



Federal Accounting Standards Advisory Board

**OCTOBER 12, 2017**

Memorandum

To: Members of the Board

*Robin M. Gilliam*

From: Robin M. Gilliam, Assistant Director

*Wendy M. Payne*

Through: Wendy M. Payne, Executive Director

Subject: **Review Gap Analysis Findings for Direct Loans and Loan Guarantees  
Risk Reporting and Recommendations<sup>1</sup> – Tab G**

**MEMBER ACTION REQUESTED**

Provide staff with feedback and answers  
to the questions by **October 20, 2017**

**MEETING OBJECTIVES**

The objective of this meeting is to review gap analysis findings for credit reform and determine next steps.

**BRIEFING MATERIAL:**

The briefing material includes this memorandum and the following attachment and appendices:

**Attachment 1:** Draft Principles-Based Broad Risk Categories

**Appendix A:** Risk Assumed – Phase II: Project History and Milestones

**Appendix B:** Department of Education (Education) Meeting Notes and Agency Financial Report (AFR) Direct Loans/Loan Guarantees Disclosure Note

**Appendix C:** Department of Housing and Urban Development (HUD) Meeting Notes and AFR Direct Loans/Loan Guarantees Disclosure Note

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<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

- Appendix D:** Small Business Administration (SBA) Meeting Notes and AFR Direct Loans/Loan Guarantees Disclosure Note
- Appendix E:** Government Accountability Office (Office) Meeting Notes

## **BACKGROUND:**

At the June 22nd Board meeting, members discussed focus group feedback to determine which suggestions should be included in risk assumed reporting.

### Members do **not** want to include

- discussions that predict unforeseen catastrophes and their potential financial impact;
- trends for using emergency funding as an indicator of fiscal exposure to risk shocks;
- comparisons of estimates to actuals; or
- management of past risk events.

### Members do want to

- include past events that affect the current financial position; and
- include and define major risk events with a relationship to long-term sustainability that are not already reported.

Members also reviewed the USAFacts 10-K risk section—Item 1A Risk Factors—to determine if it was an appropriate model for reporting risk assumed in the federal financial report. Members did not favor a separate risk section.

The Board also wanted meaningful, streamlined information presented as a broad analysis, rather than specific details within already existing disclosures. Members agreed to continue using the risk exposure categories as a foundation for the ongoing gap analysis.

## Staff Analysis and Recommendations:

At the December 20, 2016, meeting staff presented the Board with a list of risk events to include in risk assumed reporting. While the Board did not approve the “laundry list” format, they did approve further development of principles-based broad risk categories [See Attachment 1] as a framework for the risk assumed gap analysis. [Note: The information is provided here for reference only. Staff plans to present draft categories at a future Board meeting for approval.]

Staff decided to begin the gap analysis with a review of direct loans and loan guarantees within the Financial Guarantees category.

Attachment 1: Draft Principles-Based Broad Risk Categories, *Financial Guarantees Category*

Principles Based  Broad Risk Categories	Risk Exposure Types  Such as, but not limited to:	Draft Definition - Description
<b>Financial Guarantees</b>	Financial Sector Exposure – Regulations	The risk that a significant event will cause the federal government to pay required or non-required financial guarantees to stabilize the economy [ <i>state in a way that includes bailouts including guarantees not required by the full backing of the US government</i> ]
	Default on Loan Guarantees and Direct Loans	
	Change in interest rate	
	Pay out of Unfunded civilian and military pensions	
	Significant defaults on obligations to the U.S. government	
	Financial condition of state and local governments	

Staff believes that because reporting the risk of subsidizing direct loan and loan guarantee defaults is already established by the federal credit reform act (FCRA), Statement of Federal Financial Accounting Standards (SFFAS) 2: *Accounting for Direct Loans and Loan Guarantees*, and the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, that review, analysis, and amendments to SFFAS 2 can form the baseline for risk assumed standards.

Staff based their analysis on interviews with Education, HUD, SBA (referred to as “agencies”), a review of each agency’s 2016 AFR – Direct Loans/Loan Guarantees disclosures [See Appendices B – E for the full meeting notes & note disclosures], and a discussion with GAO. Below is a summary of each agency’s programs and products.

**Education** provides student loans through a variety of programs, the largest being the William D. Ford Federal Direct Loan program. Education’s products provide various ways for students to manage and pay back loans which are vulnerable to inherent risks, such as legislative, regulatory, and policy risk, as stated below.

#### **Legislative, Regulatory, and Policy Risk**

There are inherent risks from the possibility that the cost structure of the Direct Loan program may be altered through legislative, regulatory, or administrative action. In addition, even recent legislative, regulatory, and policy action may be difficult to interpret with regard to effects on financial modeling and estimation, given the lack of actual trend data availability. Some examples of current risks include the following:

***Income-Driven Repayment Plans:*** Several new income-driven repayment plans have been introduced in recent years, including Income-Based Repayment, PAYE, and Revised Pay As You Earn. In general, the proliferation of plans has made income-driven repayment terms more generous and made the plans available to a greater number of borrowers. The Department has also engaged in an outreach campaign to broaden borrower awareness of these plans. These trends have affected recent cost re-estimation significantly through changing the absolute cost of the plans as well as increasing participation in the plans.

***Public Service Loan Forgiveness:*** Enacted in 2007, the Public Service Loan Forgiveness (PSLF) program allows a Direct student loan borrower to have the balance of their Direct student loans forgiven after having made 120 qualifying monthly payments under a qualifying repayment plan, while working full time for a qualifying public service employer (such as government or not-for-profit organization). There is still uncertainty as to how many borrowers will take advantage of the program. Much of this uncertainty arises because borrowers do not need to apply for the program until after having made the 120 qualifying monthly payments.

**Source:** Education, Agency Financial Report (AFR), *Management’s Discussion and Analysis* (MD&A), page 17

**HUD** provides direct loans and loan guarantees through the Federal Housing Administration (FHA) for areas such as, single family homes, multifamily housing, and healthcare facilities, as stated below.

FHA encourages homeownership through its Single Family Forward programs (Section 203(b), which is the largest program, and Section 234) by making loans readily available with its mortgage insurance programs. These programs insure mortgage lenders against losses from default, enabling those lenders to provide mortgage financing on favorable terms to homebuyers. Multifamily Housing Programs (Section 213, Section 221(d)(4), Section 207/223(f), and Section 223(a)(7)) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, and cooperatives. Healthcare programs (Section 232 and Section 242) enable low cost financing of health care facility projects and improve access to quality healthcare by reducing the cost of capital.

The FHA also insures Home Equity Conversion Mortgages (HECM), also known as reverse mortgages. These loans are used by senior homeowners age 62 and older to convert the equity in their home into monthly streams of income and/or a line of credit to be repaid when they no longer occupy the home. Unlike ordinary home equity loans, a HUD reverse mortgage does not require repayment as long as the home is the borrower's principal residence.

The FHA also administers the HOPE for Homeowners (H4H) program. The program was established by Congress to help those at risk of default and foreclosure refinance into more affordable, sustainable loans.

