



**Rethinking Federal Credit:
Managing Loan and Loan Guarantee
Programs in a Changing Environment**

Changing Economic and Policy Environments for the World's Largest Financial Institution

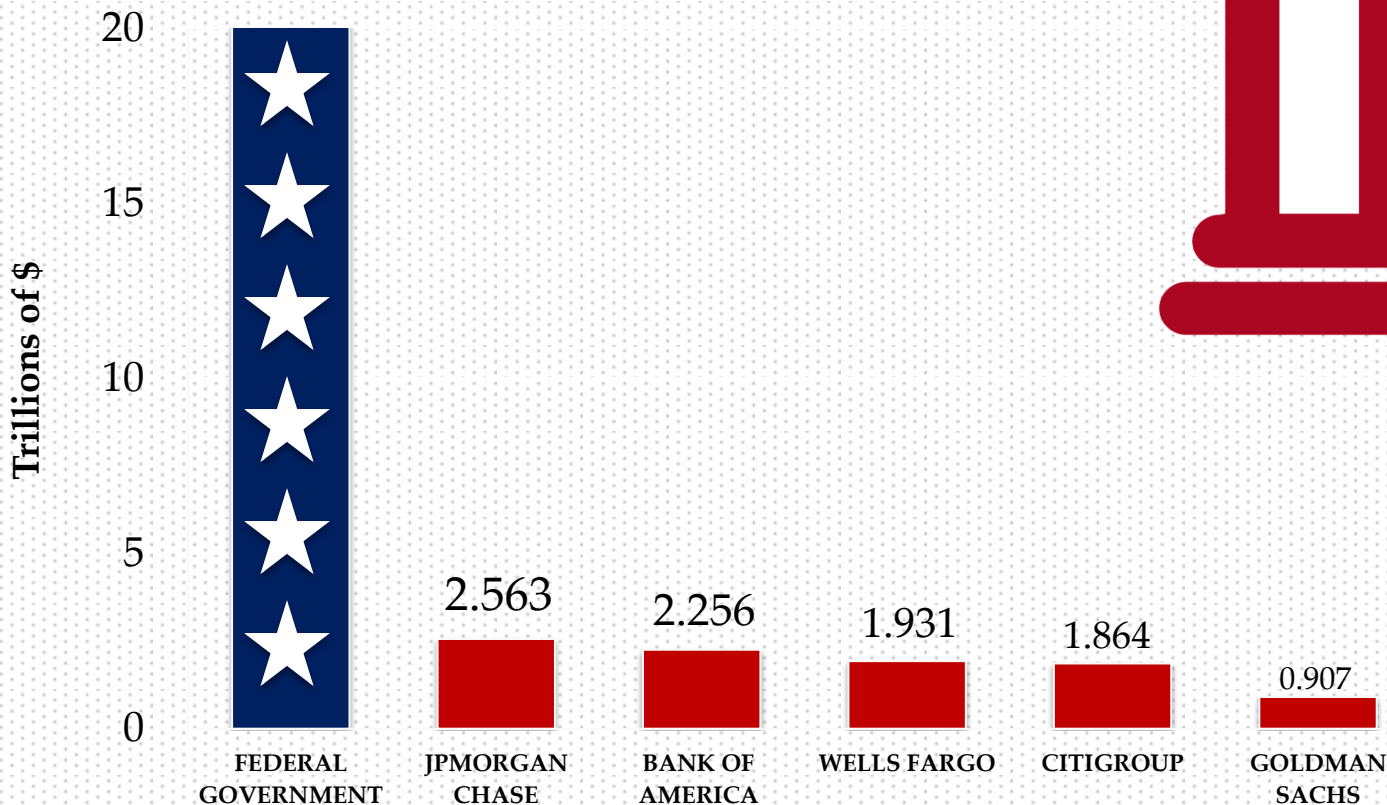
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By **EXTENDING CREDIT & PROVIDING INSURANCE**, THE U.S. GOVERNMENT
FUNCTIONS AS THE WORLD'S

LARGEST FINANCIAL INSTITUTION

ASSETS OR INSURED OBLIGATIONS



DIRECT LOANS & LOAN GUARANTIES



INSURANCE & OTHER SUPPORT



REGULATION & OVERSIGHT



World's Largest Financial Institution

- *Direct Loans & Loan Guaranties*

Chart 19-1. Face Value of Federal Credit Outstanding

Dollars in trillions

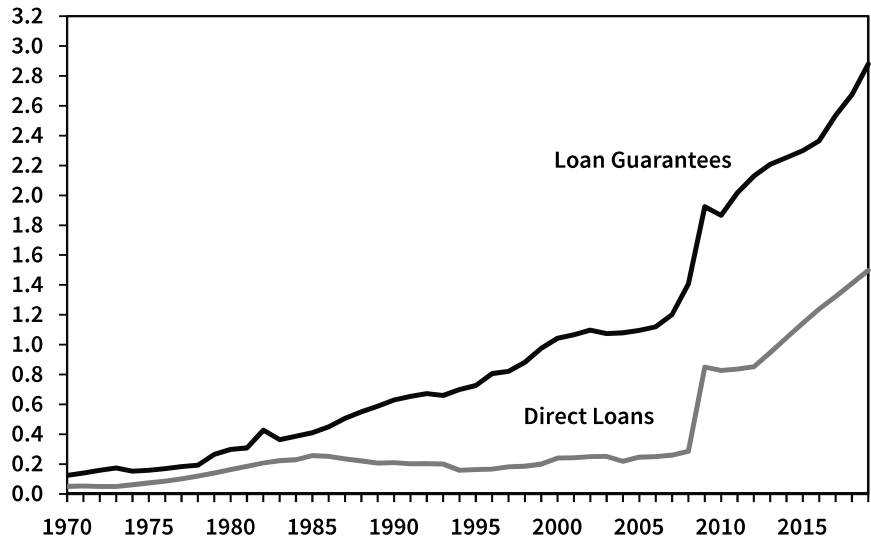
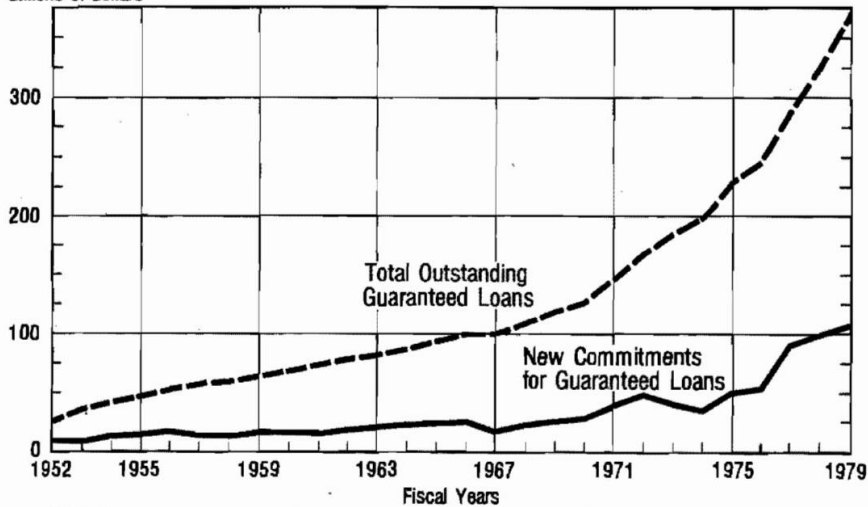


Figure 1.
Growth of New Commitments and Total Outstanding Guaranteed Loans^a
for Fiscal Years 1952-1979^b

Billions of Dollars



SOURCE: *Budget of the United States Government, Special Analysis on Credit, Fiscal Years 1952-1979.*

^a Unadjusted figures

^b Fiscal year 1978 and 1979 figures are estimates.

