

7. CREDIT AND INSURANCE

The Federal Government offers direct loans and loan guarantees to support a wide range of activities including housing, education, business and community development, and exports. At the end of 2007, there were \$260 billion in Federal direct loans outstanding and \$1,202 billion in loan guarantees. Through its insurance programs, the Federal Government insures bank, thrift, and credit union deposits, guarantees private defined-benefit pensions, and insures against some other risks such as natural disasters.

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

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

- The first section emphasizes the roles of Federal credit and insurance programs in addressing market imperfections that may prevent the private market from efficiently providing credit and insurance. Although the continued evolution and deepening of financial markets may have in part corrected many of the imperfections, Federal programs can still play a significant role in the areas where market imperfections remain serious and at the times when some adverse events disrupt the smooth functioning of the market.
- The second section interprets the results of the Program Assessment Rating Tool (PART) for credit and insurance programs in relation to their distinguishing features.
- The third section presents a special topic—the structure of financial regulation which can influence financial institutions' competitiveness and ability to innovate.
- The fourth section discusses individual credit programs and GSEs intended to support four sectors: housing, education, business and community development, and exports. The discussion focuses on program objectives, recent developments, performance, and future plans for each program.
- In a similar format, the final section reviews Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks.

I. FEDERAL PROGRAMS IN CHANGING FINANCIAL MARKETS

The Federal Role

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

Relevant market imperfections include insufficient information, limited ability to secure resources, insuffi-

cient competition, and externalities. Although these imperfections can cause inefficiencies, the presence of a market imperfection 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 causing inefficiencies elsewhere.

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

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

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. Without Government intervention, people will engage less than socially optimal in activities that generate positive externalities and more in activities that generate negative externalities.

Financial Market Developments

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

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

The role for the Federal government in addressing the information problem has diminished steadily over the years. Nowadays, lenders and insurers have easy

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

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

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

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

Overall, the financial market has become more efficient and stable. Financial evolution and other economic developments, however, are often accompanied by new risks, as evidenced by the current difficulties resulting from the rapid expansion of subprime mortgages. Subprime mortgages are a product of several innovations, such as consumer credit scoring, securitization, and credit ratings on securities. Properly used, subprime mortgages are a beneficial tool helping disadvantaged families to become homeowners. Misjudgments and some imperfections in financing techniques appear to have led to overextension of subprime mortgages. For example, while securitization facilitates the funding of mortgages, it also reduces

mortgage originators' incentives to screen borrowers carefully because securitized loans are off their balance sheets. Investors having relied on credit ratings appear to have been misguided by high ratings on some complex mortgage-backed securities that with the benefit of hindsight were too optimistic. Few financial models are perfect. In addition, rating agencies' incentives to protect investors may have been attenuated by the fees they collect from security issuers. These developments suggest that Federal agencies need to be vigilant to identify and manage new risks to the economy and to the Budget, arising from financial evolution.

Recent financial market instability presents both opportunities and challenges to Federal programs. Market disruptions have reduced private liquidity and credit availability temporarily. In this situation, Federal programs can produce larger net benefits. GSEs may inject more liquidity into the financial market, and credit programs may accommodate more deserving borrowers who are having difficulties in obtaining credit in the private market. Challenges include identifying the areas where the true needs are (e.g., identifying deserving borrowers), selecting the most effective tools, avoiding distortion of private sector credit markets, and avoiding excessive burden on taxpayers. To ensure significant net benefits, these issues need to be addressed effectively.

II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) has rated 38 credit programs and nine insurance programs. The PART evaluates programs in four areas (program purpose and design, strategic planning, program management, and program results) and assigns a numerical score (0 to 100) to each category. The overall rating (effective, moderately effective, adequate, ineffective, or results not demonstrated) is determined based on the numerical scores and the availability of reliable data.

The ratings for credit and insurance programs are clustered around the middle; 77 percent of credit and insurance programs (compared with 59 percent for other programs) are rated "adequate" or "moderately effective," while only 11 percent (18 percent for other programs) are rated "effective." These results suggest that most credit and insurance programs meet basic standards, but need to improve.

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

Program Purpose and Design. To be effective, credit and insurance programs should serve those who deserve to be served but are left out by the private market due to market imperfections. Extending credit to those who are not creditworthy, for example, would result in economic inefficiencies and large budget costs. Lending to those who can obtain credit at a reasonable rate in the private market would be unnecessary and

SUMMARY OF PART SCORES

	Purpose and Design	Strategic Planning	Program Management	Program Results
Credit and Insurance Programs				
Average	80.0	76.9	85.8	55.7
Standard Deviation	19.4	23.4	18.1	19.0
All Others Excluding Credit and Insurance Programs				
Average	87.6	75.8	83.0	48.9
Standard Deviation	18.2	24.3	17.7	26.4

might interfere with the market mechanism. To achieve intended outcomes without causing unintended consequences, therefore, credit and insurance programs need to be carefully designed; they should target the intended beneficiaries, and all parties in the transaction should face the correct incentives.

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

Strategic Planning. Financial markets have been evolving to serve target populations of Federal programs better and increasingly apply advanced technologies to risk assessments. Credit and insurance programs need to adapt to these new developments quickly. Falling behind, Federal programs can be left with many beneficiaries that do not really need Government help and with those that may pose greater risk.

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

Program Management. Risk management is a critical element of credit and insurance programs. Cash flows are uncertain both for credit and insurance programs. Default rates and claim rates can turn out to

be significantly different than expected. Credit programs also face prepayment and interest rate risks. These risks must be carefully managed to ensure the program cost stays within a reasonable range.

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

Program Results. It is generally more difficult to measure the outcomes of Federal programs pursuing various social goals than those of private entities seeking profits. Unlike profits, social outcomes are difficult to quantify and often interrelated. Credit and insurance programs face an additional difficulty of estimating the program cost accurately. Since the outcome must be weighed against the cost, an underestimation or an overestimation of the cost would make the program appear unduly effective or ineffective. Thus, results for credit and insurance programs need to be interpreted in conjunction with the accuracy of cost estimation.

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

III. STRUCTURE OF FINANCIAL REGULATION

Several groups including government, industry, and academic institutions have expressed concerns about the competitiveness of U.S. capital markets in the global financial system, and that financial regulations and the regulatory structure in the United States have become overly burdensome and complex. Recommendations have been made to streamline the U.S. regulatory structure, while acknowledging that a strong regulatory regime is critical to maintaining market confidence and the U.S. financial markets' preeminence. The analysis below reviews the regulatory systems used in foreign countries, in comparison to the system currently in place in the United States.

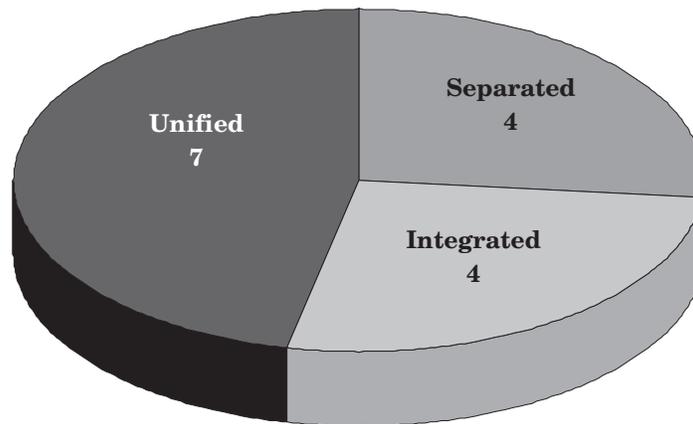
U.S. Financial Services Oversight

Financial regulators are responsible for supervising financial institutions and financial transactions. Their

domain encompasses banks and other depository institutions, insurance companies, securities firms, pension funds, finance companies, and other entities. Historically, regulators specialized in one of three financial service categories: banking, insurance, or securities.

The United States maintains a functionally separated regulatory system, with oversight responsibility divided among: five Federal banking regulators; two Federal securities/futures regulators; State-level insurance and other regulators; and self-regulatory organizations (non-governmental). The table below illustrates the multiple regulators of each type of financial services provider. The table shows that some providers can have up to five different levels of supervision in the United States.

**Chart 7-1. Financial Services Regulatory Systems
Top 15 Non-U.S. Financial Centers**



New Trends in Regulation

Outside the United States, countries have made recent changes to move toward a single, consolidated financial regulator having regulatory authority across all areas of financial services. These countries include the United Kingdom, Japan, Germany, and South Korea. Other countries have consolidated supervision of two or more financial sectors such as banking and insurance under one regulator, including Australia, Canada, and the Netherlands. Finally, countries that separate regulation of banking, insurance, and securities markets, including Hong Kong, France, and Italy, typically have only one regulator for each of those sectors. The United States has a separated system of regulation, with multiple regulators for each financial sector.

In an effort to provide more efficient and effective oversight of evolving markets, countries that have historically used a three- or multiple-pronged regulatory system are moving to consolidate regulation into one or two entities having the statutory power to supervise at least two of the three main types of financial intermediaries. This regulator is known as an “integrated” regulator; the regulatory system may be referred to as an integrated system.

The main drivers of this consolidation include:

- The need to better supervise the growing complexity and importance of financial conglomerates

and the blurring distinctions among banking, securities, and insurance products, as well as the associated systematic risk;

- The desire to maximize economies of scale and scope in regulatory efforts; and
- The need to address poor communication between and lack of cooperation among existing regulatory agencies.

Examples of integrated systems are found in Australia, Canada, the Netherlands, and Switzerland. The systems in Australia and the Netherlands provide examples of the “Twin Peaks” model, which separates prudential from market-conduct regulation. In this model, the prudential regulator oversees systemic risk and the solvency of major financial institutions.¹ For example, a prudential regulator would ensure that deposit-taking institutions are able to meet their financial obligations by regulating and overseeing bank reserve ratios and inter-bank lending rates. The market-conduct regulator oversees institutional conduct with respect to markets and shareholders. A market-conduct regulator would ensure the accuracy of financial filings and investigate market manipulation, insider trading, and customer fraud.

¹In the case of the Netherlands, the central bank has this responsibility.

REGULATORS OF FINANCIAL INSTITUTIONS

	Charter and License	Safety/Soundness Examination	Consumer Protection	Market Oversight
National Banks	OCC	OCC	FRB and OCC	SEC and CFTC
State Member Banks	States	FRB and States	FRB and States	SEC and CFTC
Insured Federal Savings Associations	OTS	OTS	FRB and OTS	SEC and CFTC
Insured State Savings Associations	States	OTS and States	FRB, OTS and States	SEC and CFTC
FDIC-insured State Nonmember Banks	States	FDIC and States	FRB, FDIC and States	SEC and CFTC
Federal Credit Unions	NCUA	NCUA	FRB and NCUA	SEC and CFTC
State Credit Unions	States	NCUA and States	FRB, FTC and States	N/A
Bank Holding Companies	FRB	FRB	FRB and FTC	SEC, CFTC and FRB
Thrift Holding Companies	OTS	OTS	OTS and FTC	SEC, CFTC and OTS
Consolidated Investment Banks	SEC	SEC	SEC	SEC, CFTC, SROs
Broker-Dealers	SEC	SEC	SEC, FTC and States	SEC and SROs
Futures Commission Merchants	CFTC and SROs	CFTC	CFTC and DOJ	CFTC and SROs
Hedge Funds	None	None	DOJ and States	SEC, CFTC and FRB
Credit Rating Agencies	SEC	SEC	N/A	N/A
Treasury Securities Primary Dealers	FRB and Treasury	FRB	N/A	FRB and Treasury
Insurance Companies	States	States	States	SEC, CFTC and States
Mortgage Companies	States	States	FRB and States	SEC and CFTC
Mortgage Brokers	States	States	FRB and States	N/A

OCC—Office of the Comptroller of the Currency OTS—Office of Thrift Supervision
 FRB—Federal Reserve Board and Regional Banks FDIC—Federal Deposit Insurance Corporation
 NCUA—National Credit Union Administration States—State Financial Regulatory Commissions
 FTC—Federal Trade Commission SEC—Securities and Exchange Commission
 CFTC—Commodity Futures Trading Commission DOJ—U.S. Department of Justice
 SROs—Self-Regulatory Organizations (e.g. Financial Industry Regulatory Authority, National Futures Association)

The most extreme form of an integrated system, the “unified” regulatory system, is also gaining in popularity. Of the top 15 international financial centers (non-U.S.), almost half are overseen by a single regulator of all banking, insurance, and securities firms, nation-wide.² These include centers in Denmark, Germany, Japan, Singapore, South Korea, Sweden, and the United Kingdom. In addition, Switzerland approved legislation on June 22, 2007 to create a unified financial services regulator from its current integrated system, taking effect in 2009.

Conclusion

The U.S. approach to financial regulation is an outlier in the global financial system. The few countries that do have a similar, functionally divided system have significantly fewer regulators. Three-quarters of countries with the largest financial centers have consolidated their regulatory systems, with almost half maintaining a unified regulator for all sectors of the financial services industry. The Administration is conducting an in-depth review of the Nation’s regulatory system and looks forward to advancing the dialogue this year.