**Source:** HUD, AFR, Note 8, *Direct Loans and Loan Guarantees, Non-Federal Borrowers*, page 72

**SBA** provides “guaranties that help small businesses obtain bank loans and licensed companies to make investments for qualifying businesses. The SBA also makes loans to microloan intermediaries and provides a direct loan program that assists homeowners, renters, and businesses to recover from disasters.”

#### MAJOR DIRECT LOAN AND LOAN GUARANTY PROGRAMS

Program group	Program type	Program
Disaster	Direct	Disaster Assistance Loans
Business	Guarantied	7(a) Loan Guaranty
Business	Guarantied	504 Certified Development Company
Business	Guarantied	Small Business Investment Company Debentures
Business	Direct	7(m) Microloan

SBA's Disaster Assistance Loan program makes direct loans to disaster victims under four categories: (1) loans for homes and personal property; (2) physical disaster loans to businesses of any size; (3) economic injury loans to small businesses without credit available elsewhere; and (4) economic injury loans to eligible businesses affected by essential employees called up to active duty in the military reserves. The maximum interest rate is 4 percent for loan applicants without credit available elsewhere and 8 percent for applicants with credit available elsewhere.

SBA's business loan programs include its flagship 7(a) Loan Guaranty program, in which the SBA guarantees up to 90 percent of the principal amount of loans made by banks and other lending institutions to small businesses not able to obtain credit elsewhere.

The Section 504 Certified Development Company program guarantees 100 percent of the principal and interest payments on debentures issued by development companies that make small business loans secured primarily by real estate.

The Small Business Investment Company Debentures program guarantees principal and interest payments on securities issued by investment capital firms, which in turn make investments in small businesses.

The 7(m) Microloan program provides direct loans to non-profit intermediaries, which use these funds to make loans up to \$50,000 to eligible small businesses.

**Source:** SBA, AFR, Note 6: *Credit Program Receivables and Liability for Loan Guarantees*, page 63

While each agency provides direct loan and loan guarantee programs/products to support different missions, staff learned that

- A. financial report **users** are ambiguous to all;
- B. **reporting** is inconsistent despite many reporting standards and regulations; and
- C. **detailed reporting** is burdensome for preparers and users.

Staff provides a discussion of each finding with recommendations below.



## A. USERS

Agencies basically agreed that the Office of Management and Budget (OMB), Congressional Budget Office (CBO), Office of Inspector General (OIG), academia, industry, and journalists were their primary users. There was no conviction that the general public was interested.

For example, **Education** revealed the following during staff's interview:

**Reaching out to users** – ED's AFR team seeks input from the public through email. They also circulate/coordinate the AFRs through FSA, the entire Department of Education, and legislative affairs, etc., to determine if there are any comments from the public or other external stakeholders, including OMB and Congress. Through these efforts, the AFR team learned that its audience is made up of primarily people in the theoretical realm—those studying credit—such as professors, the audit firm, companies who are marketing their modeling services, and the Department of the Treasury (Treasury). They do not usually get inquiries from the general public about credit modeling regarding what is included in the AFR. Mr. Soltis also said the ED inspector general is also a user of the AFR and will sometimes provide comments about what should be included in the AFR.

**Source:** Education, *8/8/17 Meeting Minutes*, page 2 [See Appendix]

**Staff recommends** further investigation with these groups to analyze what information is useful, of little value, and/or could be modified for ease of use.

**Question 1:** Does the Board want staff to engage these user groups to gain a better understanding of what information is useful and how they prefer to see credit data presented?

## B. CONSISTENCY

### 1. Uncertainty of Risk Factors

Uncertainty in the risk factors is a challenge all FCRA agencies face when modeling annual subsidy cost re-estimates.

In addition to interest rate changes which impact all agencies, policy changes may impact risk factors specific to certain agencies. For example, laws governing repayment structures for student loans will influence Education's student loan products, such as the income-driven repayment (IDR) plans. A recent increase in IDR plans increased the re-estimated subsidy costs as compared to previous years' products, when IDRs may not have been available or utilized.

Unexpected catastrophic events, such as the back-to-back hurricanes at the end of fiscal year (FY) 2017 may impact loan defaults and modifications. The change in these risk factors may significantly increase subsidy costs in relation to the re-estimates reported for FY 2016.

The president's economic assumptions (PEA) are also a significant challenge in modeling the re-estimated subsidy costs because PEA can change annually and are not official (available) until the president's budget is released. In addition, due to the timing of the publication of the AFR and budget, agencies must run two models. The model for the AFR is run with one set of assumptions, while a different set of assumptions may be applied at a later date for the budget model. PEA might be different for the two models which may create uncertainty in the related risk factors.

Another challenge related to uncertainty, is the long duration of loan or guarantee terms. It is challenging to predict 20 or 30 years of payments against policies that could change.

Despite the agencies' comprehensive understanding of uncertainties faced in modeling the annual cost re-estimates, there was inconsistency in reporting information about uncertainty of risk factors.

For example

- a. **Education** presented the following high-level, broad discussion;



The estimation process used to determine the amount of positive or negative subsidy expense each fiscal year, and subsequently the cumulative taxpayer cost of the program (allowance for subsidy), is subject to various internal and external risk factors which often show strong interdependence with one another. These risks include uncertainty about changes in the general economy, changes in the legislative and regulatory environment, and changing trends in borrower performance with regard to contractual cash flows within the loan programs.

Due to the complexity of the Direct Loan program, there is inherent projection risk in the process used for estimating long-term program costs. As stated, some uncertainty stems from potential changes in student loan legislation and regulations because these changes may fundamentally alter the cost structure of the program. Operational and policy shifts, such as growing efforts to increase borrower enrollment in income-driven repayment (IDR) plans, may also affect program costs by causing significant changes in borrower repayment timing. Actual performance may deviate from estimated performance, which is not unexpected given the long-term nature of these loans (cash flows may be estimated up to 40 years), and the multitude of projection paths and possible outcomes. The increasing enrollment of borrowers in the IDR plans has made projection of borrower incomes a key input for the estimation process. This uncertainty is directly tied to the macroeconomic climate and is another inherent program element which displays the interrelated risks facing the Direct Loan program.

**Source:** Education, AFR, Note 5. *Credit Programs for Higher Education: Credit Program Receivables, net and Liabilities for Loan Guarantees*, page 60

- b. HUD only mentioned uncertainty in Other Information in relation to an OIG finding; and

Finally, Housing has concerns about the magnitude of financial loss attributed to the long time lags for servicer foreclosure and conveyance actions. Housing's Office of Risk Management and

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**HUD FY 2016 Agency Financial Report**

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**Section 3: Other Information**

**FY 2016**

**Management's Response to the OIG Report on Management and Performance Challenges**

Regulatory Affairs performed an independent analysis on single family claims data to evaluate the \$2.09 billion holding costs identified in the draft audit report. The Office of Risk has concerns with the OIG's cost analysis. Housing requested that the OIG review these concerns and reconsider the estimated costs of untimely foreclosures and conveyances prior to issuing a final audit report. Given the uncertainty of the modeling assumptions, Housing urged the OIG not to assign a particular dollar value to the estimated costs unless those costs can be definitively documented.