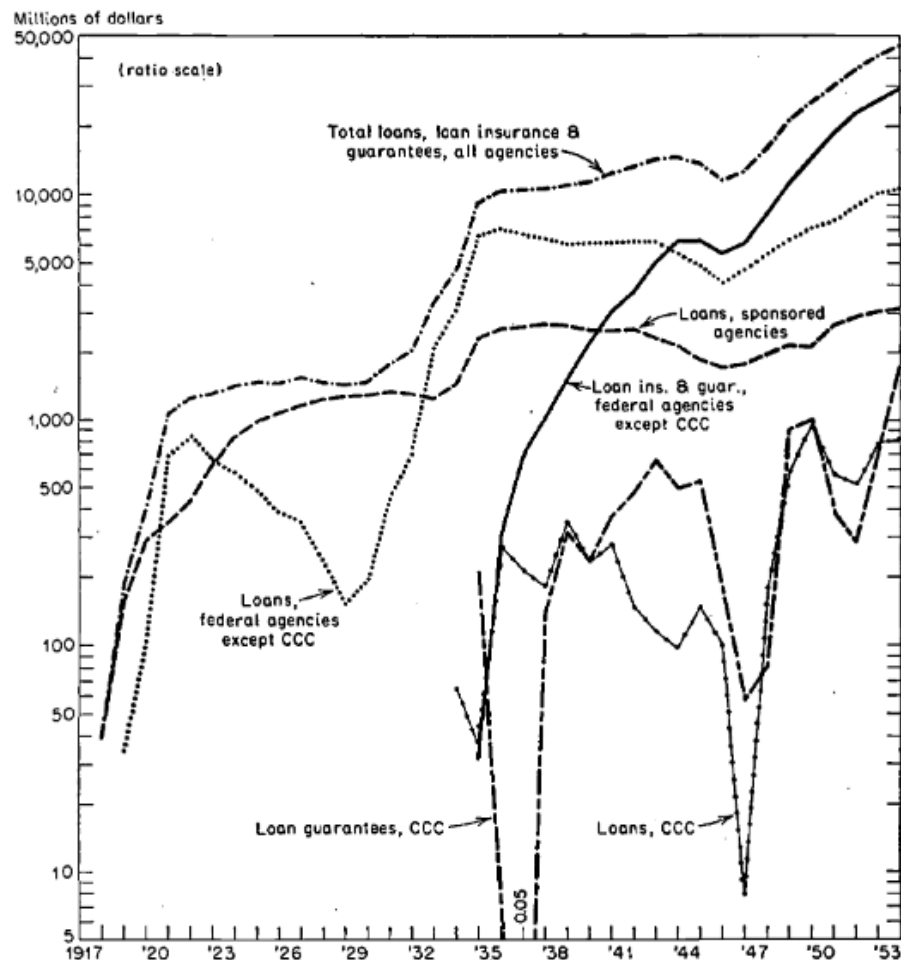
Historical perspective (thru 1950s)

- Federal credit origins: post-World War I
 - Farm loans refinanced
 - Loans to railroads returned to private control after wartime nationalization
- Expansion during '30s to counter depression & moderate impact
 - Loans to farmers, businesses & homeowners
- NBER (Saulnier, 1958), Federal Lending & Loan Insurance
 - Comprehensive look at fed credit during 1950s
 - Purpose: counteract depression, fill gaps, respond to emergencies, give preferential treatment
 - Key Qs:
 - Do credit programs reallocate resources to promote the general welfare & achieve beneficial outcomes?
 - What are the economic impacts?
 - How best to organize agencies to deliver programs?

Historical perspective (thru 1950s)

CHART 1

Federal Lending and Loan Insurance or Guarantees:
Outstandings at Year Ends, 1917-1953



Stock purchases primarily for credit aid are included with loans; for further details, see Chapter 2, footnote 1. Data except for CCC are from Tables A-1 and A-2. Series for the Commodity Credit Corporation refer to its direct loans on commodities for price support purposes and (since 1949) for construction of storage facilities, or to its guarantees of similar loans made by other lenders, and are as given by the Department of Agriculture in "Agricultural Finance Review," Vol. 17, November 1954, pp. 92ff., with the 1933 direct loan figure from "Agricultural Statistics, 1952," p. 726.

Historical perspective (1960s)

- New programs created & others expanded
- JFK Presidential Committee on Federal Credit Programs (1962-63)
 - Reduce/remove credit gaps – gov't support disappears over time
 - Subsidize credit – if valid need remains, no reasonable expectation of gov't withdrawing
- President's Commission on Budgeting Concepts (1967)
 - Basis for Congressional Budget Act (1974)
 - Created CBO
 - Later amended to include FCRA (1990)

REPORT OF THE COMMITTEE

ON

FEDERAL CREDIT PROGRAMS

to the

President of the United States



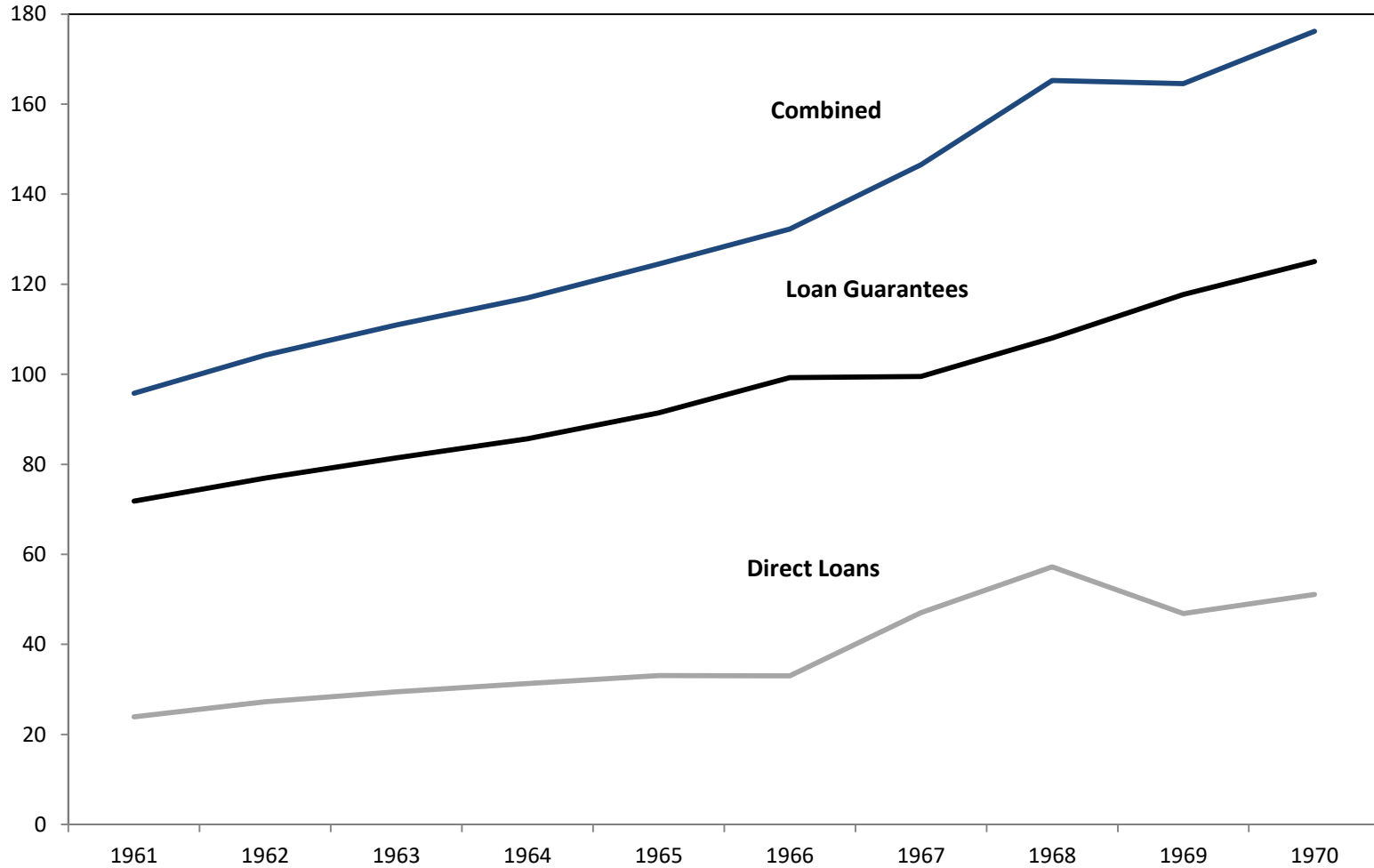
**Transmitted by the President to Agencies with Responsibilities for
Federal Credit Programs**