²In some cases, such as Germany, a single, unified regulator has the predominant regulatory and supervisory authority over all sectors, and shares some supervisory authority with state-level regulators and the central bank. The role of the central bank varies among

countries surveyed; in Singapore, for example, regulatory and supervisory responsibilities pertaining to all sectors have been merged into the central bank.

IV. CREDIT IN FOUR SECTORS

Housing Credit Programs and GSEs

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

Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase the number of first-time minority homeowners by 5.5 million through 2010. During the five years since the goal was announced, nearly 3.2 million minority families have become first-time homeowners. Through 2007, the Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) helped more than 664,000 of these first-time minority homebuyers through its loan insurance programs. FHA mortgage insurance guarantees mortgage loans that provide access to homeownership for people who lack the traditional financial resources or credit history to qualify for a home mortgage in the conventional marketplace. In 2007, FHA insured purchase and refinance mortgages for more than 532,000 households. Among purchase mortgages, over 79 percent were for first-time homebuyers and 30 percent were for minority buyers. FHA also insured over 107,000 home equity conversion mortgages for elderly homeowners.

While FHA has been a primary facilitator of mortgage credit for first-time and minority buyers since the 1930s, its loan volume fell precipitously from 2002 through 2006. This is due in part to lower interest rates that made uninsured mortgages affordable for more families. Moreover, private lenders—aided by automated underwriting tools that allow them to measure risks more accurately—expanded lending to people who previously would have had no option but FHA, those with too few resources to pay for large downpayments, and/or who had credit histories that the private sector considered too risky. The development of new products and underwriting approaches has allowed private lenders to offer loans to more homebuyers. While this is a positive development when the private sector properly assesses risks and offers fair terms, some borrowers have ended up paying too much, receiving unfair terms, or taking on excessive debts.

As private lenders expanded their underwriting to cover more borrowers, FHA's business changed. First, the percentage of FHA-insured mortgages with initial loan-to-value (LTV) ratios of 95 percent or higher increased substantially, from 62.7 percent in 1995 to 79 percent in 2007. Second, the percentage of FHA loans with downpayment assistance from seller-financed non-profit organizations grew rapidly, from 0.3 percent in 1998 to nearly 23 percent in 2007. Recent studies show

that these loans are considerably more risky than those made to borrowers who receive downpayment assistance from other sources.

The FHA single-family mortgage program was assessed in 2005 using the PART. The assessment found that the program was meeting its statutory objective to serve underserved borrowers while maintaining an adequate capital reserve. However, the program lacked quantifiable annual and long-term performance goals that would measure FHA's ability to achieve its statutory mission. In addition, both the PART and subsequent reports by the Government Accountability Office and the Inspector General noted that the program's credit model does not accurately predict losses to the FHA insurance funds and that, despite FHA efforts to deter fraud in the program, HUD has not demonstrated that those steps have reduced such fraud. Due to weak housing market conditions today, FHA will record an upward re-estimate in the cost of its Mutual Mortgage Insurance Fund programs of \$4.6 billion in 2008. Cumulatively, FHA has recorded net upward re-estimates of \$19.7 billion since 1992.

In response to PART findings, FHA measured its 2007 performance against new goals, such as the percentage of FHA Single Family loans for first-time and minority homeowners, and exceeded its goals. FHA also improved the accuracy of its annual actuarial review claim and prepayment estimates. In 2008, it will continue to develop performance goals for fraud detection and prevention.

Response to Mortgage Market Challenges

FHA plays a valuable role in providing home financing options that augment those available in the conventional market. As discussed in the section on deposit insurance, conventional credit standards have tightened in recent months. Private mortgage insurers have raised underwriting standards, reducing the availability of financing options. In addition, there are a large number of borrowers who hold adjustable rate mortgages and face the risk of foreclosure due to large increases in mortgage payments after an interest-rate reset. An estimated 1.8 million subprime mortgages for owner-occupied homes are scheduled to reset in 2008 and 2009.

FHA is addressing both of these challenges. The FHA guarantee encourages lending to borrowers who may face increased difficulty in obtaining conventional financing. For borrowers who face difficulty making their mortgages payments, re-financing under an FHA-insured loan can offer a path that keeps them in their homes and avoids costly foreclosures. To broaden the use of this re-financing, the Administration announced the FHASecure program in August 2007. This program broadens the population eligible to use FHA. Beyond borrowers who are current, it also allows credit-worthy borrowers who have fallen behind on their mortgages

due to interest rate resets to refinance into FHA. Since the announcement of FHA Secure and as of January 2008, approximately 44,000 borrowers have successfully refinanced their conventional mortgages into FHA. While these actions help the mortgage market in the short-term, FHA needs permanent changes to allow guarantees on a wider variety of financing options and the flexibility to respond to future changes in the mortgage and housing markets.

Proposals for Program Reform

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

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

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

This price structure has many advantages. First, FHA will reflect a loan's risk via the mortgage insurance premium, not through a higher interest rate as done in the subprime market. With mortgage insurance through FHA, borrowers will pay a market rate of in-

terest, and, as a result, will incur lower monthly payments and lower total costs than if they paid a higher mortgage interest rate throughout the life of the loan. Second, by using this pricing structure, FHA will promote price transparency. Each borrower will know why they are paying the premium that they are being charged and will know how to lower their borrowing costs—i.e., by raising their FICO score or their downpayment. Third, risk-based pricing will allow FHA to review the performance of its programs annually in conjunction with the preparation of its credit subsidy estimates and adjust its premiums as necessary to assure the financial soundness of the Mutual Mortgage Insurance Fund.

The Administration also proposes to increase the FHA single-family loan limit in high-cost areas to the conforming mortgage limit (from \$362,790 to \$417,000). This will enable FHA to offer its insurance in some areas that experienced rapid house price appreciation between 2001 and 2006, and where FHA is no longer a viable option because of overly-restrictive loan limits. There are areas of the country, including many major cities in California, where FHA used to provide significant support to first-time and minority homebuyers, but where it can do very little to help them now. This proposed loan-limit increase will also allow FHA to offer insurance to a more geographically diverse portfolio.

A reformed FHA will adhere to sound management practices that include a new framework of standards and incentives tied to principles of good credit program management. Further, the proposed reforms will better enable FHA to better meet its objective of serving first-time and low-income home buyers—about 280,000 first-time homebuyers in 2009 including about 80,000 minority families—by managing its risks more effectively.

VA Housing Program

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel to purchase homes as recognition of their service to the Nation. The program substitutes the Federal guarantee for the borrower's down payment. In 2007, VA provided \$24.2 billion in guarantees to assist 129,261 borrowers.

Since the main purpose of this program is to help veterans, lending terms are more favorable than loans without a VA guarantee. In particular, VA guarantees zero downpayment loans. VA provided 84,858 zero downpayment loans in 2007.

To help veterans retain their homes and avoid the expense and damage to their credit resulting from foreclosure, VA intervenes aggressively to reduce the likelihood of foreclosures when loans are referred to VA after missing three payments. VA's successful actions resulted in 57 percent of such delinquent loans avoiding foreclosure in 2007.

Rural Housing Service

The U.S. Department of Agriculture's Rural Housing Service (RHS) offers direct and guaranteed loans and grants to help very low- to moderate-income rural resi-

dents buy and maintain adequate, affordable housing. The single-family guaranteed loan program guarantees up to 90 percent of a private loan for low to moderate-income (115 percent of median income or less) rural residents. In 2007, nearly \$4.8 billion in assistance was provided by RHS for homeownership loans and loan guarantees; \$3.6 billion in guarantees went to more than 35,000 households, of which 32 percent went to very low and low-income families (with income 80 percent or less than median area income).

Historically, RHS has offered both direct and guaranteed homeownership loans. However, the direction of Rural Development's single-family housing mortgage assistance over the last two decades has been towards guaranteed loans. The single family housing guaranteed loan program was newly authorized in 1990 at \$100 million and has grown into a \$3 billion plus guaranteed loan program annually, equaling that of the Veterans Affairs (VA) guaranteed housing loan program. Meanwhile the single-family direct loan program has been stagnant at approximately a \$1-billion loan level. Consequently, the Administration is proposing that Rural Development focus solely on guaranteed loans for single-family housing.

This policy was initially proposed in 2008 because it was consistent with the other Federal homeownership programs. In fact, there are no Federal single family direct loan home ownership programs for urban areas. While some rural areas remain isolated from broad credit availability, these areas are shrinking as broadband internet access and correspondent lending grow. Therefore, relying on the private banking industry to provide this service, with a guarantee from the Federal government, is a more efficient way to deliver that assistance.

The 2009 Budget also re-proposes an increase in the single family housing guarantee fee on new purchase loans to 3 percent from 2 percent. This change allows the loans to be less costly for the Government without a significant additional burden to the borrowers, given that they can finance the fee as part of the loan. The guarantee fee for refinance loans remains 0.5 percent. The fee proposal on purchase loans will allow funding in 2009 to be \$4.8 billion, an increase of over \$600 million above 2008.

The budget also supports \$300 million in RHS guaranteed loans for multifamily housing construction loans for 2009. This level of support can be achieved at a more efficient cost through the removal of the subsidized interest authorization and the fee component of the program as part of the 2009 request. No funds are requested for the direct rural rental housing program or the farm labor housing program because fixing the current portfolio is the first priority.

Government-Sponsored Enterprises in the Mortgage Market

Homeownership has long been recognized as an important part of the American economy and part of the American dream. However, it has not always been with-

in reach for the average American. During the Great Depression, housing markets were in turmoil. A typical mortgage required a downpayment of around 50 percent and a balloon payment of principal within a few years. Limitations in financial and communication technology and restrictions on financial institutions made it difficult for surplus funds in one part of the country to be shifted to other parts of the country to finance residential housing. Starting in 1932, the Congress responded by creating a series of entities and programs that together promoted the development of long-term, amortizing mortgages and facilitated the movement of capital to support housing finance.

A key element of this response was the creation of the Federal Housing Administration in 1934. Another element was the establishment of several entities designed to develop secondary mortgage markets and to facilitate the movement of capital into housing finance. These entities were chartered by the Congress with public missions and endowed with certain benefits that give them competitive advantages when compared with fully private companies.

The Federal Home Loan Bank System, created in 1932, is comprised of twelve individual banks with shared liabilities. Together they lend money to financial institutions—mainly banks and thrifts—that are involved in mortgage financing to varying degrees, and they also finance some mortgages on their own balance sheets. The Federal National Mortgage Association, or Fannie Mae, created in 1938, and the Federal Home Loan Mortgage Corporation, or Freddie Mac, created in 1970, were established to support the stability and liquidity of a secondary market for residential mortgage loans. Fannie Mae's and Freddie Mac's public missions were later broadened to promote affordable housing. Together these three GSEs currently are involved, in one form or another, with nearly one half of the \$11-plus trillion residential mortgages outstanding in the U.S. today. Their share of outstanding residential mortgage debt peaked at 54 percent in 2003, after which management and internal control problems started to surface at Fannie Mae and Freddie Mac and originations of subprime and non-traditional mortgages led to a surge of private-label MBS.

As with other financial institutions, the Congress has also established regulatory regimes to ensure the safety and soundness of the housing GSEs. The Office of Federal Housing Enterprise Oversight (OFHEO), established in 1992 as an independent agency within the Department of Housing and Urban Development, oversees the safety and soundness of Fannie Mae and Freddie Mac while HUD is responsible for mission oversight. The Federal Housing Finance Board (FHFB), established in 1989, oversees the Federal Home Loan Bank System. Numerous government and other reports have pointed to various shortcomings with the current regulatory structure and authorities for the housing GSEs. The Administration is proposing to strengthen this structure and regulatory authorities and combine OFHEO, HUD's regulatory responsibilities for mission

oversight, and FHFB to create a new regulator to oversee all these GSEs.

Mission

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

1. Credit Guarantee Business—Fannie Mae and Freddie Mac guarantee the timely payment of principal and interest on mortgage-backed securities (MBS). They create MBS by either buying and pooling whole mortgages or by entering into swap arrangements with mortgage originators. Over time these MBS held by the public have averaged about one-quarter of the U.S. mortgage market, and they totaled \$3.5 trillion as of November 30, 2007.

2. Mortgage Investment Business—Fannie Mae and Freddie Mac manage retained mortgage portfolios composed of their own MBS, MBS issued by others, and individual, whole mortgages. As of November 30, 2007, these retained mortgages totaled \$1.4 trillion. Given Fannie Mae's and Freddie Mac's serious accounting, internal control, risk management, and systems problems, the growth of these portfolios has been temporarily constrained through agreements with OFHEO.

