) <sup>3</sup> .....	4	-*	4	-*
Public Law 480 .....	4	3	4	2
Agency for International Development .....	4	1	3	1
Other direct loan programs <sup>3</sup> .....	28	8	31	9
Total direct loans .....	852	32	947	-27
<b>Guaranteed Loans:<sup>2</sup></b>				
FHA Mutual Mortgage Insurance Fund .....	1,118	43	1,142	32
Department of Veterans Affairs (VA) Mortgages .....	296	6	349	8
Federal Student Loan Guarantees .....	291	1	264	*
FHA General and Special Risk Insurance Fund .....	143	12	148	9
Farm Service Agency, Rural Development, Rural Housing .....	97	4	112	5
Small Business Administration (SBA) Business Loan Guarantees <sup>4</sup> .....	87	4	93	3
Export-Import Bank .....	57	2	62	2
International Assistance .....	21	2	21	2
Commodity Credit Corporation Export Loan Guarantees .....	5	*	5	*
Title 17 Loan Guarantees .....	3	*	3	*
Government National Mortgage Association (GNMA) <sup>4</sup> .....	.....	*	.....	*
Other guaranteed loan programs <sup>3</sup> .....	10	*	8	1
Total guaranteed loans .....	2,128	74	2,207	62
<b>Total Federal credit .....</b>	<b>2,980</b>	<b>105</b>	<b>3,154</b>	<b>35</b>

\* \$500 million or less.

<sup>1</sup>Future costs represent balance sheet estimates of allowance for subsidy cost, liabilities for loan guarantees, and estimated uncollectible principal and interest.<sup>2</sup>Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as Commodity Credit Corporation price supports. Defaulted guaranteed loans that result in loans receivable are included in direct loan amounts.<sup>3</sup>As authorized by statute, table includes TARP and SBLF equity purchases, and International Monetary Fund (IMF) transactions resulting from the 2009 Supplemental Appropriations Act. Future costs for TARP and IMF transactions are calculated using the discount rate required by the Federal Credit Reform Act adjusted for market risks, as directed in legislation.<sup>4</sup>To avoid double-counting, outstandings for GNMA and SBA secondary market guarantees and TARP FHA Letter of Credit program are excluded from the totals.



**Table 20-3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2013-2015**

(Dollars in millions)