February 11, 1963

Historical perspective (1960s)

Face Value of Federal Credit Outstanding

Dollars in billions

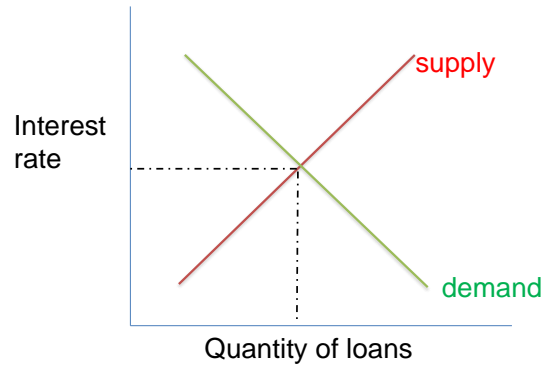


Historical perspective (1970s-1980s)

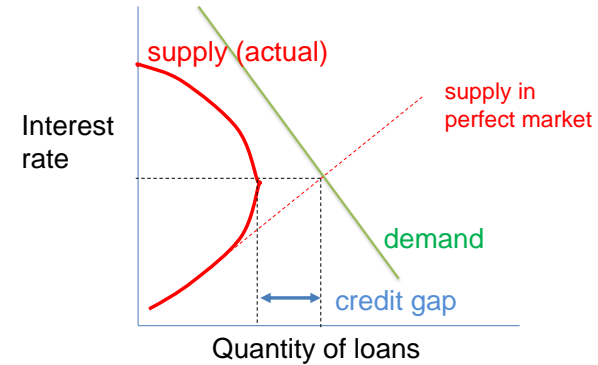
- OMB
 - Reagan-era OMB questioned need for some credit programs
 - Options for credit budgeting & reform
- CBO focus
 - Some of its earliest work focused on size & growth of credit programs across government
 - Attempts to quantify performance of guaranteed loans
 - Concerns about poor data & definitional differences regarding delinquency/default
 - Testimony
 - Rivlin (1981): Guarantee programs shifting from actuarially sound insurance programs to programs providing subsidy; need to assess costs
 - Penner (1986): Budgetary treatment of federal credit assistance fails to depict costs accurately
 - Reischauer (1990): Need to reform credit budgeting
- “Rationing in Markets with Imperfect Information,” (Stiglitz, Weiss 1981)
 - No special role for gov’t credit in perfect market
 - But credit markets are not perfect – asymmetric info between borrowers & lenders:
 - Beneficial for gov’t to fill credit gap when it leads to socially desirable outcomes where value exceeds taxpayer costs

Economic rationale for government credit support

Perfect market for loans

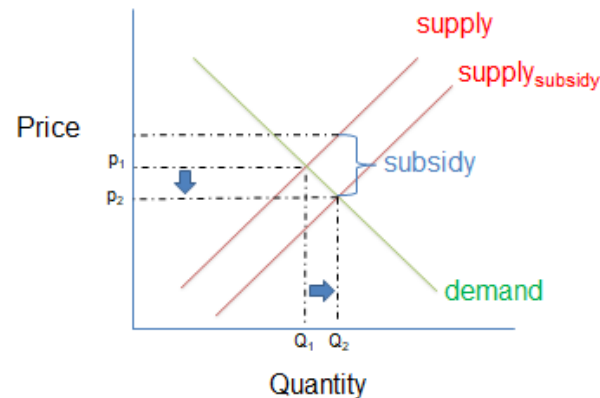


Credit gap: no market-clearing interest rate



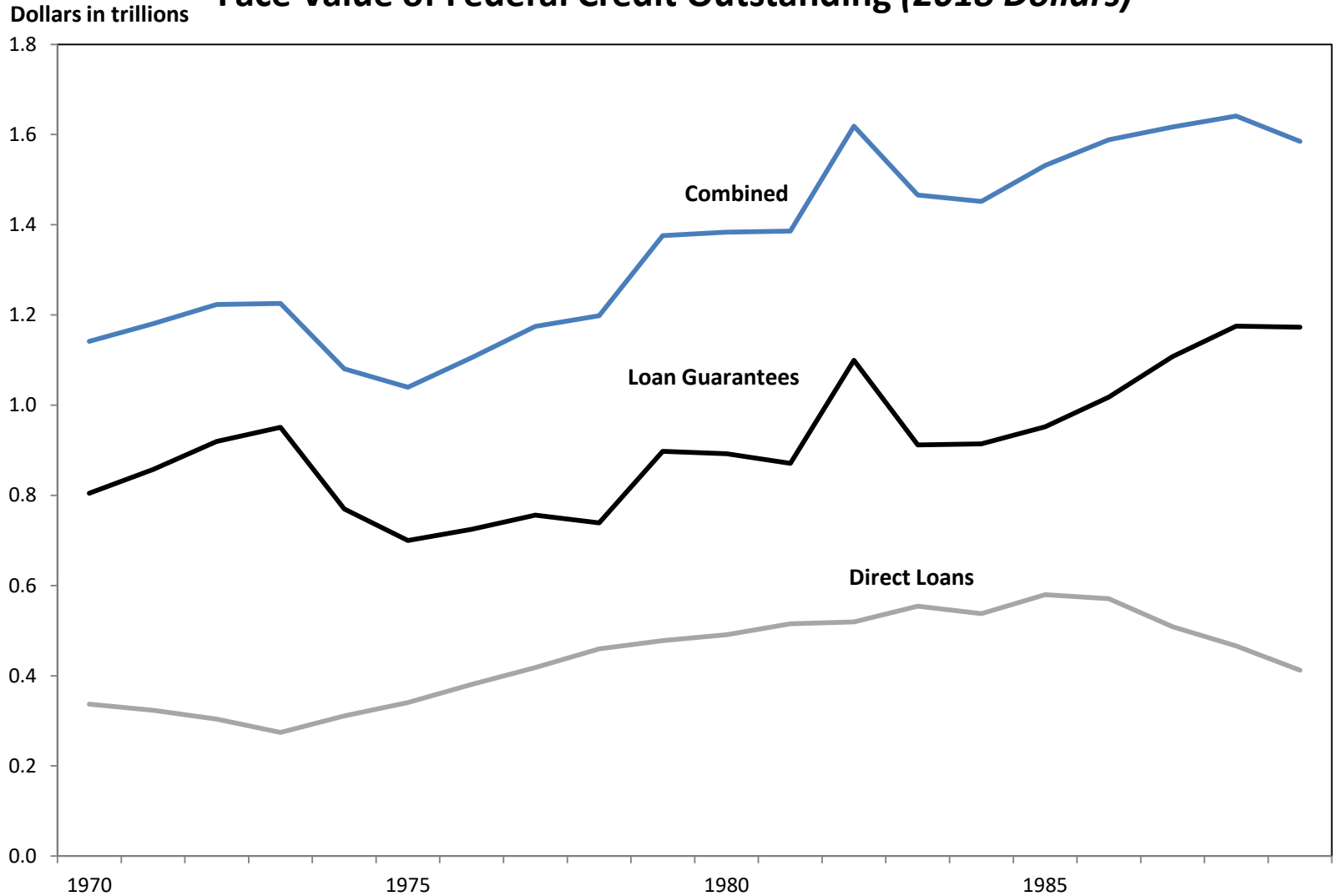
- Higher rates => lower borrower quality