**Source:** HUD, AFR 2016, *Management's Response to the OIG Report on Management and Performance Challenges*, pages 214-215

- c. **SBA** did not discuss uncertainty around risk factors at all. There was only one discussion in relation to the risks that their clients (small businesses) take.

#### AN EVER-CHANGING ECONOMY

A small business often feels the first impacts of a slowing economy. High unemployment, low wages, inflation, and regulatory uncertainty all determine whether or not entrepreneurs will invest their time and resources into a new venture. Without large reserves of capital like many corporations, a small business can be shuttered within months during economic decline. To meet these needs, the SBA plays a key role in supporting access to capital. As many lenders closed their doors during the Great Recession, the SBA stepped into the market with alternatives to traditional financing. The Agency will continue to depend on lenders to issue capital. However, the decline in the number of banks and credit unions is a concern. As fewer lenders remain in operation, small businesses must become more nimble in finding capital, and the SBA must provide this support in an ever-changing economy.

**SOURCE:** SBA, *MD&A*, page 26

Staff believes agencies can discuss specific risk factors and related uncertainty that may cause material changes in the re-estimated subsidy costs by including a **sensitivity analysis**.

Each agency uses sensitivity analyses in several ways, such as for prepared by client (PBC) audit requests; for GAO or OMB requests; for developing in-house functional processes; for interpreting models; and for monitoring program performance. Sensitivity analysis may be also used specifically for areas that are currently more sensitive, such as Education's IDR plans.

However, sensitivity analyses are rarely published. For example, in 2016, while **Education** did provide a discussion on sensitivity to a change in interest rates, it was only a one sentence discussion.

Subsidy rates are sensitive to the difference between the borrowers' rates and the rate the Department is charged by Treasury on the debt to fund the loans; for example, a 1 percent increase in projected borrower interest rates would reduce projected direct loan subsidy cost by \$4.8 billion.

**Source:** Education, AFR, Note 5. *Credit Programs for Higher Education: Credit Program Receivables, net and Liabilities for Loan Guarantees*, page 64

Therefore, for consistency of reporting, **staff recommends** including information from a sensitivity analysis to present the potential impact of uncertainty on re-estimated subsidy costs for program specific risk factors.

**Question 2:** Does the Board want to include sensitivity analysis to present the potential impact of uncertainty on re-estimated subsidy costs for program specific risk factors?

## 2. Annual Adjustments of Re-estimated Subsidy Costs

As required by FCRA, agencies must re-estimate the subsidy costs annually. While each agency does provide the schedules required by A-136, not all agencies discuss the material changes, and for those that do, the discussion is presented differently making it hard to compare.

For example,

- a. **Education** provides a lot of detail in just one paragraph;

Direct Loan program re-estimated subsidy cost was adjusted downward by \$4.6 billion in FY 2015. Updated discount rates for the 2014 and 2013 cohorts decreased cost by \$6.2 billion. Higher participation in income-dependent repayment plans increased cost by \$15 billion. The introduction of a new model for estimating income-driven repayment plan costs resulted in a decrease in subsidy costs by \$5.8 billion. Costs increased \$1.8 billion due to increases in default rates. Changes in prepayment rates reflect larger than expected prepayment activity, leading to decreased interest earnings, resulting in \$3.5 billion in upward subsidy cost. Costs decreased \$5.7 billion due to higher forbearance rates. Interest accrues during forbearance and that interest is eventually paid to the Department. Other assumption updates produced offsetting costs, with the remainder attributable to interest on the re-estimate.

**Source:** Education, AFR, Note 5. *Credit Programs for Higher Education: Credit Program Receivables, net and Liabilities for Loan Guarantees*, page 64

- b. **HUD** does not provide any discussion; and
- c. **SBA** discusses each program in a different paragraph that describes the re-estimate adjustment;

The 504 Debt Refinancing program had a net downward reestimate of \$24.7 million. The reestimate is mostly due to better than projected FY 2016 loan performance. Actual purchases in the 504 Debt Refinancing program were less than projected for both cohorts, while actual recoveries were more than projected for both cohorts. The FY 2016 loan performance contributed to revised assumptions which resulted in decreased purchase and increased recovery rate projections. Newly reauthorized in FY 2016, this amount includes a downward reestimate of \$0.2 million for the 2016 cohort reflecting decreased loss projections compared to the original loss projections.

The Section 504 First Mortgage Loan Pooling program had a net upward reestimate of \$3.7 million. The majority of the reestimate is due to lower than projected recoveries in FY 2016. Faster than projected repayment of principal also contributed to a reduction in projected on-going fee revenue.

The SBIC Debentures program had a net downward reestimate of \$156.5 million. The primary driver of the reestimate was better than projected loan performance in FY 2016. No new purchases were recorded in FY 2016 for any cohort, while actual recoveries were greater than projected, specifically in the 2003 and 2009 cohorts. Additionally, updated performance expectation of the 2016 cohort contributed to the downward reestimate.

The SBIC Participating Securities program had a net downward reestimate of \$40.5 million. The downward reestimate was due to better-than-expected loan performance in FY 2016, particularly for the 2004 cohort. The main driver of the downward reestimate was lower purchases and higher recoveries than projected in FY 2016. The better-than-projected recoveries and purchases were partially offset by lower reimbursements of prioritized payments in FY 2016.

The Secondary Market Guaranty program had a net upward reestimate of \$546.1 million. The upward reestimate was larger than expected in part due to reconciliation procedures instituted in FY 2016 related to the available cash positions between the trustee and fiscal agent accounts. The reconciliation procedures between fiscal agent and trustee, while materially reconciled in total, reduced the cash available balance category to cover future MRF liabilities and in turn resulted in an upward reestimate.

**Source:** SBA, AFR, Note 6: *Credit Program Receivables and Liability for Loan Guarantees*, page 71

Staff prefers a combination of the Education and SBA discussions. Consistency of reporting could be achieved by requiring a discussion by program for material changes in the re-estimates.

Therefore, **staff recommends** including a discussion about material re-estimated adjustments.

**Question 3:** Does the Board want to include a discussion about material re-estimated adjustments?

## C. BURDEN FOR PREPARERS & USERS

Agencies agreed that preparing and presenting required FCRA information is very burdensome and difficult for users to understand. One agency noted that even those who have been working with the disclosures for years find them difficult to prepare and understand.

There are 15 tables [A-O] with two major reconciliations required for the AFR by OMB, A-136; 13 tables all require a breakdown by program for pre and post 1991 for direct loans and loan guarantees.

Only the two reconciliations<sup>2</sup> are NOT broken out by program because *FASAB* per Paragraph 4 of SFFAS 19, *Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* decided "...not to adopt a display of program-by-program..."

The following are comments from the **Note Disclosure Survey**:

Individual	Citizen
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Simplify the FCRA note disclosures by removing most of the FCRA note disclosures. There are **so many tables and so much information that it is very confusing** and most citizens have no idea what it means. If this is needed by OMB have the agencies separately report such to OMB.

Individual	Preparer of Financial Statements
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Each note has unique issues. For example, the **credit reform** note provides important information about default rates for various loan programs, but the **reconciliation is not informative for readers**, and should not be presented.