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

Risks That GSEs Face and Cause

Like other financial institutions, the GSEs face a full range of risks, including market risk, credit risk, and operational risk. In recent years several of the Federal Home Loan Banks and Fannie Mae have faced serious market risks due to inadequate hedging. Fannie Mae and Freddie Mac have faced serious operational risk. As a result of earnings manipulation, poor accounting systems, lack of proper controls, lack of proper risk management, and misapplication of accounting principles, earnings at Fannie Mae were misstated by \$6.3 billion through June of 2004, and at Freddie Mac by \$5.0 billion through December of 2002. The housing

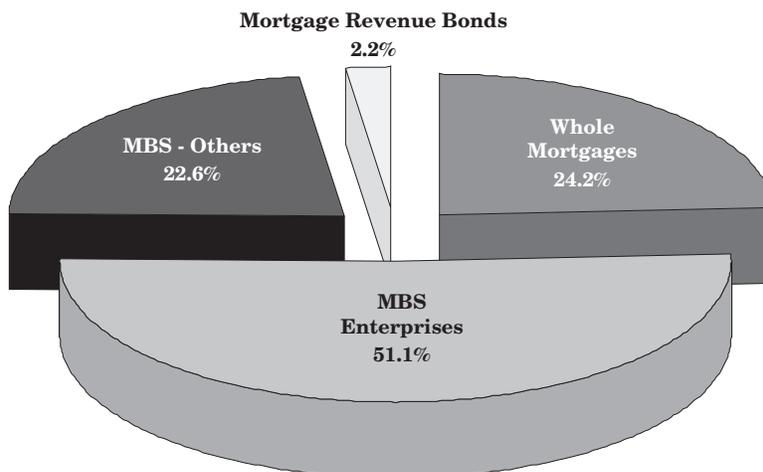
market downturn in the last year has increased significantly the credit risk faced by Fannie Mae and Freddie Mac.

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

The GSEs are among the largest borrowers in the world. As of September 2007 their combined debt and guaranteed MBS totaled \$6.0 trillion, higher than the total publicly held debt of the United States. The investors in GSE debt include thousands of banks, institutional investors such as insurance companies, pension funds, and foreign governments, and millions of individuals through mutual funds and 401k investments. Based on the prices paid by these investors, they act as if the Federal Government guarantees GSE debt. In fact, there is no such guarantee or Federal backing of GSE debt.

Because investors act as if there is an "implicit guarantee" by the Federal Government to back GSE debt, investors on average lend their money to the GSEs at interest rates roughly 30 to 40 basis points less (\$300–\$400 less per year for every \$100,000 borrowed) than to other highly rated privately held companies. In addition, investors do not demand the same financial disclosures as for other privately owned companies. Fannie Mae filed quarterly financial reports for each of the first three quarters of the year in November 2007, the first quarterly financial statements in more than three years, and has not filed a timely annual report (10-K) with the Securities and Exchange Commission (SEC) for nearly four years. Freddie Mac still has never registered with the SEC as it agreed to in 2002. It has issued quarterly reports during 2007, but they were all tardy. Yet there has been no significant impact on the pricing of GSE debt securities. In past years, the lack of market discipline facilitated the growth of the GSE asset portfolios, thereby increasing systemic risk.

**Chart 7-2. Fannie Mae and Freddie Mac
Combined Retained
Mortgage Portfolios Year-End 2006**



Retained Asset Portfolios Achieve Little for the GSEs' Housing Mission

Fannie Mae and Freddie Mac have used their funding cost advantage to amass large retained asset portfolios. Together these GSEs have \$1.5 trillion in debt outstanding, almost entirely for the purpose of funding these portfolios. From 1990 through 2006, the GSEs' competitive funding advantage enabled them to increase their portfolios of mortgage assets more than ten-fold, which far exceeds the growth of the overall mortgage market. Due to the size of and risks associated with the portfolios, the Administration is proposing that the new regulatory structure empower the regulator to address and mitigate these risks.

As chart 7-2 shows, 51 percent of Fannie Mae and Freddie Mac's combined retained mortgage portfolios at the end of 2006 was comprised of holdings of their own guaranteed MBS, which could easily be sold.

The function of these portfolio holdings is largely to increase profits, not facilitate affordable housing. In 1992, the Congress broadened Fannie Mae and Freddie Mac's mission to include providing liquidity for mortgages that served low- and moderate-income borrowers and those living in underserved areas. To measure this performance, the Congress mandated that HUD establish three affordable housing goal targets that Fannie Mae and Freddie Mac must meet each year. HUD has also implemented home purchase subgoals to encourage homeownership opportunities for first-time homeowners and minority homeowners. Given that Fannie Mae and Freddie Mac have a mission to help more families achieve homeownership as well as to expand rental op-

portunities, their retained portfolios should be largely tied to that mission. However, currently only about 30 percent of Fannie Mae and Freddie Mac's retained portfolio holdings would be eligible to qualify for any of the affordable housing goals. About half of the MBS issued by others and whole loans held by the GSEs qualify toward their affordable housing goals but none of their holdings of their own MBS contribute toward meeting the goals because loans backing the MBS are already counted. Their performance under the housing goals over time indicate that Fannie Mae and Freddie Mac should be doing more to help mission-targeted families achieve homeownership or acquire affordable rental housing.

Debt Issuance Subject to Treasury Approval

Fannie Mae and Freddie Mac fund their portfolios by issuing debt, and the U.S. Department of the Treasury has the statutory responsibility to review and approve these GSEs' debt-issuances. The Treasury Department also has debt approval over the Federal Home Loan Banks. Treasury is developing a more formalized approach to their debt approval authority. As part of that approach, Treasury is developing new debt approval procedures to enhance the clarity, transparency, standardization, and documentation of the debt approval process for Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

Recent Mortgage Market Conditions Highlight Needed Reforms

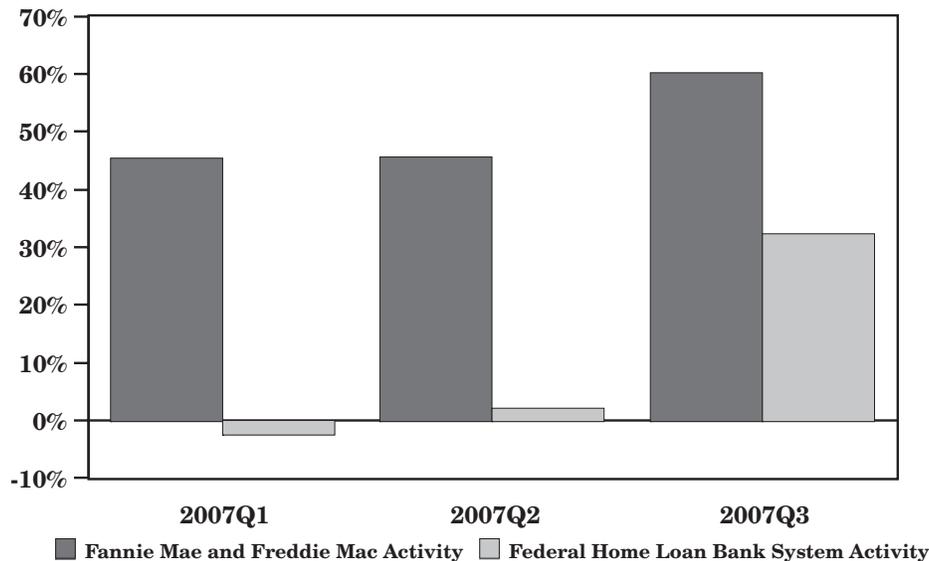
In early August 2007, there was a precipitous drop in the liquidity of subprime, nontraditional, and prime

jumbo mortgages. Faced with sharp increases in the delinquency and default rates of subprime and non-traditional loans in 2006 and 2007, as well as flat or declining home prices in much of the country, secondary market investors reassessed the risk of non-GSE MBS backed by those loans, which had previously been mispriced. The illiquidity of non-GSE MBS reduced the industry's capacity to securitize newly-originated subprime and jumbo loans, although some lenders continued to originate jumbo mortgages for portfolio. Freddie Mac and, to a lesser degree, Fannie Mae also incurred losses on investments in non-GSE MBS.

The three housing GSEs have continued to perform their missions during the recent market disruption. In

the third quarter of 2007, Fannie Mae and Freddie Mac supported the liquidity of the secondary market by engaging in \$343 billion of new business. The Federal Home Loan Banks increased their secured lending to mortgage lenders by \$184 billion in that quarter. As Chart 7-3, shows, the combined activity of Fannie Mae and Freddie Mac as a share of single-family mortgage originations rose to 60 percent in the third quarter, whereas the Federal Home Loan Bank System's share increased to 32 percent. Those increases in market share highlight the need for a strong regulator.

Chart 7-3. Mortgage Purchases and Securitization by Fannie Mae and Freddie Mac and Change in Federal Home Loan Bank Advances as a Share of Single-Family Mortgage Originations, First Three Quarters of 2007



The risks of the GSEs' large portfolios are exacerbated because they are not required to hold cushions of capital against potential losses comparable to the capital requirements for other large financial institutions. Where commercial banks that are part of a financial holding company must hold a 5 percent capital-to-total assets cushion, Fannie Mae and Freddie Mac's requirement (before the 30% surcharge imposed by OFHEO for operational weakness) is half that, whereas the Federal Home Loan Banks' is 4 percent. The risk-based capital requirements for the GSEs also differ dramatically from those applicable to commercial banks. This highlights an important shortcoming of the statutory framework governing Federal oversight of the GSEs. The minimum capital and risk-based capital rules for the GSEs were written into law in 1992. Much has changed since then with regard to financial risk

analysis, risk modeling, and capital requirements for comparable financial institutions. The reforms proposed by the Administration would repeal the statutory risk-based capital stress test, and would provide the new GSE regulator with the authority and flexibility to establish through regulation new risk-based capital requirements for the GSEs to help ensure that they operate with sufficient capital and reserves to support the risks that arise in the operations and management of each enterprise. A world-class regulator needs the flexibility and authority to change both the risk-based and minimum capital requirements without undue restriction in response to changing conditions.

The substantial increase in mortgage delinquencies and foreclosures in recent months serves as a reminder that mortgage lending involves credit risk. Fannie Mae and Freddie Mac are exposed to significant default risk

on the mortgages they hold in portfolio or that back the MBS they guarantee. The GSEs' asset portfolios pose other substantial risks as well. Mortgage portfolios carry considerable interest-rate and pre-payment risk. This risk can be mitigated—for example, through purchase of interest-rate hedges—but the GSEs protect themselves against only some of the interest rate risk of their portfolios. Moreover, hedges are imperfect because predicting interest-rate movements and mortgage refinancing activity is difficult. As GSE asset portfolios have grown in size, the GSEs' participation in the market for hedging instruments has become dominant enough to cause interest rate spikes in the event that a GSE needs to make large and sudden adjustments to its hedging position. Further, Freddie Mac and, to a lesser extent, Fannie Mae hold large amounts of non-GSE MBS, which pose significant risks. Many of these securities are backed by subprime loans, and market values have declined as concerns about those loans have risen. Increased defaults and concerns about future defaults have led to significant losses at both of those GSEs in the last half of 2007, and led to new preferred stock issues raising \$16 billion to shore up capital.

New Activities and Technological Development Require Oversight

Over the last decade, Fannie Mae and Freddie Mac have begun engaging in a wide range of new activities that were not anticipated when their charters were written. To address these changes, HUD developed a new activity review initiative under its general regulatory authority. HUD has reviewed a number of business initiatives at Fannie Mae and Freddie Mac, including international activities; partnership offices; senior housing; skilled nursing facilities; employer assisted housing plans; third party real-estate-owned programs; Commercial Mortgage-Backed Securities (CMBS); Asset-Backed Securities (ABS); multifamily variable-rate bond certificates; whole loan REMICs; and patenting programs. HUD imposed limitations on some activities and concluded that other activities were not authorized. For example, HUD's review of the GSEs' Commercial MBS programs resulted in OFHEO seeking Freddie Mac's divestiture of certain CMBS holdings, and HUD ordered Fannie Mae to end its third party Real-Estate-Owned program based on its review.

HUD completed a Financial Activities Review in late 2007. The review provided a baseline of information on Fannie Mae's and Freddie Mac's business and program activities and examined specific transactions to determine if these are consistent with the GSEs' charter authorities. HUD expects to issue its review results to the GSEs during the second quarter of fiscal year 2008.

Because of their enormous presence in the secondary market, Fannie Mae and Freddie Mac are able to exert significant influence in the *primary* mortgage market. First, their unparalleled size in the residential mortgage market gives the GSEs a unique level of access

to market information. The applicability of that information to the management of mortgage risk gives them a competitive edge in the development of new technology that can change relationships between primary market participants as well as the distribution of economic returns between the primary and secondary markets. Second, their funding advantage enables the GSEs to borrow at reduced rates in order to make investments in new areas at below-market prices, thus discouraging competition while gaining experience in those areas.

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

New Regulatory Authority

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

Education Credit Programs

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

The Department of Education helps finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Student Loan (Direct Loan) program. Eligible institutions of higher education may participate in one or both programs. Loans are available to students regardless of income. However, borrowers with low family incomes are eligible for loans with addi-

tional interest subsidies. For low-income borrowers, the Federal Government subsidizes loan interest costs while borrowers are in school, during a six-month grace period after graduation, and during certain deferment periods.