Introducing a subsidy



Historical perspective (1970s-1980s)

Face Value of Federal Credit Outstanding (2018 Dollars)

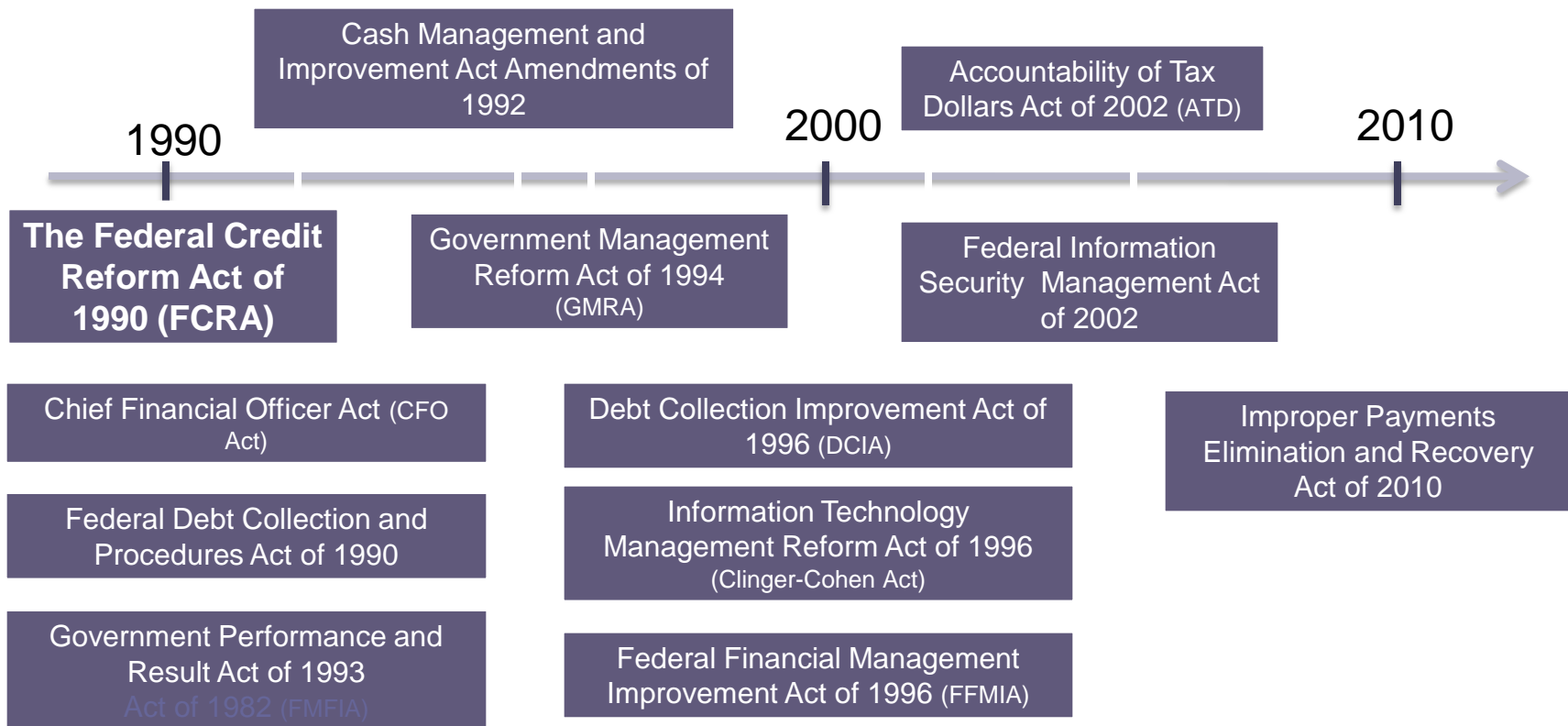


Historical perspective (1990s-2000s)

Improvements in gov't financial management focused on or applied to credit programs