Individual	Preparer of Financial Statements
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Federal Credit Reform. A-136 dictates the minimum disclosure. For some agencies this amount of disclosure is not appropriate based upon relative size of credit activity to the activity as a whole. Additionally, it may be that **much of the disclosure reported is for the benefit of Treasury and OMB**. Possibly this additional detail would be better to be reported in GFRS.

Individual	Preparer of Financial Statements
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It seems the Summary of Significant Accounting policies, **Credit Reform**, the Statement of Net Cost and the Reconciliation of Budgetary Resources Obligated to the Net Cost of Operations **Note disclosures need to be streamlined**

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<sup>2</sup> G. Schedule for Reconciling Subsidy Cost Allowance Balances (Post -1991 Direct Loans) and N. Schedule for Reconciling Loan Guarantee Liability Balances (Post-1991 Loan Guarantees)

For credit reform notes, large amounts of required info that only scratches the surface of the most important issues. Pages of information just to meet the minimum disclosure requirements, and a couple lines buried in it all addressing what is really most pressing from a cost and exposure standpoint.

These comments mirror the discussion staff had with the FCRA agencies. However, staff cannot determine at this time what can reduce the reporting burden.

Therefore, **staff recommends** a task force to recommend how to streamline information in order to reduce the burden on preparers as well as users.

**Question 4:** Does the Board want to form a credit reporting task force to identify and analyze streamlining opportunities?



## **QUESTIONS FOR THE BOARD:**

**Question 1:** Does the Board want staff to engage these user groups to gain a better understanding of what information is useful and how they prefer to see credit data presented?

**Question 2:** Does the Board want to include sensitivity analysis to present the potential impact of uncertainty on re-estimated subsidy costs for program specific risk factors?

**Question 3:** Does the Board want to include a discussion about material re-estimated adjustments?

**Question 4:** Does the Board want to form a credit reporting task force to identify and analyze streamlining opportunities?

## **NEXT STEPS:**

Next steps are to follow up on these recommendations.

## **MEMBER FEEDBACK**

Please provide editorial input and responses to the above questions to Ms. Gilliam by **Friday, October 20, 2016**, at [gilliamr@fasab.gov](mailto:gilliamr@fasab.gov) with a cc to Ms. Payne at [paynew@fasab.gov](mailto:paynew@fasab.gov)

**If you have any questions, please contact Ms. Gilliam at 202-512-7356 or [gilliamr@fasab.gov](mailto:gilliamr@fasab.gov)**



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TAB G

RISK ASSUMED II

ATTACHMENT 1

DRAFT PRINCIPLES-BASED BROAD  
RISK CATEGORIES

OCTOBER 2017

**NOTE:** Staff drafted the following principles-based risk categories from the “laundry list” of risk exposures presented at the December 2016 board meeting. The information is provided here for reference only. Staff plans to present these at a future Board meeting for approval.

Principles-Based Broad Risk Categories	Risk Exposure Types Such as, but not limited to:	Draft Definition - Description
<b>Financial Guarantees</b>	Financial Sector Exposure – Regulations	The risk that a significant event will cause the federal government to pay required or non-required financial guarantees.
	Default on Loan Guarantees and Direct Loans	
	Change in interest rate	
	Pay out of Unfunded civilian and military pensions	
	Significant defaults on obligations to the U.S. government	
	Financial condition of state and local governments	
<b>Environmental and/or Citizen socio-economic wellbeing</b>	Environmental Risks – (Water quality - Flint, Michigan, oil spills, etc.)	The risk that an event—man-made or natural—will significantly affect the environment and/or socioeconomic well-being of persons in the effected geographical areas and require federal benefits and resources. <ul style="list-style-type: none"> <li>Federal help triggered by declaration of state of emergency – activation of Stafford Act.</li> <li>Multi-agency response (material at government level, may not be at agency level)</li> </ul>
	Natural Disasters	
	Terrorist attacks	
	Sickness or epidemic	
	Social Unrest	

Principles-Based Broad Risk Categories	Risk Exposure Types Such as, but not limited to:	Draft Definition - Description
<b>Interdependencies or Interdependent Relationships</b>	Intergovernmental & Programmatic Dependencies	<p>The risk that an event involving a party in an interdependant relationship with the federal government causes the government to fulfill its contractual/non-contractual "obligations."</p> <p><i>(For example: treaty becomes active, P3 partner goes into bankruptcy; contractor does not meet or fulfill requirements wasting millions/billions amount of funds-government still needs to meet policies)</i></p>
	Government Sponsored Enterprises (GSE)	
	Public-Private Partnerships (P3)	
	Commitments, including: <ul style="list-style-type: none"> <li>• contractual (i.e. failed projects)</li> <li>• treaties,</li> <li>• other international agreements</li> </ul>	
<b>Agency Mission - Operation - Strategy</b>	Material litigation settlement	<p>The risk that an event or activity significantly disrupts or distracts operations causing the federal government to provide unfunded (over-budget) resources to return the agency to a functioning state.</p>
	Cybersecurity breach (i.e. disrupts operations, personal/personnel data breach, etc.)	
	National Security (i.e. terrorist or other aggressive acts that ramp up war activities)	
	Cost overruns	
	Social unrest	

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RISK ASSUMED II

APPENDIX A

Risk Assumed – Phase II:  
Project History and Milestones

OCTOBER 2017

## **PROJECT OBJECTIONS**

The issuance of [Statement of Federal Financial Accounting Standards](http://www.fasab.gov/ra-insurance-programs/) (SFFAS) 51, Insurance Programs, on January 18, 2017, effectively concluded the first phase of risk assumed. For the history of the risk assumed project and milestones for phase I, please see <http://www.fasab.gov/ra-insurance-programs/>.

In phase II, the Board will holistically review significant risk events other than adverse events covered by SFFAS 51, Insurance Programs, to determine accounting standards that provide concise, meaningful, and transparent information regarding the potential impact to the fiscal health of the federal government.

## **HISTORY OF BOARD DELIBERATIONS**

### **October 19-20, 2016 Board Meeting**

At the October 19, 2016, Board meeting, the risk assumed – phase II began.

The Board reviewed staff's high-level gap analysis presented in table 1: Analysis of Federal Accounting Standards in Relation to the IMF [International Monetary Fund] Recommendations for Disclosing Fiscal Risks and table 2 from the Australian Statement 8: Statement of Risks.

The Board agreed that an extensive gap analysis is necessary to determine the risk information that the consolidated financial report of the U.S. Government includes and how it is presented, the extent to which FASAB can align with enterprise risk management (ERM) as prescribed by The Office of Management and Budget Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, and the Board's preference for presenting risk assumed information going forward.

For the gap analysis, the Board agreed to determine the following:

- If federal government reporting is transparent enough for estimates and uncertainty around significant risks with a focus on broad risk categories, such as an economic downturn where revenues go down and benefit program costs go up
- If there is a significant gap in reporting to be addressed for individual risk items, such as treaties, commitments by the federal government, and intergovernmental dependencies with state and local governments
- How to present summarized risk events at the government-wide level for cross-cutting agency efforts, such as disaster relief, with access to detail at the agency level



**December 19-20, 2016**

At the December 20, 2016, Board meeting, the Board approved a framework for the risk assumed gap analysis. Members agreed that categories should not be a laundry list of events but instead should be principle-based and broad enough to encompass current and future significant risk events. The scope will include past and future events and whether uncertainty is adequately explained. Staff will review past financial reports to understand what was included before and after recent large events, such as the 2008 financial crisis, at the agency and government-wide levels.