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

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

In 2007, the President signed the College Cost Reduction and Access Act (CCRAA) into law. The CCRAA enacted broad programmatic reforms that will save \$22 billion through 2012 by reducing lender and guaranty agency subsidies that had been higher than necessary to ensure that loans are available to students in this profitable and competitive market. Stemming from proposals included in the President's 2008 Budget, the CCRAA reduced interest subsidies and default reinsurance paid to FFEL lenders; reduced fees paid to guaranty agencies; and required the Department of Education to conduct an auction pilot for the PLUS loan program, which primarily makes loans to parents to finance their child's education. As implementation of these complex provisions continues, the Administration will closely monitor the student loan marketplace to ensure it continues to be robust and efficient, and that students have access to loans from a variety of lenders. The savings from the CCRAA were used to offset the costs of providing several student and borrower benefits, including: (1) a historic increase in the Pell Grant program; (2) a reduction in student loan interest rates for subsidized loans from 6.8 percent to 3.4 percent over four years (reverting back to 6.8 percent thereafter), and (3) increased flexibility in how borrowers repay their loans.

Business and Rural Development Credit Programs and GSEs

The Federal Government guarantees small business loans to promote entrepreneurship. The Government also offers direct loans and loan guarantees to farmers

who may have difficulty obtaining credit elsewhere and to rural communities that need to develop and maintain infrastructure. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

Small Business Administration

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

The 2009 Budget requests \$657 million, including administrative funds, for SBA to leverage more than \$29 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support \$17.5 billion in guaranteed loans while the 504 Certified Development Company program will support \$7.5 billion in guaranteed loans for fixed-asset financing. SBA will supplement the capital of Small Business Investment Companies (SBICs) with \$3 billion in long-term, guaranteed loans for venture capital investments in small businesses. At the end of 2007, the outstanding balance of business loans totaled \$85 billion.

During the past few years, SBA has implemented several initiatives to streamline and improve operations by increasingly delegating responsibilities to lenders and centralizing operations while managing and mitigating risk. In 2003, SBA implemented a state-of-the-art Lender Loan Monitoring System (LLMS) to evaluate individual SBA lenders by tracking the expected risk of SBA guaranteed loans in their portfolios relative to expected performance of those loans.

In response to the challenges experienced in making and disbursing loans resulting from the 2005 Gulf Coast hurricanes, SBA has made a number of improvements, including implementing a case-manager system for processing loan applications and new metrics to track performance. By summer 2008, SBA expects to implement an Internet-based loan application system that will facilitate the collection of data from disaster victims and speed processing.

The Budget builds on these efforts by investing in core technology systems and human capital efforts. Increased funding is requested for the Loan Management and Accounting System (LMAS), a modern system to replace an aged mainframe system and ensure adequate stewardship over a loan portfolio that has grown 59 percent since 2001. Funds are also requested for a training initiative focused on core competencies and other important information technology investments.

The Budget also proposes to build upon the success of the zero-subsidy 7(a) program by making the Microloan program self-financing through modest increases in the interest rate paid by program intermediaries. The Administration is also proposing authorizing legislation to enable the secondary market guar-

antee (SMG) program to charge nominal fees on lenders seeking to pool loans; fees are expected to be less than or comparable to fees in other secondary market programs and will help stabilize the program from the need to make frequent administrative changes.

USDA Rural Infrastructure and Business Development Programs

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

The program level for the Water and Wastewater (W&W) treatment facility loan and grant program in the 2009 President's Budget is \$1.6 billion. These funds are available to communities of 10,000 or fewer residents. No change is proposed to the poverty rate for this program in 2009. The Community Facility Program is targeted to rural communities with fewer than 20,000 residents. It will have a program level of \$512 million in 2009.

USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, cooperatives, non-profits, and farmers in creating new community infrastructures (i.e. educational networks or healthcare coops), and to diversify the rural economy and employment opportunities. In 2009, USDA proposes to provide \$730 million in loan guarantees and direct loans to entities that serve communities of 50,000 or less through the Business and Industry guaranteed loan program and Intermediary Relending program. These loans are structured to save/create jobs and stabilize fluctuating rural economies. A recently implemented performance assessment tool will be used to calculate their impact on income growth in local, state, and national economies.

The President's Farm Bill proposal includes \$1.5 billion in support for Rural Development programs over 10 years. Of this, \$0.5 billion will go to enhance rural infrastructures, alleviating program backlogs, and \$0.1 billion to support rural critical access hospitals. The other \$0.9 billion will promote renewable energy activities, providing support to businesses and farmers who would like to produce renewable energy and increase their energy efficiencies.

Electric and Telecommunications Loans

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

The Budget includes \$4.1 billion in direct electric loans for distribution, transmission, and improvements to existing generation facilities, \$690 million in direct telecommunications loans, \$298 million in broadband loans, and \$20 million in DLT grants.

Since generation has been deregulated and has become a more commercial operation, the Administration supports using the commercial market for construction of new generation facilities. While the Administration has established a loan rate methodology for new non-nuclear generation facilities, the Administration has not proposed a loan level or requested funding needed to subsidize such loans. A loan level will be considered once Congress enacts legislation to authorize a fee on such loans and allows RUS to implement existing authority for recertification of the rural status of areas served by its borrowers.

The Budget includes a proposal to replace the 100 percent guaranteed electric and telecommunications loans that are financed through the Federal Financing Bank (FFB) with loans made directly through the Treasury. The proposed new direct loan program would improve the operations of USDA's rural utility loans by simplifying the Government's processes while providing the same benefits and flexibilities for the borrowers.

Loans to Farmers

The Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed on aiding beginning and socially disadvantaged farmers. FSA offers operating loans and ownership loans, both of which may be either direct or guaranteed loans. Operating loans provide credit to farmers and ranchers for annual production expenses and purchases of livestock, machinery, and equipment. Farm ownership loans assist producers in acquiring and developing their farming or ranching operations. As a condition of eligibility for direct loans, borrowers must be unable to obtain private credit at reasonable rates and terms. As FSA is the "lender of last resort," default rates on FSA direct loans are generally higher than those on private-sector loans. 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 Administration's recent farm bill proposal includes policies to improve credit assistance for farm borrowers, with particular emphasis to beginning and socially disadvantaged farmers. Specifically, the Administration proposes to double assistance targeted to beginning and socially disadvantaged farmers for the direct operating loan program and reduce the interest rate for downpayment assistance to beginning farmers. Finally, because the cost of production is high for many farmers desiring to enter into farming, the farm bill includes increased loan levels for direct loan programs.

In 2007, FSA provided loans and loan guarantees to approximately 27,000 family farmers totaling \$3.1 billion. The number of loans provided by these programs has fluctuated over the past several years. The average size for farm ownership loans has been increasing. The majority of assistance provided in the oper-

ating loan program is to existing FSA farm borrowers. In the farm ownership program, new customers receive the bulk of the benefits furnished. The demand for FSA direct and guaranteed loans continues to be high due to low crop/livestock prices and some regional production problems. In 2009, FSA proposes to make \$3.4 billion in direct and guaranteed loans through discretionary programs.

In 2005, to further improve program effectiveness, FSA conducted an in-depth review of its direct loan portfolio to assess program performance, including the effectiveness of targeted assistance and the ability of borrowers to graduate to private credit. The results of this review will assist FSA in improving the delivery of its services and the economic viability of farmers and ranchers. FSA is currently evaluating the feasibility of obtaining a similar independent review of the guaranteed loan program. In addition, FSA recently implemented a web-based system to track loan applications. The Direct Loan System (DLS) replaces the loan making components of other automated systems. A loan servicing DLS module is currently under development. FSA successfully completed a comprehensive review of all farm loan program regulations, handbooks, and information collections. This streamlining initiative was one of the most aggressive efforts to enhance both the direct and guaranteed programs in the program's 60-year history. This initiative will reduce the burden for both applicants and the Agency, resulting in an improvement in loan processing efficiencies.

The Farm Credit System and Farmer Mac

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

The Farm Credit System

The financial condition of the System's banks and associations remains sound. The ratio of capital to assets decreased to 14.8 percent as of September 30, 2007 from 15.7 percent as of September 30, 2006, as asset growth outpaced capital growth. As of September 30, 2007, capital consisted of \$2.5 billion in restricted capital held by the Farm Credit System Insurance Corporation (FCSIC) and \$24.0 billion of unrestricted capital—a record level. Non-performing loans decreased, and earnings increased, resulting from growth in the loan portfolio and higher earnings on assets. Non-performing loans as a percentage of total loans outstanding fell to .43 percent as of September 30, 2007 compared to .50 percent a year earlier. Assets have grown at a 10.8 percent annual rate over the past five years, while the number of FCS institutions has decreased due to consolidation. As of September 30, 2007, the

System consisted of five banks and 95 associations compared with seven banks and 104 associations in September 2002. As of September 30, 2007, 98 of the 100 FCS banks and associations had one of the top two examination ratings (1 or 2 in a 1–5 scale), while two FCS institutions had a 3 rating.

The FCSIC ensures the timely payment of principal and interest on FCS obligations on which the System banks are jointly and severally liable. FCSIC manages the Insurance Fund, which supplements the System's capital and the joint and several liability of the System banks. At September 30, 2007, the assets in Insurance Fund totaled \$2.519 billion. Of that amount \$40 million was allocated to the Allocated Insurance Reserve Accounts (AIRAs). At September 30, 2007, the Insurance Fund as a percentage of adjusted insured debt was 1.71 percent in the unallocated Insurance Fund and 1.74 percent including the AIRAs. This was below the statutory Secure Base amount of 2 percent. During 2007 growth in System debt has outpaced the capitalization of the Insurance Fund that occurs through investment earnings and premiums.

Over the 12-month period ending September 30, 2007, the System's loans outstanding grew by \$19.2 billion, or 16.6 percent, while over the past five years they grew by \$47.2 billion, or 53.6 percent. As required by law, borrowers are also stockholder owners of System banks and associations. As of September 30, 2007, the System had 472,925 stockholders. Loans to young, beginning, and small farmers and ranchers represented 11.7, 19.4, and 27.7 percent, respectively, of the total dollar volume of farm loans outstanding at the end of 2006. The percentage of loans to beginning farmers in 2006 remained the same as the percentage of loans in 2005, while percentages to young and small farmers were slightly lower. Young, beginning, and small farmers are not mutually exclusive groups and, thus, cannot be added across categories. Providing credit and related services to young, beginning, and small farmers and ranchers is a legislative mandate for the System.

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

Farmer Mac

Farmer Mac was established in 1988 as a Federally chartered instrumentality and institution of the System to facilitate a secondary market for farm real estate and rural housing loans. The Farm Credit System Reform Act of 1996 expanded Farmer Mac's role from a guarantor of securities backed by loan pools to a direct purchaser of mortgages, enabling it to form pools

to securitize. This change increased Farmer Mac's ability to provide liquidity to agricultural mortgage lenders.

Farmer Mac continues to meet core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, AgVantage bond assets, and real estate owned) as of September 30, 2007, totaled \$8.4 billion. That volume represents an increase of 19 percent from program activity at September 30, 2006. Of total program activity, \$2 billion were on-balance sheet loans and agricultural mortgage-backed securities, and \$6.3 billion were off-balance sheet obligations. Total assets were \$5.4 billion at the close of the third quarter, with non-program investments accounting for \$3.3 billion of those assets. Farmer Mac's net loss for first three quarters of 2007 was \$6.3 million, a significant change from the same period in 2006 during which net income was \$22 million.

The currently reported year-to-date loss amount is primarily the result of fluctuations in the market value of financial derivatives and trading assets that are now recognized in the income statement and is not the result of negative developments in its operations or cash flows. This change was instituted in November 2006, when Farmer Mac opted to change its accounting methods to remove the impact of accounting for derivatives as hedges against interest rate movements. Farmer Mac has stated that it does not expect the accounting change to impact its ability to carry out its business plans or have any effect on its business model.

International Credit Programs

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

Leveling the Playing Field

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

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

Stabilizing International Financial Markets

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

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

Using Credit to Promote Sustainable Development

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

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

uity to local companies with strong development potential.

Ongoing Coordination

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

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

Promoting Economic Growth and Poverty Reduction through Debt Sustainability

The Enhanced Heavily Indebted Poorest 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. Under the HIPC process, the debt of most countries is restructured before being completely forgiven. While not considered part of HIPC relief, a restructuring is often a precursor to HIPC relief. The 2009 President's Budget uses an improved methodology for estimating the long term cost to the Federal Government of HIPC debt restructuring. The revised methodology more accurately reflects a country's creditworthiness after a restructuring given the likelihood of receiving 100 percent debt reduction in the future.

Self-Sufficient Export-Import Bank

The Budget estimates that the Bank's export credit support will total \$14 billion, and will be funded entirely by receipts collected from the Bank's customers. The Bank estimates it will collect \$164 million in 2009 in excess of expected losses on transactions authorized in 2009 and prior years. These amounts will be used to: (1) cover the estimated costs for that portion of new authorizations where fees are insufficient to cover expected losses; and (2) to cover administrative expenses.