Agency and Program	2013 Actual			2014 Enacted			2015 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
<b>Agriculture:</b>									
Agricultural Credit Insurance Fund Program Account .....	5.18	80	1,542	3.70	70	1,891	1.45	41	2,873
Farm Storage Facility Loans Program Account .....	-2.47	-6	244	-2.54	-9	320	-3.00	-10	320
Rural Electrification and Telecommunications Loans Program Account .....	-6.26	-319	5,106	-3.14	-176	5,590	-5.24	-298	5,690
Distance Learning, Telemedicine, and Broadband Program .....	9.47	8	89	13.07	6	44	18.20	8	46
Rural Water and Waste Disposal Program Account .....	8.07	71	877	-1.13	-14	1,240	-0.61	-7	1,200
Rural Community Facilities Program Account .....	-2.08	-28	1,343	-13.21	-291	2,200	-12.41	-273	2,200
Multifamily Housing Revitalization Program Account .....	57.38	8	14	45.56	9	21	55.93	48	87
Rural Housing Insurance Fund Program Account .....	7.61	67	891	4.35	45	1,029	11.24	54	473
Rural Microenterprise Investment Program Account .....	.....	.....	.....	6.26	3	50	12.81	5	38
Rural Development Loan Fund Program Account .....	32.04	6	17	21.61	4	19	30.80	3	10
Rural Economic Development Loans Program Account .....	12.39	6	49	8.45	4	50	12.77	12	93
<b>Commerce:</b>									
Fisheries Finance Program Account .....	-4.72	-2	39	-7.50	-9	124	-4.39	-6	124
<b>Defense—Military Programs:</b>									
Defense Family Housing Improvement Fund .....	17.55	58	330	.....	.....	.....	.....	.....	.....
<b>Education:</b>									
College Housing and Academic Facilities Loans Program Account .....	6.29	13	215	3.09	19	303	5.94	20	340
TEACH Grant Program Account .....	11.01	13	119	13.75	15	106	16.53	18	108
Federal Perkins Loan Program Account .....	.....	.....	.....	.....	.....	.....	-17.67	-828	4,684
Federal Direct Student Loan Program Account .....	-19.75	-29,952	151,641	-15.71	-21,585	137,358	-10.22	-14,399	140,895
<b>Energy:</b>									
Title 17 Innovative Technology Loan Guarantee Program ...	.....	.....	.....	<sup>2</sup> 0.47	34	7,226	<sup>2</sup> 2.17	123	5,666
Advanced Technology Vehicles Manufacturing Loan Program Account .....	.....	.....	.....	<sup>2</sup> 25.42	4,220	16,602	.....	.....	.....
<b>Health and Human Services:</b>									
Consumer Operated and Oriented Plan Program Account ...	41.37	122	294	.....	.....	.....	.....	.....	.....
Consumer Operated and Oriented Plan Program Contingency Fund .....	37.66	2	7	40.64	210	518	.....	.....	.....
<b>Homeland Security:</b>									
Disaster Assistance Direct Loan Program Account .....	91.63	160	175	95.25	28	30	96.35	29	30
<b>Housing and Urban Development:</b>									
FHA-Mutual Mortgage Insurance Program Account .....	.....	.....	.....	.....	.....	20	.....	.....	20
FHA-General and Special Risk Program Account .....	.....	.....	.....	.....	.....	1	.....	.....	1
Emergency Homeowners' Relief Fund .....	97.71	4	4	.....	.....	.....	.....	.....	.....
<b>State:</b>									
Repatriation Loans Program Account .....	57.67	1	2	63.06	2	2	52.65	1	2
<b>Transportation:</b>									
TIFIA General Fund Program Account, Federal Highway Administration, Transportation .....	7.41	37	499	.....	.....	.....	.....	.....	.....
Federal-aid Highways .....	8.87	145	1,639	7.07	925	13,083	9.53	925	9,706
Railroad Rehabilitation and Improvement Program .....	.....	.....	.....	.....	.....	600	.....	.....	600
<b>Treasury:</b>									
Community Development Financial Institutions Fund Program Account .....	-1.02	-4	338	<sup>2</sup> 0.29	3	775	<sup>2</sup> 0.30	3	1,025
<b>Veterans Affairs:</b>									
Veterans Housing Benefit Program Fund .....	-2.29	*	2	-23.26	-51	220	-20.27	-68	331
Native American Veteran Housing Loan Program Account ...	-12.55	-1	7	-13.12	-2	14	-13.31	-2	14
<b>International Assistance Programs:</b>									
Overseas Private Investment Corporation Program Account ...	-8.45	-62	729	-4.28	-17	400	-3.74	-26	700

**Table 20–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2013–<sup>2015</sup>—Continued**  
(Dollars in millions)

Agency and Program	2013 Actual			2014 Enacted			2015 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
Small Business Administration:									
Disaster Loans Program Account .....	11.11	146	1,317	8.48	93	1,100	12.37	136	1,100
Business Loans Program Account .....	15.71	7	43	18.64	5	25	10.12	3	25
Export-Import Bank of the United States:									
Export-Import Bank Loans Program Account .....	–8.68	–597	6,874	–0.05	–2	5,020	–9.26	–278	3,000
National Infrastructure Bank:									
National Infrastructure Bank Program Account .....	.....	.....	.....	.....	.....	.....	<sup>2</sup> 11.57	116	1,000
<b>Total .....</b>	<b>N/A</b>	<b>–30,017</b>	<b>174,446</b>	<b>N/A</b>	<b>–16,461</b>	<b>195,981</b>	<b>N/A</b>	<b>–14,650</b>	<b>182,401</b>

N/A = Not applicable

\* Less than \$500,000.

<sup>1</sup>Additional information on credit subsidy rates is available in the Federal Credit Supplement.

<sup>2</sup>Rate reflects notional estimate. Estimates will be determined at the time of execution, and will reflect the terms of the contracts and other characteristics.