Staff will utilize roundtable discussions to discover if current disclosures are clear, relevant, and add value in relation to the available standards. If roundtable participants do not feel that current disclosures are clear, relevant, or valuable, the group will discuss what is missing and should be included.

Staff will work on the gap analysis over the next several months and present findings and recommendations to the Board upon completion.

**June 21-22, 2017**

Members did **not** want to include discussions that

- predict unforeseen catastrophes and their potential financial effect;
- trends for using emergency funding as an indicator of fiscal exposure to risk shocks;
- comparisons of estimates to actuals;
- how past risk events were managed; or
- a separate risk section [as presented in the USAFacts 10-K Report -risk section—Item 1A Risk Factors] within federal financial reports.

Members **did want to**

- include past events that affect the current financial position;
- include and define major risk events with a relationship to long-term sustainability that are not already reported;
- use the principle-based broad risk categories as a foundation for continuing the gap analysis; and
- present meaningful streamlined information as a broad analysis rather than specific details.

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RISK ASSUMED II

Appendix B

Education Meeting Notes and AFR Direct  
Loans/Loan Guarantees Disclosure Note

OCTOBER 2017

**EDUCATION**  
**Direct Loans/Loan Guarantees – Credit Reporting**  
**MEETING MINUTES**  
PCP, 550 12th Street SW, Room WDCPCP-6083  
August 8, 2017, 9:00-10:00 a.m.

**Participants**

Federal Accounting Standards Advisory Board (FASAB):

- Wendy Payne, Executive Director
- Robin Gilliam, Assistance Director, Risk Assumed Project Lead

Education (ED):

- Tim Soltis, Delegated Chief Financial Officer
- Jay (John) Hurt, Chief Financial Officer, Federal Student Aid
- Anthony Chavez, Director, Financial Management Group, Finance Office, Federal Student Aid
- Erica Navarro, Director, Budget Service
- Larry Kean, Deputy Director, Budget Service
- James Wilson, Budget and Financial Analyst, Budget Service
- Hillary Perkins, Budget and Financial Analyst, Budget Service
- Daniel Simpson, Director, Cost Estimation and Analysis Division, Budget Service

**Introductions / General Information**

Ms. Gilliam opened the meeting with a brief discussion about the risk assumed project history and issuance of Statement of Federal Financial Accounting Standards (SFFAS) 51, *Insurance Programs* (phase one), and a brief description of the purpose of the project's second phase.

Mr. Soltis explained that Budget Service manages the assumptions and the credit model and provides the information to Federal Student Aid (FSA) and the Financial Statement team, which prepares the agency financial reports (AFRs). Budget Service prepares all budget documents submitted to the Office of Management and Budget (OMB) and others and addresses relevant questions pertaining to the credit model.

**Discussion**

**1. WHO ARE THE PRIMARY USERS?**

Mr. Soltis said that there are multiple users for information related to credit modeling. For example, the budget is a **future-oriented** look at what is needed to implement policy while the AFR is a stewardship report that **looks back** at the financial position resulting from the operations accounted for in the reporting period. While ED primarily focuses on the past, they do include some futuristic information in the 2016 AFR and work hard to present a balanced picture that indicates the current **risks** and related **uncertainties** in projecting actuals.

The question is the **collectability** of the borrowed money. When people graduate how much of that debt is going to come **back through collections** [self-financing arrangement] **or taxes** [subsidized by the government]? This discussion is not included in ED's AFR.

Ms. Payne asked how much financial information makes it to the performance reports. Mr. Soltis said limited information related to the credit model is included in ED's Annual Performance

Report, which relates primarily to post-secondary education affordability and completeness. However, a new strategic plan is currently under development.

**Reaching out to users** – ED’s AFR team seeks input from the public through email. They also circulate/coordinate the AFRs through FSA, the entire Department of Education, and legislative affairs, etc., to determine if there are any comments from the public or other external stakeholders, including OMB and Congress. Through these efforts, the AFR team learned that its audience is made up of primarily people in the theoretical realm—those studying credit—such as professors, the audit firm, companies who are marketing their modeling services, and the Department of the Treasury (Treasury). They do not usually get inquiries from the general public about credit modeling regarding what is included in the AFR. Mr. Soltis also said the ED inspector general is also a user of the AFR and will sometimes provide comments about what should be included in the AFR.

## 2. SENSITIVITY ANALYSIS

Ms. Payne asked if **sensitivity analysis** is used in either the budget or AFR reporting and why.

Ms. Perkins said sensitivity analyses are used in several ways, such as for prepared by client (PBC) audit requests; Government Accountability Office (GAO) or OMB requests; and in-house function development processes, specifically for areas that are currently more sensitive, such as the income-driven repayment plan (IDR). In-house sensitivity analyses do not get published

Ms. Gilliam referenced the sensitivity information published on page 64 of the AFR. Ms. Perkins said the information was a PBC item for the auditor. Ms. Gilliam noted that the presentation is in a narrative form. Would it be burdensome to present it in a chart? Ms. Perkins said she could prepare a chart, but she does not make presentation decisions in the AFR. Mr. Soltis said ED could create a chart, but he questioned its utility and thought more prescriptive requirements could cause more harm than good.

Every year ED decides the best way to provide a balanced display to avoid overstating one area over another. To address this, ED added a high-level picture in the financial highlights section, page 23, of the cash flow and the model.

Ms. Perkins added that the information estimated and presented reflects the current interest (hot topics—like IDR). But hot topics constantly change, so the team uses judgement on what it thinks people want to see for that year.

## 3. REDUCING BURDEN OF REPORTING – RECOMMENDATIONS TO IMPROVE AFRs

Ms. Payne discussed the new streamlining project that will be managed through the reporting model and note disclosure projects. Roundtables showed a lot of interest in streamlining the direct loan / loan guarantee disclosure. Noting that some of the requirements come from OMB Circular A-136 and SFFAS 2, as amended; she asked what information might be removed and what information remains vital.

Mr. Soltis said one challenge with the A-136 is that it is too **prescriptive** by requiring fixed tables that auditors audit against for exact compliance. For example, ED has received critique stating, “You missed this one line in the table, required on page 110, paragraph two.” Therefore, ED is pushing for A-136 to be shorter and provide more flexibility.

Mr. Soltis explained that it is difficult to know when to discuss risk factors. For example, the biggest driver for the model is interest rates. ED needs to explain the impact of an extreme interest rate spike without crying wolf when mild swings occur.

Ms. Gilliam asked for an explanation on how interest rates are used to determine subsidy cost.

Ms. Perkins said the difference is the timing between when the student rate [borrower] and the borrowing rate from Treasury are set. She explained that the negative 1.5 interest rate reestimate for 2016 represents that lag for cohorts. Cohorts go into reestimate when 90% disbursed. Loans are disbursed over two fiscal years—every six quarters. Subsidy costs are calculated using the OMB Credit Subsidy Calculator tool where interest rates are embedded.