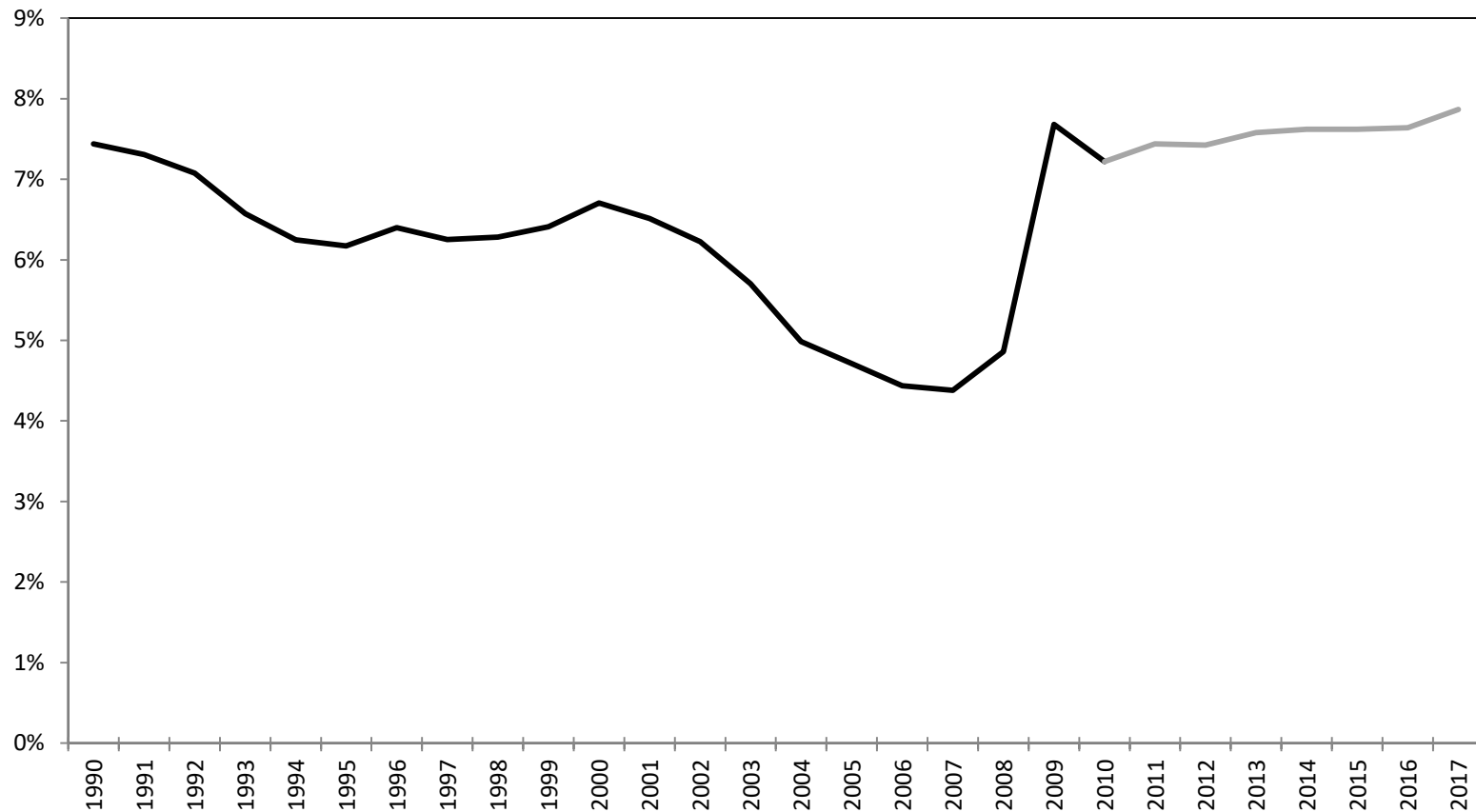
FCRA enacted & effective for FY92

- Implementation focus during 1990s & into early 2000s



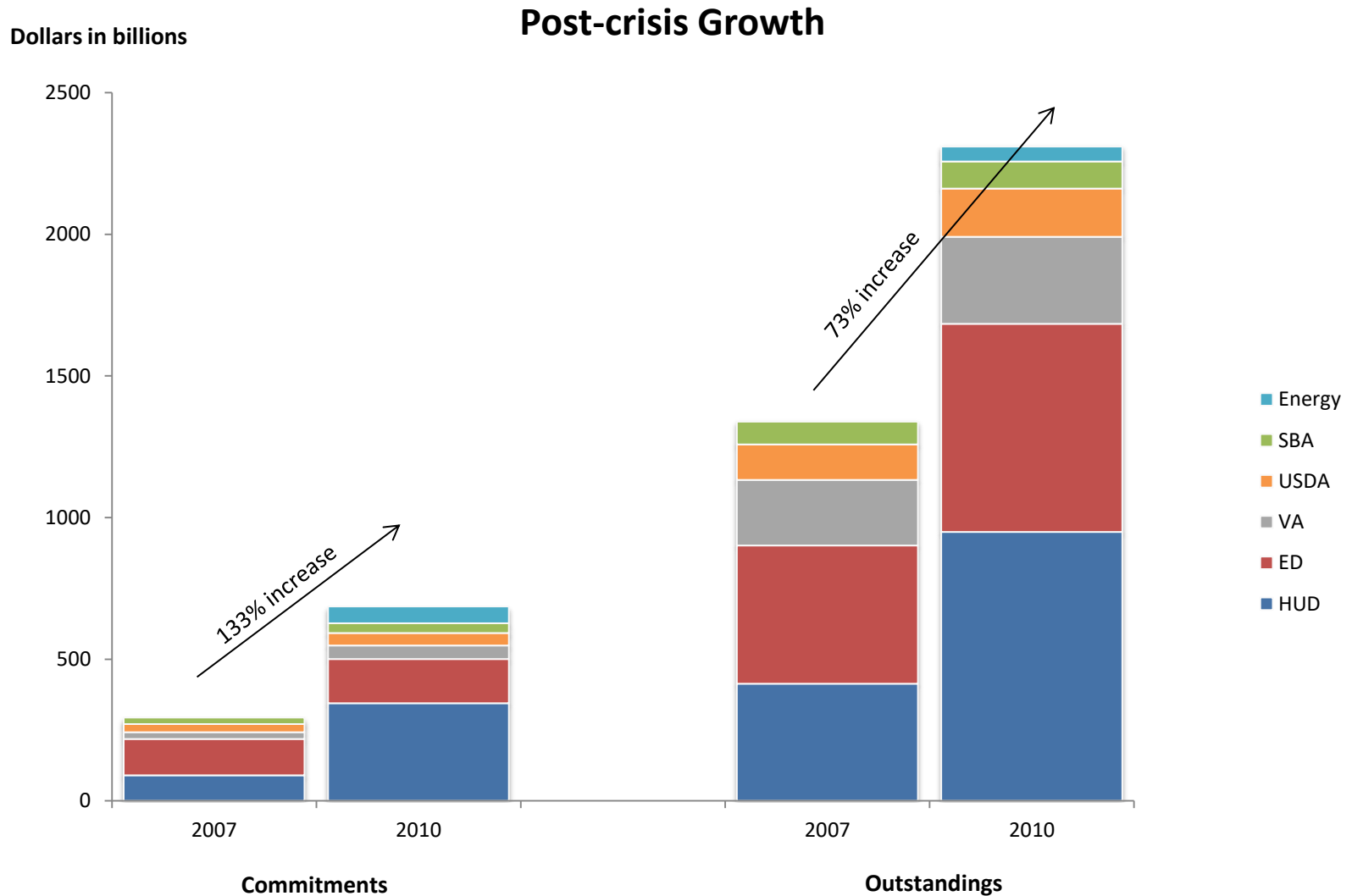
Historical perspective (1990s-2000s)

Federal Participation Rate in Credit Market



*Outstanding federal direct loans & guarantees divided by total liabilities of domestic nonfinancial sector

Historical perspective (2007-2010)