**Table 20–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2013-2015**

(Dollars in millions)

Agency and Program	2013 Actual			2014 Enacted			2015 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
<b>Agriculture:</b>									
Agricultural Credit Insurance Fund Program Account .....	0.40	10	2,398	0.40	14	3,650	0.34	12	3,543
Commodity Credit Corporation Export Loans Program Account .....	–1.10	–39	3,545	–1.17	–64	5,500	–1.11	–61	5,500
Rural Water and Waste Disposal Program Account .....	1.06	*	18	0.71	*	42	0.59	1	172
Rural Community Facilities Program Account .....	6.75	7	101	4.97	9	189	4.78	1	13
Rural Housing Insurance Fund Program Account .....	–0.25	–56	22,403	–0.14	–34	24,150	–0.58	–141	24,150
Rural Business Program Account .....	5.72	54	939	6.98	79	1,126	5.11	41	806
Rural Business Investment Program Account .....							10.19	4	39
Rural Energy for America Program .....	24.01	8	33	27.43	43	155	10.58	36	342
Biorefinery Assistance Program Account .....				41.43	131	315	40.32	50	124
<b>Commerce:</b>									
Economic Development Assistance Programs .....							15.60	5	32
<b>Defense—Military Programs:</b>									
Defense Family Housing Improvement Fund .....	14.71	69	471						
<b>Health and Human Services:</b>									
Health Resources and Services .....				4.18	*	12	4.37	*	6
<b>Housing and Urban Development:</b>									
Indian Housing Loan Guarantee Fund Program Account .....	1.35	9	642	0.47	4	900	0.84	10	1,200
Native Hawaiian Housing Loan Guarantee Fund Program Account .....	0.50	*	25	0.53	*	25	0.62	*	25
Native American Housing Block Grant .....	10.91	2	16	12.10	3	25	11.21	3	27
Community Development Loan Guarantees Program Account .....	2.46	6	231	2.56	8	313	0.00	*	500
FHA-Mutual Mortgage Insurance Program Account .....	–6.83	–17,444	255,164	–6.63	–10,186	153,530	–8.10	–12,190	150,642
FHA-General and Special Risk Program Account .....	–4.29	–1,045	24,356	–3.86	–888	23,039	–4.22	–886	20,945
<b>Interior:</b>									
Indian Guaranteed Loan Program Account .....	5.53	4	73	5.75	4	70	6.64	4	70
<b>Transportation:</b>									
Minority Business Resource Center Program .....	1.73	*	3	1.76	*	18	2.27	*	18
Maritime Guaranteed Loan (Title XI) Program Account .....				10.35	64	626	9.25	8	85
<b>Veterans Affairs:</b>									
Veterans Housing Benefit Program Fund .....	–0.10	–135	134,859	–0.02	–22	112,026	0.27	249	92,070
<b>International Assistance Programs:</b>									
Loan Guarantees to Israel Program Account .....						1,909			1,905
MENA Loan Guarantee Program Account .....				9.75	122	1,250			
Development Credit Authority Program Account .....	2.02	10	496	4.07	25	618	6.30	37	581
Overseas Private Investment Corporation Program Account .....	–12.51	–411	3,289	–5.85	–148	2,530	–5.60	–181	3,230
<b>Small Business Administration:</b>									
Disaster Loans Program Account .....							1.93	*	18
Business Loans Program Account .....	0.65	377	58,063	0.19	130	67,599	0.06	45	75,010
<b>Export-Import Bank of the United States:</b>									
Export-Import Bank Loans Program Account .....	–1.80	–368	20,466	–2.19	–568	25,915	–3.37	–1,163	34,557
<b>National Infrastructure Bank:</b>									
National Infrastructure Bank Program Account .....							<sup>2</sup> 8.85	18	200
<b>Total .....</b>	<b>N/A</b>	<b>–18,942</b>	<b>527,591</b>	<b>N/A</b>	<b>–11,274</b>	<b>425,532</b>	<b>N/A</b>	<b>–14,098</b>	<b>415,810</b>