V. INSURANCE PROGRAMS

Deposit Insurance

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

Since its creation, the system has undergone a series of reforms, most recently in 2006. The Federal Deposit Insurance Reform Act of 2005 allows the FDIC to better manage the Deposit Insurance Fund. For example, the Act authorizes the FDIC to charge premiums for deposit insurance on a risk-adjusted basis regardless of the level of the FDIC's reserves against its insured deposits, and ensures that all financial institutions pay premiums for Federal insurance on their insured deposits. The FDIC completed implementation of these reforms during 2007.

The FDIC insures deposits in banks and savings associations (thrifts). The National Credit Union Administration (NCUA) insures deposits (shares) in most credit unions (certain credit unions are privately insured). FDIC and NCUA insure deposits up to \$100,000 per

account. Under the Federal Deposit Insurance Reform Act of 2005, the deposit insurance ceiling for retirement accounts was increased to \$250,000. In addition, beginning in 2010, and every five years thereafter, FDIC and NCUA will have the authority to increase deposit insurance coverage limits for retirement and non-retirement accounts based on inflation if the Boards of the FDIC and NCUA determine such an increase is warranted. As of September 30, 2007, FDIC insured \$4.24 trillion of deposits at 8,560 commercial banks and thrifts, and NCUA insured \$556 billion of deposits (shares) at 8,163 credit unions.

Current Industry Conditions

Significant challenges have confronted the financial sector throughout the second half of calendar year 2007. Although to date the challenges have not caused a large number of failures of insured depository institutions, the outlook for the industry remains uncertain as of the beginning of 2008. During the summer of 2007, a slowdown in the U.S. housing market began to trigger concerns. Rising defaults on "subprime" loans led to markdowns on the value of debt securities backed by these loans. These securities had been packaged by financial institutions and sold to investors around the world. Uncertainty about the value of these complex financial instruments and lack of transparency about who held them led to a much lower appetite for risk and a clear preference for the most liquid and safe

investments. This reassessment of risk caused widespread volatility in financial markets.³

Many depository institutions entered this period of market uncertainty with strong profitability and a significant capital cushion. The period from 2004–2006 was one of record growth and profitability for many banks and thrifts, and this previous strong performance has to date provided a cushion. As of September 2007, total risk-based capital ratios in the industry averaged 12.75 percent, versus a minimum required level of 8 percent. Depository institutions are also insulated by the fact that many had sold their mortgages—and hence their risk exposure—to the secondary market. In addition, many of the subprime mortgages losing value were originated by state-chartered mortgage companies rather than depository institutions. Thus the risk has been spread beyond the core banking system subject to Federal deposit insurance.

In the current market environment, institutions with a significant presence in structuring and trading mortgage-backed securities (especially the major investment banks) have recorded losses on their portfolios of mortgage-backed securities, as well as lost the fees earned in repackaging and reselling these loans. In the 3rd and 4th quarters of calendar year 2007, major investment banks recorded nearly \$70 billion in writedowns due to losses on investments linked to subprime mortgages and structured credit products. While the Federal Government has no direct risk exposure from investment bank losses, many banks and other firms have also encountered difficulty raising cash through the short-term corporate debt markets.

Due to the increasing consolidation of the U.S. banking industry in recent years, the largest institutions have accounted for a growing share of total assets—whereas in 1984 depository institutions with over \$10 billion in assets accounted for 42 percent of total assets in the industry, by 2004 the share of those institutions had risen to 73 percent. This consolidation, combined with the fact that many of the larger institutions with significant market and trading presence are those most affected by the current market conditions, has increased the potential risks of a major failure that could put a significant strain on the resources of the Federal deposit insurance funds.

Administration and Regulatory Responses

The financial regulators and the Administration have taken a number of steps to address the underlying problems in the credit and mortgage markets. The President's Working Group on Financial Markets (including the Treasury Department, the Federal Reserve Board, the Securities and Exchange Commission and the Commodity Futures Trading Commission) has the responsibility to examine the recent uncertainty in credit markets and work to ensure that market integrity and efficiency are not compromised. In regard to mortgage markets, in addition to the Administration

proposals for modernization of the Federal Housing Administration and reform of the oversight of the housing GSEs (mentioned earlier in this chapter) the Administration has partnered with the private sector to assemble a group of lenders, loan servicers, mortgage counselors, and investors (the HOPE NOW Alliance) to identify troubled borrowers and help them refinance or modify their mortgages, so more families can stay in their homes. The HOPE NOW Alliance consists of four counseling organizations, 21 mortgage servicers and lenders (comprising 65 percent of the U.S. market for mortgage servicing and almost 85 percent of the subprime servicing market), three investor groups (including the American Securitization Forum, which represents over 370 members), and 10 trade associations. These efforts should reduce foreclosure rates and support the continued flow of capital to mortgage markets.

To aid this effort, during December 2007 Congress passed the Mortgage Forgiveness Debt Relief Act of 2007, an Administration proposal that for the next few years (through 2010) will allow borrowers to obtain relief from taxes on writedowns of loan principal during a refinancing. The Administration has also proposed to allow state and local governments to temporarily broaden their tax-exempt bond programs to include mortgage refinancings.

The Federal banking regulators (Federal Reserve, Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and FDIC) have been closely monitoring banks' core capital levels as well as their potential susceptibility to market disruptions. During 2007, the regulators jointly issued final guidance addressing non-traditional and subprime mortgage practices, as well as guidance encouraging their institutions to proactively aid borrowers to refinance subprime mortgages.

The Federal Reserve and other Federal banking regulators have been developing new regulations to improve disclosure of mortgage and credit card terms, restrain certain practices in mortgage lending, and address unfair and deceptive lending practices more broadly. Complementing these efforts, this year HUD will also propose clearer disclosure of mortgage lending and home purchase closing costs, as mandated by the Real Estate Settlement Procedures Act. The draft text of the regulations on credit cards and mortgage lending were released for public comment in 2007, and the regulators will likely finalize these regulations during 2008.

Recent Performance of the Federal Deposit Insurance Funds

From July 2004 through January 2007, the performance of the Federal deposit insurance program was strong. No banks or thrifts failed during this period—the longest interlude without a failure in the 73-year history of the FDIC. However, there has been a deterioration of conditions in the industry since summer 2007. As of September 30, 2007, the FDIC classified 65 institutions with \$18.5 billion in assets as “problem institutions” (institutions with the highest risk ratings), a

³For a much more detailed discussion of the problems in credit markets during 2007 and their implications, please see Chapter 2 of the 2008 Economic Report of the President.

level of problem assets more than four times higher than the comparable statistics from September 2006. The largest institution to fail since the early 1990s, NetBank (a Georgia thrift with \$2.5 billion in assets) was placed in FDIC receivership in September 2007, and overall three institutions failed during 2007.

At the end of September 2007, the Deposit Insurance Fund reserve ratio (ratio of insurance reserves to insured deposits) stood at 1.22 percent—\$1.2 billion below the level that would meet the target reserve ratio. Taking the redemption of credits into consideration, along with continued growth in insured deposits and a higher rate of potential failures given current conditions in the industry, the Budget projects that the FDIC will collect approximately \$4.7 billion in new revenue from premiums during 2008 and 2009 combined.

The National Credit Union Share Insurance Fund, the Federal fund for credit unions that is analogous to the Deposit Insurance Fund for banks and thrifts, ended September 2007 with assets of \$7.4 billion and an equity ratio of 1.31 percent, topping the NCUA-set target ratio of 1.30 percent. Over the past five years, the Share Insurance Fund's equity ratio has gradually risen from about 1.27 percent, reflecting few losses due to failures in the credit union industry. Recent market volatility, however, may increase observed losses in the credit union industry. The number of problem institutions reported by the NCUA has steadily risen during 2007, and the Share Insurance Fund has set aside more than \$57 million to cover potential insurance losses from January through November 2007, versus only \$2.5 million in loss expenses for all of calendar year 2006.

Basel II: Transition to a New Bank Capital Regime

A major regulatory initiative is currently underway in the banking sector, which is likely to have a significant impact on the banking sector as a whole and, by extension, on the Federal deposit insurance system. The Federal banking regulators are implementing an international agreement called the Revised Framework for the International Convergence of Capital Measurement and Capital Standards ("Basel II").

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

During 2007, the Federal banking regulators completed issuance of the rules implementing the Basel II advanced approach, the first half of the US effort to implement the Revised Basel Capital Accord. In the final Basel II advanced rule, U.S. regulators require the ten or so largest banks (including those that have major international operations, complex financial struc-

tures and expertise) to use an advanced internal ratings-based approach to calculate their credit risk capital requirements. The Basel II rulemaking allows for greater sensitivity to risk in the portfolios these banks hold. Rather than grouping assets into broad risk categories, capital requirements are tied to banks' internal assessments of the likelihood and severity of default losses from the assets they hold. The rules are also intended to allow capital requirements to more accurately account for the benefits or risk-mitigation activities undertaken by banks. The rulemaking also requires banks to hold capital to cover operational risk, which is not covered under the existing (Basel I) requirements.

Implementation of the Basel II standard in Europe began during 2007. Implementation of the U.S. Basel II rulemaking will begin with a "parallel run" on April 1, 2008 and formally go into effect for the first of three transitional years on January 1, 2009. This delay has led to concerns about a competitive imbalance between U.S. and foreign banks. There are also concerns about competitive imbalance between U.S. banks, and for that reason, regulators are expected to allow banks other than the ten largest U.S. banks to be able to choose between adopting the "Basel II advanced" approach, the current "Basel I" system, and an alternative "Basel II standardized" approach.

The "Basel II standardized" approach is intended to be more risk-sensitive than Basel I, but easier to implement than the advanced Basel II approach. The "standardized" approach is intended to be broadly based upon a system proposed by the Basel committee that provides additional risk-sensitivity through use of external credit ratings, and internal risk measures for some types of assets (i.e., loan-to-value ratios for mortgages). This alternative approach would allow banks to potentially lower their capital requirements and provide small- and mid-sized banks a means to stay competitive with the larger Basel II banks. The regulators are working to develop the standardized approach and are expected to release the draft text for public comment during 2008.

Pension Guarantees

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

PBGC monitors companies with underfunded plans and acts to protect the interests of the pension insur-

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

As a result of a flawed pension funding system and exposure to losses from financially troubled plan sponsors, PBGC's single-employer program incurred substantial losses from underfunded plan terminations in 2001 through 2006. The table below shows the ten largest plan termination losses in PBGC's history. Nine of the ten have come since 2001.

The program's deficit at 2007 year-end stood at \$13.1 billion, compared to a \$9.7 billion surplus at 2000 year-end. This is actually a \$5 billion improvement from 2006. PBGC's operating results are subject to significant fluctuation from year to year, depending on the severity of losses from plan terminations, changes in the interest factors used to discount future benefit payments, investment performance, general economic conditions and other factors such as changes in law. While the improvement may give the impression that PBGC's financial condition has improved, in fact its long-term loss exposure and flawed funding system continue to threaten its financial sustainability.⁴

⁴In addition, the airline relief provisions in the Pension Protection Act of 2006, which resulted in large plans previously classified as probable terminations being changed to the reasonably possible classification in 2006, likely postponed rather than eliminated losses, as it is likely that the airlines will eventually relapse and present a claim to the PBGC. If PBGC's deficit were calculated without regard to PPA airline provisions, PBGC estimates that its net deficit shown in this report would be approximately \$8 billion higher (assuming 2006 underfunding levels for the specific airline plans remained constant).

In February 2005 the Administration proposed comprehensive reforms to address structural flaws in the statutory plan funding requirements and in the design of the insurance program. The proposal sought to strengthen funding for workers' defined-benefit pensions; provide more accurate information about pension liabilities and plan underfunding; and enable PBGC to meet its obligations to participants in terminated pension plans. Many of the President's reforms were incorporated into the Deficit Reduction Act (DRA) of 2005, enacted in February 2006, and the Pension Protection Act of 2006 (PPA), enacted in August 2006. This legislation made significant structural changes to the retirement system, but did not fully address the long-term challenges facing PBGC. While the PBGC has sufficient liquidity to meet its obligations for a number of years, neither the single-employer nor multiemployer program has the resources to satisfy fully the agency's long-term obligations to plan participants.

Further reforms are needed to address the current \$14 billion gap between PBGC's liabilities and its assets. The Budget proposes to give PBGC's Board the authority to raise premiums to produce the revenue necessary to meet expected future claims and retire PBGC's deficit over ten years. The current rate-setting mechanism is inflexible and does not allow the PBGC to respond to changing conditions in the defined benefit plan universe, in the financial markets in which pension plans invest, or in its own financial condition.