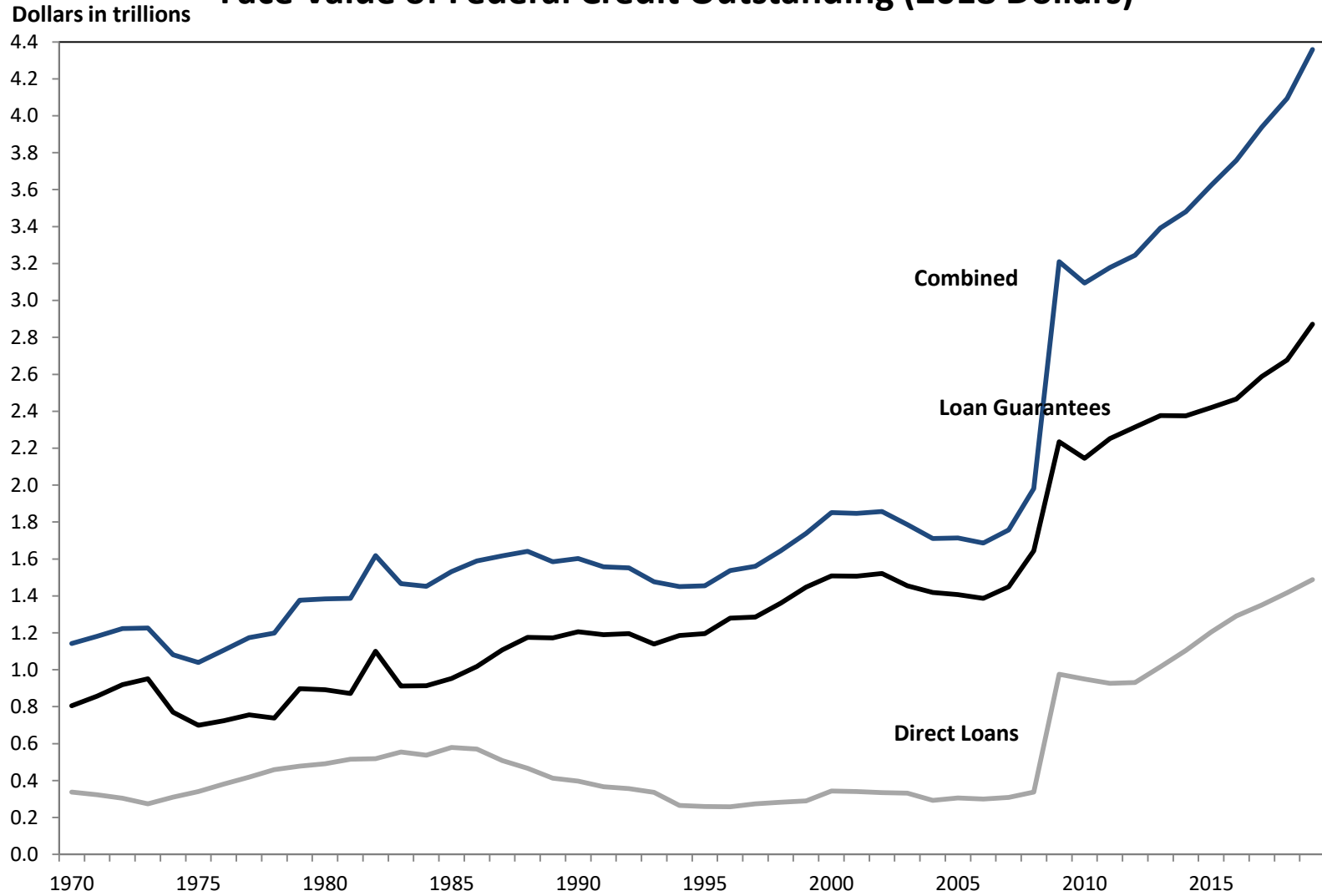


Historical perspective (2010-present)

- Today, it is clear that government loan programs to finance the acquisition of homes, businesses, farms, and college educations have become a well established part of U.S. credit marketplace
 - Two departments with portfolios exceeding \$1 trillion
 - Others managing significantly larger portfolios than in past
- Questions
 - Have we receded from concerns about role of government in credit marketplace?
 - Has the government's role post-financial crisis, combined with FCRA budgetary treatment, created complacency in addressing appropriate role of government in credit markets?
 - How will advances in data & technology be used to assess & revise programs?

Bringing it all together

Face Value of Federal Credit Outstanding (2018 Dollars)



Bringing it all together

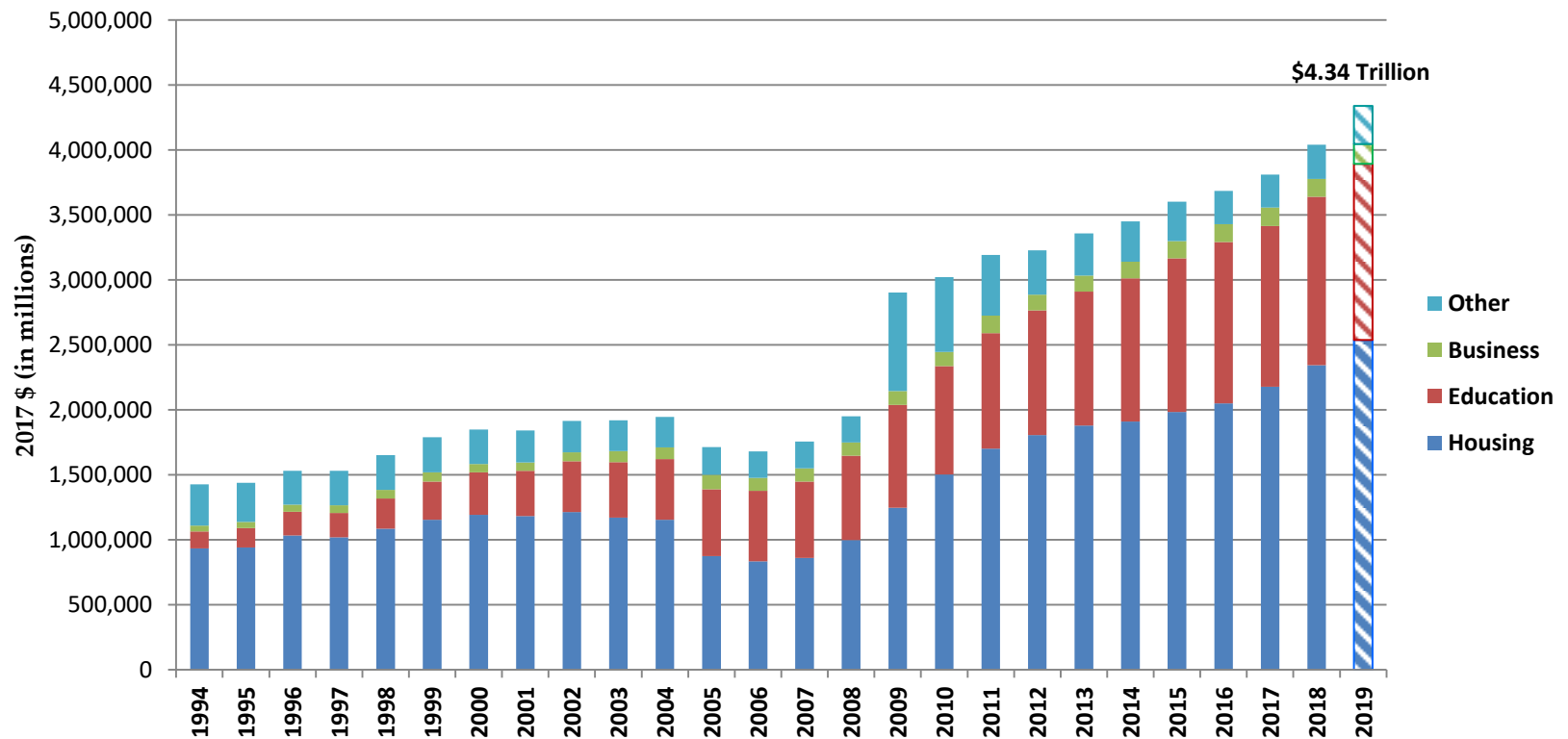
Federal Credit Obligations/Commitments (2018 Dollars)



Looking forward: President's FY19 Budget

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Federal Loans Outstanding (Direct & Guaranteed)



President's FY19 Budget: Credit Programs

PRESIDENT'S 2019 BUDGET: STUDENT LOANS



Direct lending of **\$163 billion** in '19 drives direct loan portfolio above **\$1 trillion** for first time

BIG CHANGES PROPOSED FOR NEW LOAN REPAYMENT OPTIONS


- New, single Income Driven Repayment (IDR) plan
 - Maximum payment of 12.5% of monthly income
 - 15 years for undergrad & 30 years for grad borrowers (forgiveness follows)
 - Severely delinquent borrowers auto-enrolled in IDR
 - Income verification with IRS
- Eliminated subsidized loan program & public service loan forgiveness
- Risk share: raises notion of postsecondary institutions sharing portion of financial risk associated with student loans

BUDGET DATA POINTS

- Budget assumes student loans will generate budgetary savings in '19, but estimates have traditionally been overly optimistic
 - Existing direct loans expected to cost **\$48B** more than initial estimates
- Undergrad default rates forecast to drop from about 25% to 16%
- Loan servicing costs expected to exceed \$1 billion in '19



PRESIDENT'S 2019 BUDGET: HOME MORTGAGES

HUD/FHA forecasts **\$242 billion** in single-family mortgage guarantees, with portfolio **>\$1.3 trillion** by close of '19 

- Up to additional **\$158 billion** available if demand exceeds forecasts
- Ginnie Mae provided authority to guarantee **\$550 billion** in new mortgage-backed securities

PROGRAM REFORMS

- For HECM reverse mortgages, HUD has already raised premiums & lowered share of equity homeowners can borrow against
 - HUD plans to implement additional program changes for 2019 to keep expected budgetary costs below zero

BUDGET DATA POINTS

- Budget assumes single family guarantees generate budgetary savings in '19, but estimates have consistently been too optimistic
 - Single-family loans originated over past 25 years now expected to cost **\$97 billion** more than initially estimated



PRESIDENT'S 2019 BUDGET: MORTGAGES (cont.)