**Table 20–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2013–2015—Continued**

(Dollars in millions)

Agency and Program	2013 Actual			2014 Enacted			2015 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
<b>ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS</b>									
Government National Mortgage Association:									
Guarantees of Mortgage-backed Securities Loan Guarantee Program Account .....	–0.23	–1,068	460,373	–0.22	–542	246,500	–0.28	–832	297,000
Treasury:									
Troubled Asset Relief Program, Housing Programs <sup>3</sup> .....	2.48	5	183	.....	.....	.....	.....	.....	.....
Small Business Administration:									
Secondary Market Guarantee Program .....	.....	.....	4,490	.....	.....	12,000	.....	.....	12,000
<b>Total, secondary guaranteed loan commitments .....</b>	<b>N/A</b>	<b>–1,063</b>	<b>465,046</b>	<b>N/A</b>	<b>–542</b>	<b>258,500</b>	<b>N/A</b>	<b>–832</b>	<b>309,000</b>

N/A = Not applicable.

<sup>\*</sup>Less than \$500,000.<sup>1</sup>Additional information on credit subsidy rates is available in the Federal Credit Supplement.<sup>2</sup>Rate reflects notional estimate. Estimates will be determined at the time of execution, and will reflect the terms of the contracts and other characteristics.<sup>3</sup>Amounts reflect the TARP FHA Refinance Letter of Credit Program. Subsidy costs for this program are calculated using the discount rate required by the Federal Credit Reform Act, adjusted for market risks, as directed in legislation.**Table 20–5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES<sup>1</sup>**

(In billions of dollars)

	Actual								Estimate	
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Direct loans:</b>										
Obligations .....	57.8	42.5	75.6	812.9	246.0	296.3	191.1	174.4	196.0	182.4
Disbursements .....	46.6	41.7	41.1	669.4	218.9	186.7	170.0	157.5	156.8	165.7
New subsidy budget authority <sup>2</sup> .....	4.7	1.4	3.7	140.1	–9.2	–15.7	–27.2	–29.8	–16.5	–14.8
Reestimated subsidy budget authority <sup>2,3</sup> .....	3.1	3.4	–0.8	–0.1	–125.1	–66.8	16.8	–19.7	–0.8	.....
<b>Total subsidy budget authority .....</b>	<b>7.8</b>	<b>4.8</b>	<b>–1.3</b>	<b>140.0</b>	<b>–134.3</b>	<b>–82.5</b>	<b>–10.4</b>	<b>–49.4</b>	<b>–17.2</b>	<b>–14.8</b>
<b>Loan guarantees:</b>										
Commitments <sup>4</sup> .....	280.7	270.2	367.7	879.2	507.3	446.7	479.7	527.6	425.5	415.8
Lender disbursements <sup>4</sup> .....	256.0	251.2	354.6	841.5	494.8	384.1	444.3	491.5	373.0	352.9
New subsidy budget authority <sup>2</sup> .....	17.2	5.7	–1.4	–7.8	–4.9	–7.4	–6.9	–17.9	–10.7	–13.3
Reestimated subsidy budget authority <sup>2,3</sup> .....	7.0	–6.8	3.6	0.5	7.6	–4.0	–4.9	20.8	1.2	.....
<b>Total subsidy budget authority .....</b>	<b>24.2</b>	<b>–1.1</b>	<b>2.2</b>	<b>–7.2</b>	<b>2.8</b>	<b>–11.4</b>	<b>–11.8</b>	<b>2.8</b>	<b>–9.6</b>	<b>–13.3</b>

<sup>1</sup> As authorized by statute, table includes TARP and SBLF equity purchases and International Monetary Fund (IMF) transactions resulting from the 2009 Supplemental Appropriations Act.<sup>2</sup> Credit subsidy costs for TARP and IMF transactions are calculated using the discount rate required by the Federal Credit Reform Act adjusted for market risks, as directed in legislation.<sup>3</sup> Includes interest on reestimate.<sup>4</sup> To avoid double-counting, the face value of GNMA and SBA secondary market guarantees and the TARP FHA Letter of Credit program are excluded from the totals.