Mr. Soltis added that policy changes for risk factors that unburden the borrower, such as loan consolidations and term changes, also affect subsidy costs—better terms for the student means more cost to the government.

Ms. Perkins stated that it is very challenging to predict 20 years of payments against policies that are always under review and pressure to change.

Ms. Gilliam asked if ED's enterprise risk management (ERM) contributes any information to the credit reform reporting. Mr. Soltis said ERM is a separate group in FSA. Its focus is on policy for defaults, collections, loan collectors, and information that affects the operations of FSA. The information provided in the AFR is more arcane accounting, specifically driven by credit accounting and specific information required by A-136.

Mr. Soltis explained that the Federal Credit Reform Act (FCRA) was a big change that paid subsidy costs out of appropriated funds, which act like accounts payable but are hard to predict because the budget authority behind them is driven by an estimate. Yet the FCRA requires pure accounting—a matching principle—that usually does not apply to appropriations.

Ms. Perkins said that due to the magnitude of information it is hard to explain this type of accounting to an audience that is not familiar with what it is looking at. For example, do AFR users really understand what an estimate or reestimate really means when there are 30 cohorts and 40 years for each cohort that aggregated together equals the annual subsidy cost? It is complicated in itself to provide information to help understand what these numbers really represent.

Mr. Soltis added that users often misinterpret or apply the reestimates incorrectly. For example, ED received a question as to whether the \$10 – \$20 billion in reestimates was a 50% adjustment. The answer was no. This was applied against a trillion dollar portfolio with the cash flows adjustment approximately 2 – 3%. He referenced the GAO report<sup>1</sup> that showed credit programs' percentages as being fairly stable.

**Loans are growing in absolute dollars because ED's portfolio is materially increasing. Therefore, historically, the adjustment [reestimated subsidiary cost] grows every year, but in correlation to the total portfolio, it is not independently material.**

Ms. Gilliam said that FASAB is working to reduce the information presented because some Board members are interested in paragraphs and not pages of information. Ms. Perkins said reestimate information is explained concisely, such as the one sentence about how a 1%

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<sup>1</sup>GAO-16-41 CREDIT REFORM: Cost Estimates: Current Method to Estimate Credit Subsidy Costs is More Appropriate for Budget Estimates than Fair Value (FV) Approach.- [Credit Subsidy Cost Estimates]

interest rate (page 84) change would be twice as large now as it would have been in 2011 based on portfolio expansion. She reiterated that more loan volume means more reestimates.

Mr. Soltis explained that information is presented in the AFR to cover the impact of credit modeling as follows:

- The Financial Highlights present a balanced summary of all the information in a concise manner. It cannot overlay the credit subsidy cost because it is not the biggest item.
- Forward-looking information in Management's Discussion and Analysis discusses risks and uncertainties. It disproportionately focuses on credit modeling because that is where most of ED's risk is.
- Footnote #5 reports the accounting detail.

#### **4. WHAT RISK FACTORS DOES ED MONITOR?**

Mr. Simpson said risk factors, such as interest rates, are identified by OMB; however, policy changes for individual products, such as IDRs, could impact the payout rate. For example, if a borrower opts into an IDR plan at 4% his or her payment will differ for a \$30,000 salary than a \$50,000 salary. The challenge is to model how that interest revenue will change by predicting how much people currently make and how much their wages will grow.

Ms. Gilliam asked about the colleges that recently went bankrupt and forgiving the debt for those enrolled students. Was that a recent policy to protect these students?

Mr. Simpson said the Borrower Defense provision has been in existence for a long time but has not been utilized until recently when Corinthian went bankrupt. Mr. Soltis said that provision is now being tested. These major school closures are a **good example about how inherently** difficult it is to project **all risk** factors. This one has been dormant for years but is now creating an impact on the subsidy cost re-estimate.

Ms. Payne asked if ED's experience with Corinthian changed the analysis of concentration of risk in particular for-profit schools.

Mr. Soltis said the new administration is coming up with a new rule set—decision tree—to determine when a loan can be discharged under the Borrower Defense Act. There are many complicated factors to consider. Did the student graduate or leave? Were the credits viable and transferable? If a student was enrolled for two years, is it a partial loss or is it completely worthless? Is the student employable and at what salary? Is that related to the student's industry of choice or the validation of the degree, and how does that translate into a loan forgiveness amount?

#### **5. METHODOLOGY**

Ms. Gilliam asked how ED determines what methodology to use. Mr. Simpson said that ED follows the FCRA models and decides how much detail to provide depending on what is happening that year.



## 6. RECONCILIATION FOR ALLOWANCE FOR SUBSIDY

Ms. Payne asked if the reconciliation for the allowance for subsidy is routine and if ED receives a lot of questions about it.

Ms. Perkins said the reconciliation of this estimate for the financial statements is the crux of the audit. The auditors ask a lot of questions about the line items in the reconciliation and how they were calculated. Two subsidy reestimates are done annually. The OMB reestimate encapsulates the financial statement estimate. ED does the reestimate in two pieces and adds them together. After the AFR is done, ED reviews it with OMB because it becomes half of the reestimate that will be in the budget.

Ms. Perkins said the \$23.3 million for the Technical and Default Re-estimates line, page 62, is everything else that is not included in the individual lines on the reconciliation. Items are discussed on page 63. ED keeps track of each risk factor separately and each could be included in a table. However, some items are very technical and the in-house table is very large, which could cause users' confusion.

## 7. CONSOLIDATED FINANCIAL REPORT

Ms. Gilliam asked about the Consolidated Financial Report (CFR) and why direct loans / loan guarantees are not included, especially since their materiality is increasing. Mr. Soltis pointed out that this is a Treasury report and that there is discussion in the CFO council that materiality should be pushed down into the components with the AFR notes providing the explanation. He emphasized that it is important when information is consolidated that it makes sense going from the agencies into the CFR. For example, how should **Treasury tell the government-wide consolidated debt story?**

In closing, Ms. Payne, thanked participants for their time and the quality of their reporting.

## EDUCATION AFR 2016 – NOTE 5

### **Note 5. Credit Programs for Higher Education: Credit Program Receivables, Net and Liabilities for Loan Guarantees**

The Department currently operates two major student loan programs, Direct Loan and FFEL. The Direct Loan program offers four types of loans: Stafford, Unsubsidized Stafford, PLUS, and Consolidation. Evidence of financial need is required for an undergraduate student to receive a subsidized Stafford loan. The other three loan programs are available to borrowers at all income levels. Loans can be used only to meet qualified educational expenses.

The Department holds \$1,076.6 billion in outstanding credit program net receivables. This outstanding balance is comprised primarily of direct loans, defaulted FFEL loans, and FFEL loans purchased using authority provided in the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA). There are several other loan programs that the Department administers—including the Federal Perkins Loan program, TEACH grant program, HEAL program, and the Facilities Loan programs.