VA to guarantee **\$43B** in mortgages, with portfolio approaching **\$200B** by close of '19

Federally backed mortgage lending to veterans expected to remain near record levels

- Key program features proposed to be extended in Budget
- VA typically provides full guarantee on first 25% of default losses

BUDGET DATA POINTS

- Cost of loan guarantees forecast to drop significantly: from \$891 million in '17 to \$110 million in '19
- Over time & on average, VA estimates of loan costs have been accurate



PRESIDENT'S 2019 BUDGET: BUSINESS LOANS

Supports **\$43 billion** in SBA business lending as portfolio approaches **\$150 billion**

- Proposed counter-cyclical policies aimed at maintaining SBA operations while ensuring private lending not displaced
 - Fee adjustments across business loan guarantee programs to cover anticipated lending & offset administrative costs
 - Admin flexibility allows SBA to increase loan levels by 15%
 - SBA Express loan limits increased from \$350k to \$1 million
 - Annual fee assessed on secondary market guarantees to ensure viability
- Business & industry (B&I) loan guaranties at USDA eliminated
- ExIm Bank to focus efforts on market segments where U.S. support is critical to compete (e.g., areas of national security importance, small & medium-sized exporters)

BUDGET DATA POINTS

- SBA fees would be set to cover expected program & admin costs
- Lending has cost **\$6 billion** more than initially estimated over past 25 years



PRESIDENT'S 2019 BUDGET: DEVELOPMENT FINANCE

Merger of USAID's Development Credit Authority & Overseas Private Investment Corporation (OPIC) to support **\$4.1 billion** in lending & other support



NEW DEVELOPMENT FINANCE INSTITUTION (DFI)

- Aimed at encouraging participation of US private sector capital & skills in economic & social development of emerging markets
- Annual limit of **\$8B** on total commitments, including insurance activities
 - OPIC traditionally provides political risk insurance against losses due to expropriation, invertibility & damage from political violence
- \$94 million** in admin funding to cover DFI operations & continued administration of USAID and OPIC legacy credit portfolios



PRESIDENT'S 2019 BUDGET: INFRASTRUCTURE PLAN



Aims to spend **\$200B** across a range of activities to stimulate

Administration-projected **\$1.5T** in investment through leveraging State, local & private funds & shorten approval process to 2 years or less, while empowering state & local authorities, rural infrastructure & workforce development

Credit assistance: Infrastructure Financing Programs—\$20B to increase capacity of existing Federal credit programs and use of private activity bonds

- \$14B** in 10-yr budget authority to expand & broaden TIFIA,¹ RRIF² & WIFIA³ eligibility & expand Rural Utilities Service lending programs (\$28B in '19 lending)
- \$6B** to create flexibility and broaden eligibility for PABs to provide tools and mechanisms for market participants to invest in infrastructure

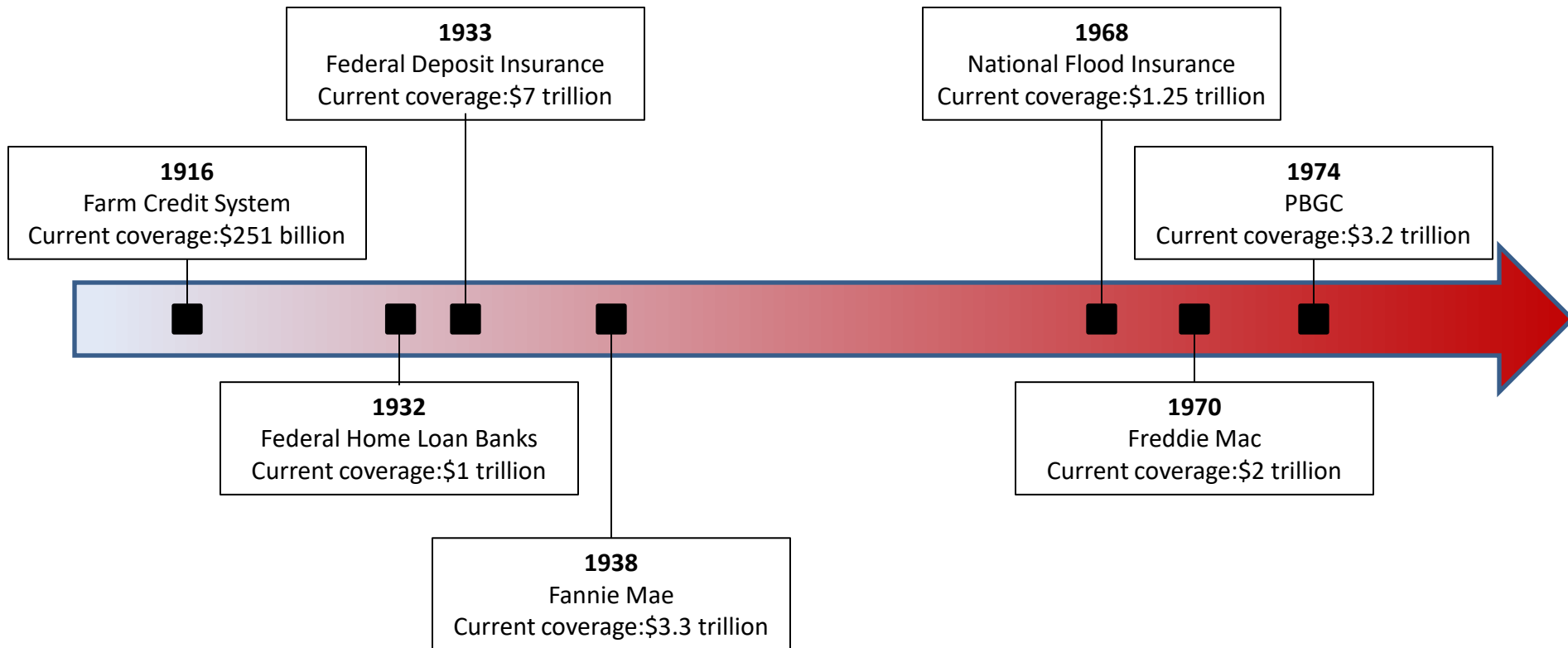
¹ Transportation Infrastructure Finance and Innovation Act
² Railroad Rehabilitation & Improvement Financing
³ Water Infrastructure Finance and Innovation Act