Under this proposal, PBGC's Board would have the flexibility to make a broad range of changes to pre-

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

Top 10 Firms	Fiscal Years of Plan Terminations	Claims (by firm)	Percent of Total Claims (1975-2005)
1. United Airlines	2005	\$7,484,348,482	22.90%
2. Bethlehem Steel	2003	3,654,380,116	11.20%
3. US Airways	2003, 2005	2,690,222,805	8.20%
4. LTV Steel*	2002, 2003, 2004	2,136,698,831	6.50%
5. National Steel	2003	1,275,628,286	3.90%
6. Pan American Air	1991, 1992	841,082,434	2.60%
7. Weirton Steel	2004	690,181,783	2.10%
8. Trans World Airlines	2001	668,377,106	2.00%
9. Kaiser Aluminum	2004	600,009,879	1.80%
10. Kemper Insurance	2005	568,417,151	1.70%
Top 10 Total .....	.....	20,609,346,871	63.20%
All Other Total .....	.....	12,017,433,400	36.80%
TOTAL .....	.....	\$32,626,780,271	100.00%

Sources: PBGC Fiscal Year Closing File (9/30/07), PBGC Case Administration System, and PBGC Participant System (PRISM).

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

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

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

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

miums in an effort to improve PBGC's financial condition and safeguard the future benefits of American workers. The Administration is committed to restoring the solvency of the pension insurance system and avoiding a future taxpayer bailout.

Disaster Insurance

Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP), which is administered by the Federal Emergency Management Agency of the Department of Homeland Security (DHS). Flood insurance is available to homeowners and businesses in communities that have adopted and enforced appropriate flood plain management measures. Coverage is limited to buildings and their contents. By the end of 2007, the program had over 5.5 million policies in more than 20,200 communities with over \$1 trillion of insurance in force.

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

DHS is using three strategies to increase the number of flood insurance policies in force: lender compliance, program simplification, and expanded marketing. DHS is educating financial regulators about the mandatory flood insurance requirement for properties that are located in floodplains and have mortgages from federally regulated lenders. These strategies have resulted in policy growth of over 3 percent in 2007 with an increase of more than 180,000 policies.

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

for floodplain management, save over \$1 billion annually in avoided flood damages.

The program's reserve account, which is a cash fund, has sometimes had expenses greater than its revenue, forcing the NFIP to borrow funds from the Treasury in order to meet claims obligations. However, since the program began in 1968 and until 2005, the program has continued to repay all borrowed funds with interest. However, hurricanes Katrina, Rita, and Wilma generated more flood insurance claims than the cumulative number of claims from 1968 to 2004. These three storms resulted in over 234,000 claims with total claims payments expected to be approximately \$20 billion. As a result, the Administration and the Congress have increased the borrowing authority to \$20.8 billion to date in order to make certain that all claims could be paid.

The catastrophic nature of the 2005 hurricane season has also triggered an examination of the program, and the Administration is working with the Congress to improve the program, based on the following principles: protecting the NFIP's integrity by covering existing commitments; phasing out subsidized premiums in order to charge fair and actuarially sound premiums; increasing program participation incentives and improving enforcement of mandatory participation in the program; increasing risk awareness by educating property owners; and reducing future risks by implementing and enhancing mitigation measures. Although flood insurance reform was not achieved in 2007, the Administration looks forward to continuing to work with the Congress to enact program reforms that further mitigate the impact of flood damages and losses.

Crop Insurance

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

The 2009 Budget reflects the Administration's Farm Bill proposals, which include specific proposals for Crop Insurance. These include allowing farmers to purchase supplemental insurance that would cover their deductible in the event of a county-wide loss, reducing the expected loss ratio to 1.00 from 1.075, allowing the private insurance companies access to their data mining information, allow the Standard Reinsurance Agreement to be renegotiated once every 3 years, along with

a continuation of a series of crop insurance reforms that have been proposed in the past that will increase program participation and at the same time control program costs.

The 2009 Budget also includes language to open up authorized purposes under the mandatory R&D funds provided by Agriculture Risk Protection Act of 2000 (ARPA). Expansion of authorized uses will include data mining activities, the Common Information Management System (CIMS), and other IT cost related to reducing fraud waste and abuse and IT modernization.

In addition, the 2009 Budget includes a proposal to implement a participation fee in the Federal crop insurance program. The participation fee would be charged to insurance companies participating in the Federal crop insurance program; based on a rate of about one-third cent per dollar of premium sold, the fee is expected to be sufficient to generate about \$15 million annually beginning in 2010. The existing IT system is nearing the end of its useful life and recent years have seen increases in "down-time" resulting from system failures. New plans of insurance such as revenue and livestock insurance have greatly increased the size and complexity of the crop insurance program. These changes place a greater burden on the aging IT system resulting in increased IT maintenance costs and limit RMA's ability to comply with Congressional mandates pertaining to data reconciliation with the Farm Service Agency. The participation fee will help alleviate these problems.

There are various types of insurance programs. The most basic type of coverage is catastrophic coverage (CAT), which compensates the farmer for losses in excess of 50 percent of the individual's average yield at 55 percent of the expected market price. The CAT premium is entirely subsidized, and farmers pay only an administrative fee. Higher levels of coverage, called buy-up coverage, are also available. A premium is charged for buy-up coverage. The premium is determined by the level of coverage selected and varies from crop to crop and county to county. For the ten principal crops, which accounted for about 80 percent of total liability in 2007, the most recent data show that over 79 percent of eligible acres participated in the crop insurance program.

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

RMA is continuously trying to develop new products or expand existing products in order to cover more types of crops. Two new Group Risk Protection risk management tools for pasture, rangeland and forage (PRF) protection were approved for the 2007 crop year. These innovative pilot programs are based on vegetation greenness and rainfall indices and were developed to provide livestock producers the ability to purchase insurance protection for losses of forage produced for

grazing or harvested for hay. The pilots proved to be more popular than anticipated and both programs are being expanded to new areas for the 2008 crop year. Also new for the 2008 crop year is the Biotech Yield Endorsement (BYE) for non-irrigated corn. The BYE is being pilot tested in four states and will provide producers a premium rate reduction if they plant non-irrigated corn that is intended to be harvested for grain and has three specific biotech traits. The premium reduction is based on data showing that non-irrigated corn containing these specific traits has a lower risk of yield loss than non-traited corn. RMA continues to pursue a number of avenues to increase program participation among underserved States and commodities by working on declining yield issues and looking at discount programs for good experienced producers who pose less risk.

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

Insurance Against Security-Related Risks

Terrorism Risk Insurance

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act (TRIA) of 2002 (P.L. 107-297), which was intended to help stabilize the insurance industry during a time of significant transition that followed the terrorist attacks of September 11, 2001. The Act established a temporary, three-year Federal program that provided a system of shared public and private compensation for insured commercial property and casualty losses arising from acts of foreign terrorism (as defined by the Act). In 2005, Congress passed a two-year extension (P.L.109-144), that narrowed the Government's role by increasing private sector retentions, reducing lines of insurance covered by the program, and adding an event trigger amount for Federal payments. In December 2007, Congress passed a seven-year extension (P.L.110-318). The 2007 extension of TRIA added a requirement for commercial property and casualty insurance companies to offer insurance for losses from domestic as well as foreign acts of terrorism. The 2007 extension maintains for all seven extension years an insurer deductible of 20 percent of the prior year's direct earned premiums, an insurer co-payment of 15 percent of insured losses above the deductible, and a \$100 million event trigger amount for Federal payments. The 2007 extension changes mandatory recoupment provisions, requiring Treasury to collect 133 percent of the Federal payments made under the program, and accelerates time horizons for recoupment of any payments made before September 30, 2017.

The President's Working Group on Financial Markets (PWG) reported in September 2006 that the Terrorism Risk Insurance Program had achieved its goals of supporting the insurance industry post September 11, 2001. In terms of insurance availability, the PWG and successive industry analyses found record take-up rates

in 2006 of nearly 60 percent, compared with 27 percent in 2002. In addition, the PWG found significant improvements in affordability demonstrated by median terrorism insurance premiums falling from \$37,700 in 2005 to \$16,750 in 2006. These trends are also present in high risk commercial areas like New York City. Furthermore, the estimated \$450 billion in industry-wide surplus currently held by property and casualty insurers exceeds pre-September 2001 levels.

The Administration believes that TRIA should not be a permanent program, that private sector retentions under it should be increased, and that over time, the private market is the best provider of reinsurance. Over the coming year the Administration will examine possible changes to current law that could further develop the private terrorism reinsurance market.

The Budget, for the first time, includes the estimated Federal cost of providing terrorism risk insurance, reflecting the 2007 TRIA extension. The growth in the private insurance market for this coverage provides data in the form of insurance premiums that show how private insurers estimate the likelihood of attack and price their projected losses. Using this market driven data, the Government can project annual outlays and recoupment under TRIA. These estimates represent the weighted average of TRIA payments over a full range of scenarios, most of which include no terrorist attacks (and therefore no TRIA payments), and some of which include terrorist attacks of varying magnitudes. The Budget projections, however, are in no way an official forecast of future attacks.

On this basis, the Budget projects the 2007 TRIA extension will have a net deficit impact (spending less receipts from premium surcharges) of \$1.78 billion over the 2009–2013 period and \$3.85 billion over the 2009–2018 period.

Airline War Risk Insurance

After the September 11, 2001 attacks, private insurers cancelled third-party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In addition to a number of short term responses, the Congress also passed the Homeland Security Act of 2002 (P.L. 107–296). Among other provisions, this Act required the Secretary to provide additional war risk insurance coverage for hull losses and passenger liability to air carriers insured for third-party war risk liability as of June 19, 2002. The Department of Transportation Appropriations Act for 2008 (P.L. 110–161) further extended the requirement to provide insurance coverage through August 31, 2008. Acting on behalf of the Secretary, the FAA has made available insurance coverage for (i) hull losses at agreed value; (ii) death, injury, or property loss liability to passengers or crew, the limit being the same as that of the air

carrier's commercial coverage before September 11, 2001; and (iii) third party liability, the limit generally being twice that of such coverage. The Secretary is also authorized to limit an air carrier's third party liability to \$100 million, when the Secretary certifies that the loss is from an act of terrorism.

This program provides airlines with financial protection from war risk occurrences, and thus allows airlines to meet the basic requirement for adequate hull loss and liability coverage found in most aircraft mortgage covenants, leases and in government regulation. Without such coverage, many airlines might be grounded. Currently, aviation war risk insurance coverage is generally available from private insurers, but premiums are significantly higher in the private market. Also, private insurance coverage for occurrences involving weapons of mass destruction is more limited.

Currently 75 air carriers are insured by Department of Transportation. Coverage for individual carriers ranges from \$80 million to \$4 billion per carrier, with the median insurance coverage at approximately \$1.8 billion per occurrence. Premiums collected by the Government for these policies are deposited into the Aviation Insurance Revolving Fund. In 2007, the Fund earned approximately \$170 million in premiums for insurance provided by DOT, and it is anticipated that an additional \$157 million in premiums will be earned in 2008. At the end of 2007, the balance in the Aviation Insurance Revolving Fund available for payment of future claims was \$951 million. Although no claims have been paid by the Fund since 2001, the balance in the Fund would be inadequate to meet either the coverage limits of the largest policies in force (\$4 billion) or to meet a series of large claims in succession. The Federal Government would pay any claims by the airlines that exceed the balance in the Aviation Insurance Revolving Fund.

Aviation insurance program authority expires on March 30, 2008. The Administration does not support a straight extension of this program and instead favors a return to private sector mechanisms for managing risk. As part of the Federal Aviation Administration (FAA) reauthorization, the Administration has proposed reforms that would gradually transition airlines from government provided insurance to privately provided insurance. Current law caps the premium rates that FAA may charge. Continuation of insurance coverage, if any, should allow FAA to set deductible levels as the first step in moving airlines to the private insurance market and reducing the indirect subsidy that the government currently provides. The Administration is committed to working with the Congress to reform this program, and to ensure that air carriers more equitably share in the risks associated with this program.

Chart 7-4. Face Value of Federal Credit Outstanding

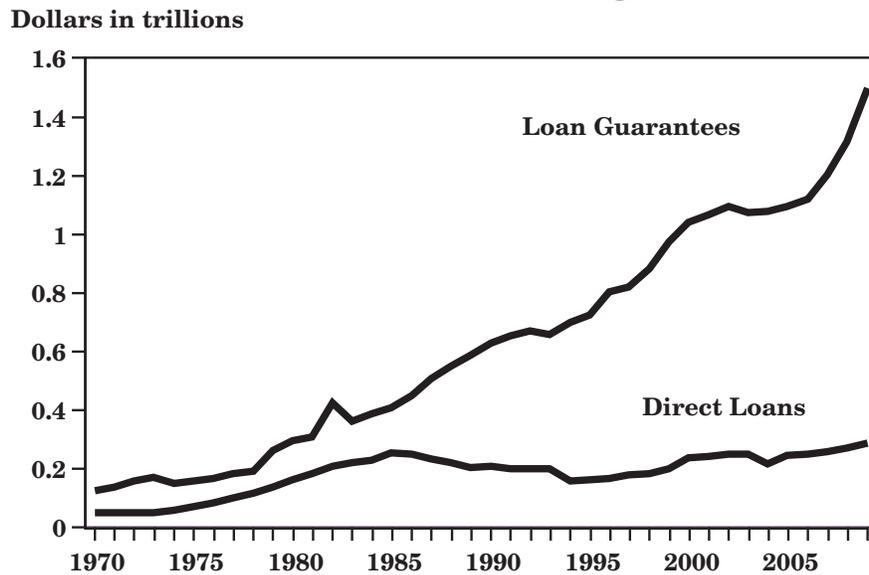


Table 7-1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(In billions of dollars)

Program	Outstanding 2006	Estimated Future Costs of 2006 Outstanding ¹	Outstanding 2007	Estimated Future Costs of 2007 Outstanding ¹
Direct Loans:²				
Federal Student Loans	116	16	124	15
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	43	10	44	10
Rural Utilities Service and Rural Telephone Bank	38	2	40	1
Housing and Urban Development	11	3	10	3
P.L. 480	8	4	8	4
Disaster Assistance	7	2	10	2
Export-Import Bank	7	2	6	2
Agency for International Development	7	3	6	2
Commodity Credit Corporation	2	1	1	.....
VA Mortgage	1	.....	1	-1
Other Direct Loan Programs	12	4	11	5
Total Direct Loans	251	47	260	44
Guaranteed Loans:²				
Federal Student Loans	325	52	363	51
FHA-Mutual Mortgage Insurance Fund	317	3	322	7
VA Mortgage	211	3	232	4
FHA-General and Special Risk Insurance Fund	98	1	108	.....
Small Business ³	67	2	72	2
Export-Import Bank	36	2	39	1
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	31	.....	32	.....
International Assistance	22	2	22	2
Commodity Credit Corporation	3	.....	3	.....
Maritime Administration	3	.....	3	.....