Credit program receivables, as of September 30, 2016 and 2015, consisted of the following:

**Credit Program Receivables, Net**

(Dollars in Millions)

	2016			
	Principal	Accrued Interest	Allowance for Subsidy	Net
Direct Loan Program	\$ 902,754	\$ 50,835	\$ 5,292	\$ 958,881
FFEL Program	109,804	18,191	(13,125)	114,870
Other Credit Programs for Higher Education	2,988	389	(549)	2,828
<b>Total Credit Receivables</b>	<b>\$ 1,015,546</b>	<b>\$ 69,415</b>	<b>\$ (8,382)</b>	<b>\$ 1,076,579</b>

  

	2015			
	Principal	Accrued Interest	Allowance for Subsidy*	Net
Direct Loan Program	\$ 800,811	\$ 44,250	\$ 35,496	\$ 880,557
FFEL Program	114,704	17,529	2,471	134,704
Other Credit Programs for Higher Education	2,876	361	(765)	2,472
<b>Total Credit Receivables</b>	<b>\$ 918,391</b>	<b>\$ 62,140</b>	<b>\$ 37,202</b>	<b>\$ 1,017,733</b>

\* Includes allowance for subsidy and liability for loan guarantees

The federal student loan programs provide students and their families with the funds to help meet postsecondary education costs. Funding for these programs is provided through permanent indefinite budget authority. What follows is a comprehensive description of the student loan programs at the Department, including summary financial data and subsidy rates.

**William D. Ford Federal Direct Loan Program.** The federal government makes loans directly to students and parents through participating institutions of higher education under the Direct Loan program. Direct Loans are originated and serviced through contracts with private vendors.

The Department records an estimated obligation each year for direct loan awards to be made in a fiscal year based on estimates of schools' receipt of aid applications. Half of all loan awards are issued in the fourth quarter of the fiscal year. Loans awarded are typically disbursed in multiple installments over an academic period. As a result, loans may be disbursed over multiple fiscal years. Loan awards may not be fully disbursed due to students leaving or transferring to other schools. The Department's estimate may also not reflect the actual amount of awards made. Based on historical averages, the Department expects approximately 6.2 percent of the amount obligated for new loan awards will not be disbursed.

Direct Loan program loan receivables includes defaulted and nondefaulted loans owned and held by the Department. Of the \$953.6 billion in gross receivables, as of September 30, 2016, \$57.3 billion (6.0 percent) in loan principal was in default and had been transferred to the Department's defaulted loan servicer, compared to \$44.1 billion (5.2 percent) as of September 30, 2015.

The allowance for subsidy represents the estimated cost (to taxpayers) of financing the entire loan program for all loans outstanding. The subsidy cost figures are estimated using OMB-reviewed financial modeling methodologies which are subject to the FCRA. The allowance is the aggregate of all positive and negative subsidies as well as modification adjustments, at a point in time, for the current fiscal year and all those prior.

Positive subsidies, which are resources provided by Treasury to the Department for continuing loan origination and servicing activities, are required when estimated program cash outflows

are expected to exceed inflows. Alternatively, when the estimated cash inflows are expected to exceed outflows, the Department transfers excess subsidy funds back to the Treasury (negative subsidy transfers). Positive subsidy increases aggregate program costs and negative subsidy decreases aggregate program costs to taxpayers.

The estimation process used to determine the amount of positive or negative subsidy expense each fiscal year, and subsequently the cumulative taxpayer cost of the program (allowance for subsidy), is subject to various internal and external risk factors which often show strong interdependence with one another. These risks include uncertainty about changes in the general economy, changes in the legislative and regulatory environment, and changing trends in borrower performance with regard to contractual cash flows within the loan programs.

Due to the complexity of the Direct Loan program, there is inherent projection risk in the process used for estimating long-term program costs. As stated, some uncertainty stems from potential changes in student loan legislation and regulations because these changes may fundamentally alter the cost structure of the program. Operational and policy shifts, such as growing efforts to increase borrower enrollment in income-driven repayment (IDR) plans, may also affect program costs by causing significant changes in borrower repayment timing. Actual performance may deviate from estimated performance, which is not unexpected given the long-term nature of these loans (cash flows may be estimated up to 40 years), and the multitude of projection paths and possible outcomes. The increasing enrollment of borrowers in the IDR plans has made projection of borrower incomes a key input for the estimation process. This uncertainty is directly tied to the macroeconomic climate and is another inherent program element which displays the interrelated risks facing the Direct Loan program.

The following schedule provides a reconciliation between the beginning and ending balances of the allowance for subsidy for the Direct Loan program:

### Direct Loan Program Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (35,496)</b>	<b>\$ (47,358)</b>
<b>Activity</b>		
Fee Collections	1,685	1,618
Loan Cancellations	(5,065)	(4,777)
Subsidy Allowance Amortization	17,815	16,373
Other	(350)	(460)
<b>Total Activity</b>	<b>14,085</b>	<b>12,754</b>
<b>Subsidy Expense for Direct Loans Disbursed in the Current Year by Component</b>		
Interest Rate Differential	(15,463)	(15,555)
Defaults, Net of Recoveries	(127)	217
Fees	(1,993)	(1,678)
Other	11,887	10,830
<b>Total of the Above Subsidy Expense Components</b>	<b>(5,696)</b>	<b>(6,186)</b>
<b>Loan Modification</b>	<b>-</b>	<b>9,936</b>
<b>Components of Subsidy Re-estimates</b>		
Interest Rate Re-estimates	(1,536)	1,506
Technical and Default Re-estimates	23,351	(6,148)
<b>Upward/(Downward) Subsidy Re-estimates</b>	<b>21,815</b>	<b>(4,642)</b>
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (5,292)</b>	<b>\$ (35,496)</b>

Loan cancellations include write-offs of loans because the borrower died, became disabled, or declared bankruptcy. The interest rate re-estimate reflects the cost of finalizing the Treasury borrowing rate to be used for borrowings received to fund the disbursed portion of the loan awards obligated. The remaining components of subsidy expense for direct loans disbursed in the current year consist of contract collection costs, program review collections, fees, loan forgiveness under PAYE and other accruals. Components of the FY 2015 subsidy expense for direct loans disbursed in the current year were reclassified to better reflect the fiscal year of underlying loan disbursement versus actual subsidy disbursement. Due to the interaction of the timing of disbursements by loan type and other underlying subsidy rates, the bulk of these expenses for both the 2015 cohort and 2016 cohort were recorded in FY 2016.