World's Largest Financial Institution

- *Insurance & Other Support*

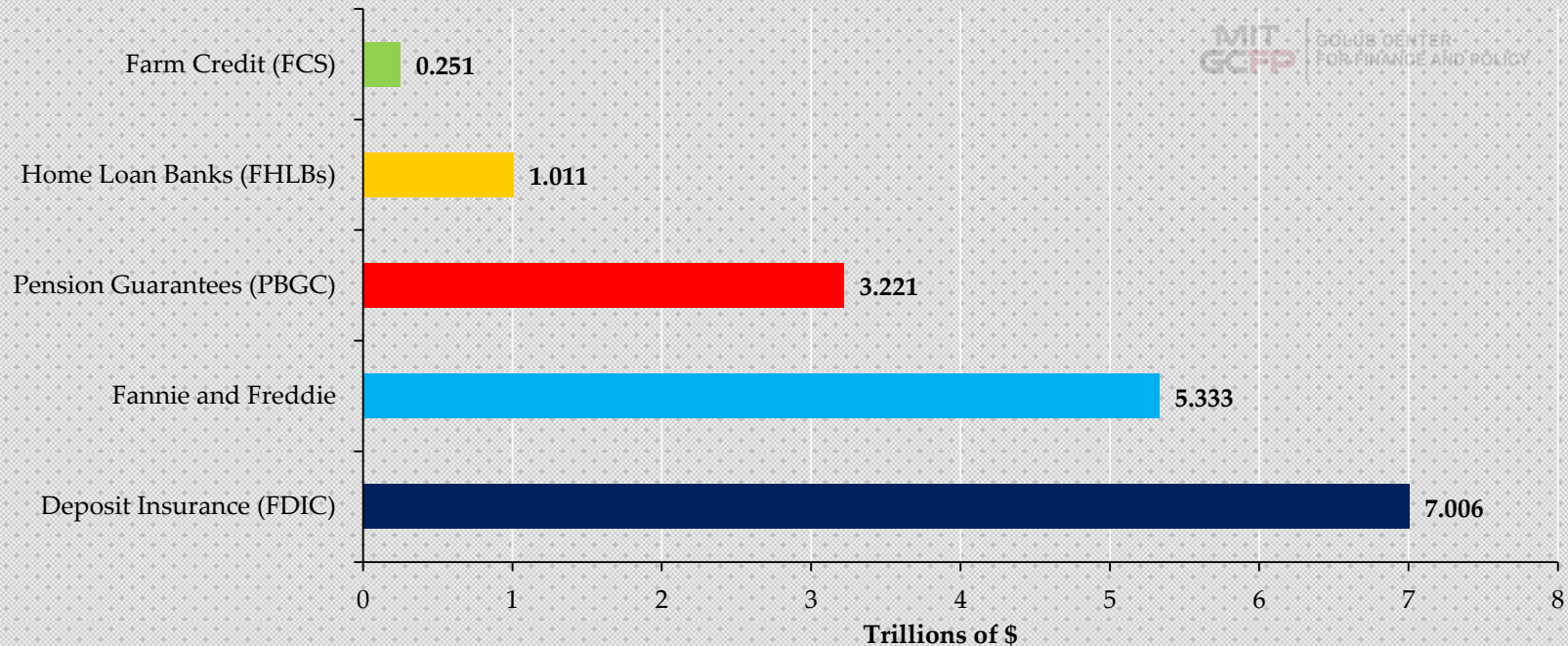
Federal Insurance Programs



INSURANCE & OTHER ACTIVITIES*

Federally Backed Credit & Insurance Outstanding, June 2017

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*Excludes the Federal Reserves emergency lending facilities

*Excludes federal health/life/P&C/disaster insurance

*No explicit guaranty for FHLBs

President's FY19 Budget: Insurance & Other

PRESIDENT'S 2019 BUDGET: *FANNIE MAE & FREDDIE MAC*

Higher guaranty fees; Administration reports intent to work with Congress to facilitate sustainable housing finance system

- No formal reform proposal or budgetary estimates included
- Guaranty fees Fannie & Freddie charge to back MBS payments would increase by 0.1 percentage points
- Increases of \$4.7 billion (Fannie) & \$0.4 billion (Freddie) in senior preferred stock purchase agreement draws expected in 2018 due to accounting-related write downs of deferred tax assets

BUDGET DATA POINTS

- As conservator, government responsible for credit risk for more than \$5 trillion in outstanding mortgages guaranteed by Fannie and Freddie
- GSEs continue to be reflected as non-budgetary entities, though Budget indicates status will be reviewed

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PRESIDENT'S 2019 BUDGET: *PENSION BENEFIT GUARANTY CORPORATION*

PBGC SEEKS TO BOLSTER MULTIEMPLOYER PROGRAM SOLVENCY

Multi-employer program protects 10M people in 1,400 plans

- Insolvency risk by 2025 → Budget creates new variable rate premium (VRP) & exit premium (\$16 billion over 10 years)
- VRP requires plans to pay premiums based on underfunding, up to a cap, as done in Single-employer program
- Exit premium, equal to 10 times VRP cap, assessed on withdrawing employers (PBGC would have authority to waive)

\$

Single-employer program protects 30M workers & retirees in 22,500 plans – Underfunded, but financial position projected to improve given several premium increases in recent years

BUDGET DATA POINTS

- Combined liabilities exceed assets by \$76 billion at FY17 close
- PBGC designed to be financed by premiums paid by plans or companies, investment income & assets from terminated plans
 - \$445M requested for admin in 2019
 - PBGC responsible for almost 1.5M people in 4,800 failed plans

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PRESIDENT'S 2019 BUDGET: *CDFI FUND & FLOOD INSURANCE*

SUPPORT FOR CDFI BONDS & TAX CREDITS

Budget makes substantial commitment to Bond Guarantee Program (\$500 million) & New Markets Tax Credits while eliminating funding for other programs at Community Development Financial Institutions Fund

SUSTAINABLE FLOOD INSURANCE?

For National Flood Insurance Program, Budget indicates intention to put program on more sustainable financial footing by increasing premiums for homeowners living in high-risk areas

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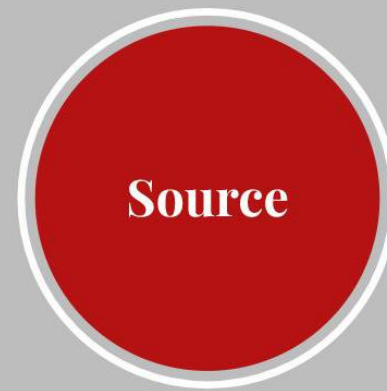
World's Largest Financial Institution

- *Regulation & Oversight*



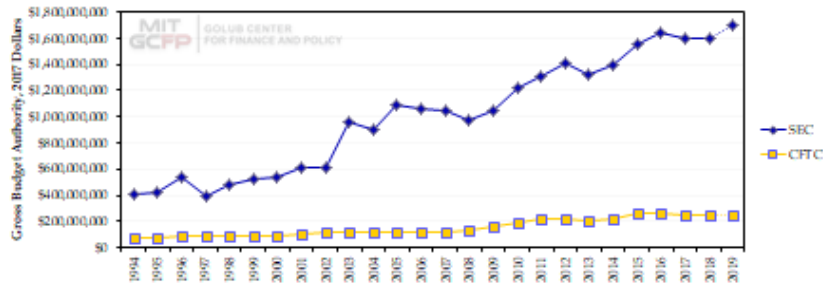
Banking Reform Clearinghouse (BRiC)

I want to see information about
regulatory reform organized by...

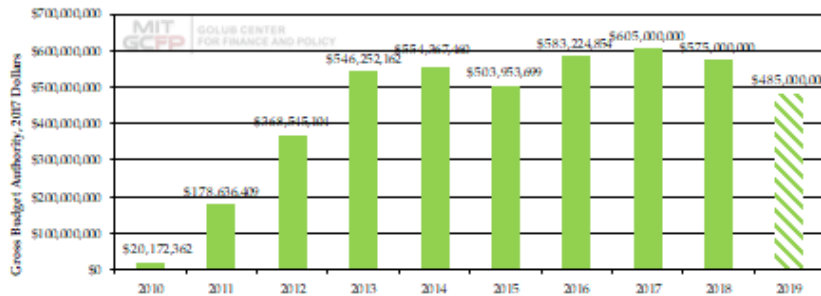


President's FY19 Budget: Financial Regulation

Funding for Financial Regulators



Consumer Financial Protection Bureau (CFPB) Funding



PRESIDENT'S 2019 BUDGET: *PROPOSALS AFFECTING REGULATORY AGENCIES*

REDUCE AUTOMATIC FUNDING for Consumer Financial Protection Bureau (CFPB) and transition it to the Congressional Appropriations process starting in 2020

REDUCE FUNDING AND STAFFING for the Office of Financial Research and subject it to the normal appropriations process.

FDIC Deposit Insurance Fund reserve ratio **ON-TRACK**