Table 7-1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS—Continued

(In billions of dollars)

Program	Outstanding 2006	Estimated Future Costs of 2006 Outstanding ¹	Outstanding 2007	Estimated Future Costs of 2007 Outstanding ¹
Government National Mortgage Association (GNMA) ³ .....	.....	*	.....	*
Other Guaranteed Loan Programs	7	1	6	2
Total Guaranteed Loans	1,120	66	1,202	69
Total Federal Credit	1,371	113	1,461	113

* Less than \$500 million.

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

Table 7-2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992-2007¹—Continued

(Budget authority and outlays, in millions of dollars)

Program	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Rural Housing Insurance Fund	-10	.....	109	.....	152	-56	32	50	66	44	.....	-19
Rural Community Advancement Program ²	-10	.....	41	.....	63	17	91	15	29	-64	-16	-10
Renewable Energy .....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	*	*
Commerce:												
Fisheries Finance .....	.....	-2	.....	.....	-3	-1	3	*	1	*	1	*
Emergency Steel Guaranteed Loans .....	.....	.....	.....	.....	.....	.....	50	*	3	-75	-13	1
Emergency Oil and Gas Guaranteed Loans .....	.....	.....	.....	.....	*	*	*	*	*	-1	*	*
Defense:												
Military Housing Improvement Fund .....	.....	.....	.....	.....	.....	.....	.....	-3	-1	-3	-5	-1
Defense Export Loan Guarantee .....	.....	.....	.....	.....	.....	.....	.....	.....	-5	.....	.....	.....
Arms Initiative Guaranteed Loan Program .....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	20
Education:												
Federal Family Education Loan Program: ³												
Volume Reestimate	99	.....	-13	-60	-42	.....	277	.....	.....	.....	.....	.....
Other Technical Reestimate .....	.....	.....	-140	667	-3,484	.....	-2,483	-3,278	1,348	6,837	-3,399	-189
Health and Human Services:												
Health Center Loan Guarantees .....	.....	.....	.....	3	.....	*	*	.....	1	*	*	-1
Health Education Assistance Loans .....	.....	.....	.....	.....	.....	.....	-5	-37	-33	-18	-20	*
Housing and Urban Development:												
Indian Housing Loan Guarantee .....	.....	.....	.....	.....	-6	*	-1	*	-3	-1	*	-5
Title VI Indian Guarantees .....	.....	.....	.....	.....	.....	.....	-1	1	4	*	-4	-3
Community Development Loan Guarantees .....	.....	.....	.....	.....	.....	.....	.....	19	-10	-2	4	1
FHA-Mutual Mortgage Insurance	-340	.....	3,789	2,413	-1,308	1,100	5,947	1,979	2,842	636	3,923	3,923
FHA-General and Special Risk	-25	743	79	.....	-217	-403	77	352	507	238	-1,254	-362
Interior:												
Bureau of Indian Affairs Guaranteed Loans	31	.....	.....	.....	-14	-1	-2	-2	*	15	5	-30
Transportation:												
Maritime Guaranteed Loans (Title XI) .....	.....	.....	-71	30	-15	187	27	-16	4	-76	-11	-51
Minority Business Resource Center .....	.....	.....	.....	.....	.....	1	.....	*	*	.....	*	*
Treasury:												
Air Transportation Stabilization Program .....	.....	.....	.....	.....	.....	.....	113	-199	292	-109	-95	.....
Veterans Affairs:												
Veterans Housing Benefit Fund Program	-706	38	492	229	-770	-163	-184	-1,515	-462	-842	-525	183
International Assistance Programs:												
U.S. Agency for International Development:												
Development Credit Authority .....	.....	.....	.....	.....	.....	-1	.....	1	-3	-2	2	11
Micro and Small Enterprise Development .....	.....	.....	.....	.....	.....	.....	.....	2	-2	.....	-3	*
Urban and Environmental Credit .....	.....	-14	.....	.....	.....	-4	-15	48	-2	-5	-11	-22
Assistance to the New Independent States of the Former Soviet Union .....	.....	.....	.....	.....	.....	-34	.....	.....	.....	.....	.....	.....
Loan Guarantees to Israel .....	.....	.....	.....	.....	.....	.....	.....	-76	-111	188	34	-16
Loan Guarantees to Egypt .....	.....	.....	.....	.....	.....	.....	.....	.....	.....	7	14	-12
Overseas Private Investment Corporation:												
OPIC Guaranteed Loans .....	.....	.....	.....	.....	.....	5	77	60	-212	-21	-149	-268
Small Business Administration:												
Business Loans	-16	-279	-545	-235	-528	-226	304	1,750	1,034	-390	-268	-140
Other Independent Agencies:												
Export-Import Bank Guarantees .....	.....	.....	.....	-191	-1,520	-417	-2,042	-1,133	-655	-1,164	-579	-174
Total	-832	5,642	4,518	-3,357	-6,427	-1,854	-142	3,468	6,008	9,003	-3,441	2,161

* Less than \$500,000.

¹Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.²Includes Rural Water and Waste Disposal, Rural Community Facilities, and Rural Business and Industry programs.³Volume reestimates in mandatory programs represent a change in volume of loans disbursed in the prior years.

Table 7-3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2007-2009

(In millions of dollars)

Agency and Program	2007 Actual			2008 Enacted			2009 Proposed		
	Subsidy rate ¹	Subsidy budget authority	Loan levels	Subsidy rate ¹	Subsidy budget authority	Loan levels	Subsidy rate ¹	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural Credit Insurance Fund Program Account	9.32	92	985	9.28	88	948	9.37	88	944
Farm Storage Facility Loans Program Account	0.38	1	174	1.01	2	153	6.11	9	153
Rural Community Advancement Program ²	9.09	132	1,451						
Rural Electrification and Telecommunications Loans Program Account	-0.67	-29	4,267	-0.57	-41	7,284	-2.05	-98	4,790
Distance Learning, Telemedicine, and Broadband Program	1.98	5	283	2.15	12	523	3.90	12	298
Rural Water and Waste Disposal Program Account				6.81	70	1,025	3.77	48	1,269
Rural Community Facilities Program Account				5.55	22	404	5.72	17	302
Rural Housing Assistance Grants	47.82	1	2						
Farm Labor Program Account	47.95	16	33	43.26	13	31			
Multifamily Housing Revitalization Program Account				46.39	6	14			
Rural Housing Insurance Fund Program Account	13.42	181	1,354	11.85	156	1,313	12.93	6	38
Rural Development Loan Fund Program Account	44.07	15	34	42.89	14	34	41.85	14	34
Rural Economic Development Loans Program Account	21.84	6	26	22.59	7	33			
Commerce:									
Fisheries Finance Program Account	-8.02	-4	48	-3.72	-4	90	-12.78	-1	8
Defense—Military:									
Defense Family Housing Improvement Fund	14.57	59	406	23.86	109	457	43.50	47	107
Education:									
College Housing and Academic Facilities Loans Program Account	65.22	304	467				16.31	10	61
TEACH Grant Program Account				13.03	7	57	13.05	14	105
Loans for Short-Term Training Program Account							-0.27		46
Federal Direct Student Loan Program Program Account	1.37	258	18,850	0.76	169	19,891	1.13	250	21,048
Homeland Security:									
Disaster Assistance Direct Loan Program Account				1.73		25	1.04		25
Housing and Urban Development:									
FHA-Mutual Mortgage Insurance Program Account			3			50			50
State:									
Repatriation Loans Program Account	60.14	1	1	60.22	1	1	59.77	1	1
Transportation:									
Federal-aid Highways	3.92	30	766	10.00	232	2,320	10.00	100	998
Railroad Rehabilitation and Improvement Program			103			600			600
Treasury:									
Community Development Financial Institutions Fund Program Account	37.47		1	37.52	3	8	37.88	1	2
Veterans Affairs:									
Housing Program Account	5.08	6	122	0.55	2	337	-0.16		328
Native American Veteran Housing Loan Program Account	-13.46	-1	8	-14.48	-2	12	-10.07	-1	13
General Operating Expenses	2.00		3	2.16		3	1.93		3
International Assistance Programs:									
Debt Restructuring		31			107			34	
Overseas Private Investment Corporation Program Account	4.42	13	291	3.22	11	342	2.34	11	450
Small Business Administration:									
Disaster Loans Program Account	17.73	267	1,506	16.27	156	959	14.92	158	1,061
Business Loans Program Account	10.21	2	19	10.12	2	20			25
Export-Import Bank of the United States:									
Export-Import Bank Loans Program Account				33.01	17	50	33.01	17	50
Total	N/A	1,386	31,203	N/A	1,159	36,984	N/A	737	32,809

¹ Additional information on credit subsidy rates is contained in the Federal Credit Supplement.² 2007 data include Rural Water and Waste Disposal and Rural Community Facilities loan programs.

N/A = Not applicable.

Table 7-4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2007-2009

(In millions of dollars)

Agency and Program	2007 Actual			2008 Enacted			2009 Proposed		
	Subsidy rate ¹	Subsidy budget authority	Loan levels	Subsidy rate ¹	Subsidy budget authority	Loan levels	Subsidy rate ¹	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural Credit Insurance Fund Program Account	2.58	56	2,155	2.58	67	2,607	2.61	65	2,497
Commodity Credit Corporation Export Loans Program Account	2.92	39	1,334	2.33	53	2,274	0.96	26	2,675
Rural Community Advancement Program ²	4.09	45	1,090						
Rural Water and Waste Disposal Program Account				-0.82	-1	75	-0.82	-1	75
Rural Community Facilities Program Account				3.68	8	210	3.08	6	210
Rural Housing Insurance Fund Program Account	1.37	51	3,754	1.37	84	6,141	0.30	16	5,149
Rural Business Program Account				4.33	63	1,463	4.35	30	700
Renewable Energy Program Account	6.49	4	57	9.69	18	184			
Education:									
Loans for Short-Term Training Program Account							1.02	3	316
Federal Family Education Loan Program Account	6.29	6,850	108,873	1.07	1,077	100,559	2.21	2,407	109,117
Energy:									
Title 17 Innovative Technology Loan Guarantee Program					90	600			2,220
Health and Human Services:									
Health Resources and Services	3.42	1	28	3.41		8			
Housing and Urban Development:									
Indian Housing Loan Guarantee Fund Program Account	2.35	5	235	2.42	9	367	2.52	11	420
Native Hawaiian Housing Loan Guarantee Fund Program Account	2.35	1	43	2.42	1	41	2.52	1	41
Native American Housing Block Grant	11.99	1	12	12.12	2	17	12.34	2	17
Community Development Loan Guarantees Program Account	2.17	4	201	2.25	5	200			
FHA-Mutual Mortgage Insurance Program Account	-0.37	-209	56,519	-0.51	-368	72,172	-0.49	-749	151,280
FHA-General and Special Risk Program Account	-2.46	-813	32,927	-1.76	-693	39,346	-2.20	-143	6,530
Interior:									
Indian Guaranteed Loan Program Account	6.45	6	87	6.53	6	86	7.73	7	85
Transportation:									
Minority Business Resource Center Program	1.82		3	2.03		18	1.86		18
Federal-aid Highways				10.00	20	200	10.00	20	200
Railroad Rehabilitation and Improvement Program						100			100
Maritime Guaranteed Loan (Title XI) Program Account				4.35	5	115			
Veterans Affairs:									
Housing Program Account	-0.36	-87	24,186	-0.34	-120	35,197	-0.66	-236	35,817
International Assistance Programs:									
Loan Guarantees to Israel Program Account						700			700
Development Credit Authority Program Account	1.99	7	350	6.00	21	348	3.05	15	475
Overseas Private Investment Corporation Program Account	-0.59	-8	1,333	-1.75	-23	1,338	-0.84	-11	1,400
Small Business Administration:									
Business Loans Program Account			20,506			28,000	-0.01	-5	28,000
Export-Import Bank of the United States:									
Export-Import Bank Loans Program Account	-0.15	-18	12,569	-1.74	-238	13,710	-1.79	-248	13,807
Total	N/A	5,935	266,262	N/A	86	306,076	N/A	1,216	361,849
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENTS									
GNMA:									
Guarantees of Mortgage-backed Securities Loan Guarantee Program Account	-0.21	-193	85,071	-0.21	-163	77,400	-0.21	-163	77,400
SBA:									
Secondary Market Guarantee Program			3,678			12,000			12,000
Total, secondary guaranteed loan commitments	N/A	-193	88,749	N/A	-163	89,400	N/A	-163	89,400

¹ Additional information on credit subsidy rates is contained in the Federal Credit Supplement.² 2007 data include Rural Water and Waste Disposal, Rural Community Facilities, and Rural Business and Industry loan guarantee programs.

N/A = Not applicable.

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

(In billions of dollars)

	Actual								Estimate	
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Direct Loans:										
Obligations	37.1	39.1	43.7	45.4	42.0	56.3	57.8	42.5	44.7	39.9
Disbursements	35.5	37.1	39.6	39.7	38.7	50.6	46.6	41.7	42.1	40.5
New subsidy budget authority	-0.4	0.3	*	0.7	0.4	2.1	4.7	1.7	5.3	0.7
Reestimated subsidy budget authority ¹	-4.4	-1.8	0.5	2.9	2.6	3.8	3.1	3.4	-0.6	.....
Total subsidy budget authority	-4.8	-1.5	0.5	3.5	3.0	6.0	7.8	5.1	4.7	0.7
Loan Guarantees:										
Commitments ²	192.6	256.4	303.7	345.9	300.6	248.5	280.7	266.5	306.1	361.9
Lender disbursements ²	180.8	212.9	271.4	331.3	279.9	221.6	256.0	251.2	270.3	340.6
New subsidy budget authority	3.6	2.3	2.9	3.8	7.3	10.1	17.2	5.7	-2.6	1.1
Reestimated subsidy budget authority ¹	0.3	-7.1	-2.4	-3.5	2.0	3.5	7.0	-6.8	3.6	.....
Total subsidy budget authority	3.9	-4.8	0.5	0.3	9.3	13.6	24.2	-1.1	1.0	1.1

* Less than \$50 million.

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

Table 7-6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of out-standing loans ¹		
	2007 Actual	2008 Estimate	2009 Estimate	2007 Actual	2008 Estimate	2009 Estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural Credit Insurance Fund	98	70	70	1.55	1.13	1.15
Rural Community Facility	1	.....	.....	0.05	.....	.....
Rural Electrification and Telecommunications Loans	1	.....	.....	0.00	.....	.....
Rural Business Investment Program	14	4	4	22.95	8.51	10.26
Rural Housing Insurance Fund	168	97	100	0.68	0.40	0.42
Rural Development Loan Fund	1	1	1	0.06	0.06	0.07
Commerce:						
Economic Development Revolving Fund	1	.....	.....	16.67	.....	.....
Education:						
Student Financial Assistance	14	13	13	4.40	4.21	4.33
Perkins Loan Assets .....	.....	.....	54	.....	.....	1.46
Housing and Urban Development:						
Revolving Fund (Liquidating Programs)	1	1	1	16.67	25.00	50.00
Guarantees of Mortgage-backed Securities	1	12	13	12.50	85.71	56.52
Interior:						
Revolving Fund for Loans	3	1	1	21.43	10.00	12.50
Treasury:						
Community Development Financial Institutions Fund	1	.....	.....	1.54	.....	.....
Veterans Affairs:						
Veterans Housing Benefit Program	40	78	49	4.72	10.68	6.51
International Assistance Programs:						
Debt Restructuring .....	.....	29	.....	.....	12.89	.....
Overseas Private Investment Corporation	2	15	15	0.26	1.73	1.48
Small Business Administration:						
Disaster Loans	107	136	157	1.34	1.51	1.81
Business Loans	7	5	4	4.05	3.27	2.96
Other Independent Agencies:						
Debt Reduction (Export-Import Bank)	7	65	.....	2.33	24.62	.....
Export-Import Bank	16	10	10	0.28	0.26	0.32
Spectrum Auction Program	1	172	111	0.25	59.11	74.00
Tennessee Valley Authority Fund	1	1	1	1.89	1.79	1.67
Total, direct loan writeoffs	485	710	604	0.21	0.30	0.25
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural Credit Insurance Fund	8	48	48	0.08	0.46	0.42
Commodity Credit Corporation Export Loans	16	26	17	0.50	0.67	0.35
Rural Business and Industry Loans	95	112	132	2.52	2.98	3.35
Rural Community Facility Loans	4	4	4	0.66	0.54	0.45
Rural Housing Insurance Fund	239	271	312	1.46	1.46	1.49
Defense—Military:						
Procurement of Ammunition, Army	15	.....	.....	125.00	.....	.....
Family Housing Improvement Fund .....	.....	7	7	.....	1.43	1.46
Education:						
Loans for Short-Term Training .....	.....	.....	3	.....	.....	3.85
Federal Family Education Loans	7,416	7,004	7,924	2.16	1.83	1.88
Energy:						
Title 17 Innovative Technology Guarantees .....	.....	1	3	.....	0.67	0.39
Health and Human Services:						
Health Education Assistance Loans	18	19	19	1.44	1.78	2.04
Health Center Loan Guarantees .....	.....	1	.....	.....	1.64	.....
Housing and Urban Development:						
Indian Housing Loan Guarantee	1	1	1	0.21	0.13	0.09
Native American Housing Block Grant .....	.....	2	2	.....	2.15	1.98
FHA-Mutual Mortgage Insurance	5,152	8,476	10,290	1.61	2.52	2.56
FHA-General and Special Risk Insurance	1,009	1,737	2,176	0.98	1.56	1.89

Table 7-6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of out-standing loans ¹		
	2007 Actual	2008 Estimate	2009 Estimate	2007 Actual	2008 Estimate	2009 Estimate
Interior:						
Indian Guaranteed Loans	2	2	3	0.60	0.56	0.84
Veterans Affairs:						
Veterans Housing Benefit Program	855	1,881	1,806	0.39	0.77	0.66
International Assistance Programs:						
Micro and Small Enterprise Development	1	1	1	14.29	25.00	50.00
Urban and Environmental Credit Program	3	5	5	1.53	1.15	1.32
Housing and Other Credit Guaranty Programs	15	7	12	14.29	25.00	50.00
Development Credit Authority	3	2	2	1.31	0.66	0.51
Overseas Private Investment Corporation	172	100	150	4.01	2.08	2.79
Small Business Administration:						
Business Loans	1,083	1,254	1,620	1.56	1.70	2.04
Other Independent Agencies:						
Export-Import Bank	237	225	225	0.64	0.57	0.54
Total, guaranteed loan terminations for default	16,344	21,186	24,762	1.03	1.25	1.33
Total, direct loan writeoffs and guaranteed loan terminations	16,829	21,896	25,366	0.93	1.14	1.20
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural Credit Insurance Fund	5	7	7	9.80	11.67	10.94
Education:						
Federal Family Education Loan	1,091	1,228	1,308	5.38	5.71	6.05
Housing and Urban Development:						
FHA-Mutual Mortgage Insurance		20	4		0.74	0.16
FHA-General and Special Risk Insurance	299	27	22	8.42	0.66	0.41
Interior:						
Indian Guaranteed Loans	6	2		60.00	33.33	
International Assistance Programs:						
Overseas Private Investment Corporation	22	13	20	18.97	12.15	11.76
Small Business Administration:						
Business loans	546	279	279	13.75	6.88	6.66
Total, writeoffs of loans receivable	1,969	1,576	1,640	6.30	4.86	4.83

¹ Average of loans outstanding for the year.

Table 7-7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS ¹

(In millions of dollars)

Agency and Program	2007 Actual	2008 Actual	2009 Estimate
DIRECT LOAN OBLIGATIONS			
Agriculture:			
Agricultural Credit Insurance Fund Direct Loan Financing Account	910	899	944
Commerce:			
Fisheries Finance Direct Loan Financing Account	48	90	8
Education:			
Historically Black College and University Capital Financing Direct Loan Financing Account	216		100
Loans for Short-Term Training Direct Loan Financing Account			46
Homeland Security:			
Disaster Assistance Direct Loan Financing Account	25	25	25
Housing and Urban Development:			
FHA-General and Special Risk Direct Loan Financing Account	50	50	50
FHA-Mutual Mortgage Insurance Direct Loan Financing Account	50	50	50
State:			
Repatriation Loans Financing Account	1	1	1
Transportation:			
Railroad Rehabilitation and Improvement Direct Loan Financing Account			600
Treasury:			
Community Development Financial Institutions Fund Direct Loan Financing Account	8	16	6
Veterans Affairs:			
Vocational Rehabilitation Direct Loan Financing Account	2	3	3
Small Business Administration:			
Business Direct Loan Financing Account	19	20	25
Total, limitations on direct loan obligations	1,329	1,154	1,858
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural Credit Insurance Fund Guaranteed Loan Financing Account	2,153	2,526	2,497
Education:			
Loans for Short-Term Training Guaranteed Loan Financing Account			316
Energy:			
Title 17 Innovative Technology Guaranteed Loan Financing Account	4,000		38,500
Housing and Urban Development:			
Indian Housing Loan Guarantee Fund Financing Account	251	367	350
Title VI Indian Federal Guarantees Financing Account	18	12	17
Native Hawaiian Housing Loan Guarantee Fund Financing Account	36	41	
Community Development Loan Guarantees Financing Account	131	200	
FHA-General and Special Risk Guaranteed Loan Financing Account	45,000	45,000	35,000
FHA-Mutual Mortgage Insurance Guaranteed Loan Financing Account	185,000	185,000	185,000
Interior:			
Indian Guaranteed Loan Financing Account	87	86	85
Transportation:			
Minority Business Resource Center Guaranteed Loan Financing Account	18	18	18
RRIF Guaranteed Loan Financing Account			100
International Assistance Programs:			
Development Credit Authority Guaranteed Loan Financing Account	700	700	700
Small Business Administration:			
Business Guaranteed Loan Financing Account	20,506	28,000	28,000
Total, limitations on loan guarantee commitments	257,900	261,950	290,583
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS			
Housing and Urban Development:			
Guarantees of Mortgage-backed Securities Financing Account	200,000	200,000	200,000
Small Business Administration:			
Secondary Market Guarantees	12,000	12,000	12,000
Total, limitations on secondary guaranteed loan commitments	212,000	212,000	212,000

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

Table 7-8. FACE VALUE OF GOVERNMENT-SPONSORED LENDING¹
(In billions of dollars)

	Outstanding	
	2006	2007
Government Sponsored Enterprises		
Fannie Mae ²	2,528	N/A
Freddie Mac ³	1,543	N/A
Federal Home Loan Banks	621	824
Farm Credit System	105	111
Total	4,797	N/A

N/A = Not available.

¹ Net of purchases of federally guaranteed loans.

² 2007 financial data for Fannie Mae are not presented here because Fannie Mae audited financial results for 2007 have not been released.

³ 2007 financial data for Freddie Mac are not presented here because Freddie Mac audited financial results for 2007 have not been released.

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

(In millions of dollars)

Enterprise	2007
LENDING	
Federal National Mortgage Association: ²	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: ³	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	1,712
Outstandings	30,475
Farm credit banks:	
Net change	4,764
Outstandings	80,949
Federal Agricultural Mortgage Corporation:	
Net change	1,303
Outstandings	8,362
Federal Home Loan Banks: ⁴	
Net change	173,108
Outstandings	916,963
Less guaranteed loans purchased by:	
Federal National Mortgage Association: ²	
Net change	N/A
Outstandings	N/A
Other:	
Net change	N/A
Outstandings	N/A
BORROWING	
Federal National Mortgage Association: ²	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: ³	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	1,889
Outstandings	34,736
Farm credit banks:	
Net change	5,828
Outstandings	100,204
Federal Agricultural Mortgage Corporation:	
Net change	490
Outstandings	5,044
Federal Home Loan Banks: ⁴	
Net change	192,621
Outstandings	1,136,660

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

(In millions of dollars)

Enterprise	2007
DEDUCTIONS ⁵	
Less borrowing from other GSEs:	
Net change	N/A
Outstandings	N/A
Less purchase of Federal debt securities:	
Net change	N/A
Outstandings	N/A
Federal National Mortgage Association:	
Net change	N/A
Outstandings	N/A
Other:	
Net change	N/A
Outstandings	N/A

N/A = Not available.

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

² Financial data for Fannie Mae are not presented here because audited financial results for 2007 have not been released.

³ Financial data for Freddie Mac are not presented here because audited financial statements for 2007 have not been released.

⁴ The net change in borrowings is derived from the difference in borrowings between 2007 and the Federal Home Loan Banks' audited financial statements of 2006.

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