The following schedule summarizes the Direct Loan interest expense and interest revenue for the years ended September 30, 2016 and 2015:

### Direct Loan Program Interest Expense and Revenue

(Dollars in Millions)

	2016	2015
Interest Expense on Treasury Borrowing	\$ 30,503	\$ 27,593
<b>Total Interest Expense</b>	<b>\$ 30,503</b>	<b>\$ 27,593</b>
Interest Revenue from the Public	\$ 44,375	\$ 39,760
Amortization of Subsidy	(17,815)	(16,373)
Interest Revenue on Uninvested Funds	3,943	4,206
<b>Total Interest Revenue</b>	<b>\$ 30,503</b>	<b>\$ 27,593</b>

The following schedule summarizes the Direct Loan subsidy expense for the years ended September 30, 2016 and 2015:

### Direct Loan Program Subsidy Expense

(Dollars in Millions)

	2016	2015
<b>Subsidy Expense for New Direct Loans Disbursed</b>		
Interest Rate Differential	\$ (15,463)	\$ (15,555)
Defaults, Net of Recoveries	(127)	217
Fees	(1,993)	(1,678)
Other	11,887	10,830
<b>Total Subsidy Expense for New Direct Loans Disbursed</b>	<b>(5,696)</b>	<b>(6,186)</b>
Loan Modification	-	9,936
Upward/(Downward) Subsidy Re-estimates	21,815	(4,642)
<b>Direct Loan Subsidy Expense</b>	<b>\$ 16,119</b>	<b>\$ (892)</b>

Direct Loan program re-estimated subsidy cost was adjusted upward by \$21.8 billion in FY 2016. The re-estimates reflect several updated assumptions: however, in this case, the size of the net upward re-estimate was due largely to collection rates on defaulted loans and repayment plan selection. Actual collections on defaults since FY 2011 were lower than anticipated, which reduced estimated lifetime rates and increased the cost to the Department by \$10.1 billion. For repayment plan selection, a greater percentage of borrowers chose costlier plans than had been estimated and increased the cost to the Department by \$8.1 billion. The

percentage of borrowers choosing an income-driven repayment plan was the primary cost driver for that assumption.

Subsidy rates are sensitive to the difference between the borrowers' rates and the rate the Department is charged by Treasury on the debt to fund the loans; for example, a 1 percent increase in projected borrower interest rates would reduce projected direct loan subsidy cost by \$4.8 billion. Re-estimated costs only include cohorts that are 90 percent disbursed; cohort years 1994–2015. With the increase in income-driven repayment participation, the Department also conducted sensitivities on incomes for students in IDR and Public Service Loan Forgiveness (PSLF) plans. A 10 percent upward increase in borrower incomes decreases costs almost \$8.7 billion for cohorts 1994–2015. A 10 percent increase in PSLF plan participation would increase costs \$6.3 billion for cohorts 1994–2015.

Direct Loan program re-estimated subsidy cost was adjusted downward by \$4.6 billion in FY 2015. Updated discount rates for the 2014 and 2013 cohorts decreased cost by \$6.2 billion. Higher participation in income-dependent repayment plans increased cost by \$15 billion. The introduction of a new model for estimating income-driven repayment plan costs resulted in a decrease in subsidy costs by \$5.8 billion. Costs increased \$1.8 billion due to increases in default rates. Changes in prepayment rates reflect larger than expected prepayment activity, leading to decreased interest earnings, resulting in \$3.5 billion in upward subsidy cost. Costs decreased \$5.7 billion due to higher forbearance rates. Interest accrues during forbearance and that interest is eventually paid to the Department. Other assumption updates produced offsetting costs, with the remainder attributable to interest on the re-estimate.

**FY 2015 Modification.** Recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between the discount rate used to calculate the cost of the modification and the interest rate at which the cohort pays or earns interest.

The Department modified direct loans in FY 2015. Borrowers formerly ineligible for a more generous PAYE repayment plan became eligible for a modified version of PAYE leading to increased costs, resulting in a \$9.3 billion upward modification of subsidy cost and a \$629 million net upward modification adjustment transfer. In FY 2015, the Department forgave \$2.1 billion in interest for borrowers participating in the PAYE/income-based repayment (IBR) plans, which provide that, if the borrower's monthly payment amount is not sufficient to pay the accrued interest on the borrower's direct subsidized loan or the subsidized portion of a direct consolidation loan, the Secretary does not charge the borrower the remaining accrued interest for a period not to exceed three consecutive years from the established repayment period start date on that loan under the PAYE/IBR plan.

The subsidy rates applicable to the 2016 loan cohort year follow:

#### Direct Loan Subsidy Rates—Cohort 2016

	Interest Differential	Defaults	Fees	Other	Total
Stafford	6.82%	1.56%	(1.68)%	4.98%	11.68%
Unsubsidized Stafford	(8.34)%	1.06%	(1.68)%	6.24%	(2.72)%
PLUS	(22.04)%	0.78%	(4.27)%	5.38%	(20.15)%
Consolidation	3.32%	(0.50)%	0.00%	10.68%	13.50%
<b>Total</b>	<b>(4.40)%</b>	<b>0.65%</b>	<b>(1.58)%</b>	<b>7.18%</b>	<b>1.85%</b>

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year and are weighted on gross volume. The subsidy

expense for new direct loans reported in the current year relates to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans. The subsidy expense reported in the current year may include re-estimates. The subsidy rates shown above, which reflect aggregate positive subsidy in the FY 2016 cohort, cannot be applied to direct loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole. The Department does not re-estimate student loan cohorts until they are at least 90 percent disbursed. As a result, the financial statement re-estimate does not include a re-estimate of the current year cohort. The first re-estimate of this cohort will take place upon execution of the FY 2018 President's Budget.

The subsidy costs of the Department's student loan programs, especially the Direct Loan program, are highly sensitive to changes in actual and forecasted interest rates. The formulas for determining program interest rates are established by statute; the existing loan portfolio has a mixture of borrower and lender rate formulas. Interest rate projections are based on probabilistic interest rate scenario inputs developed and provided by OMB.

The following schedule summarizes the Direct Loan program loan disbursements by loan type for the years ended September 30, 2016 and 2015:

**Direct Loan Program Loan Disbursements by Loan Type**

(Dollars in Millions)

	2016	2015
Stafford	\$ (23,752)	\$ (23,953)
Unsubsidized Stafford	(52,254)	(52,698)
PLUS	(19,001)	(19,163)
Consolidation	(45,518)	(46,434)
<b>Total Expenditures</b>	<b>\$ (140,525)</b>	<b>\$ (142,248)</b>

The allocation of disbursements for the first three loan types is estimated based on historical trend information.

Student and parent borrowers may prepay existing loans without penalty through a new consolidation loan. Under the FCRA and requirements provided by OMB regulations, the retirement of direct loans being consolidated is considered a collection of principal and interest. This receipt is offset by the disbursement related to the newly created consolidation loan. Underlying direct or guaranteed loans, performing or nonperforming, are paid off in their original cohort; new consolidation loans are originated in the cohort in which the new consolidation loan was obligated. Consolidation activity is taken into consideration in establishing subsidy rates for defaults and other cash flows. The cost of new consolidations is included in subsidy expense for the current-year cohort; the effect of prepayments on existing loans could contribute to re-estimates of prior cohort subsidy costs. The net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect subsidy costs associated with anticipated future consolidation loans.

Direct loan consolidations were \$46 billion during both FY 2016 and FY 2015. Under the FCRA, the subsidy costs of new consolidation loans are not reflected until the future fiscal year in which they are disbursed. The effect of the early payoff of the existing loans—those being consolidated—is recognized in the future projected cash flows of the past cohort year in which the loans were originated.

**Federal Family Education Loan Program.** As a result of the *SAFRA Act*, no new FFEL loans have been made since July 1, 2010. Federal guarantees on FFEL program loans and commitments remain in effect for loans made before July 1, 2010, unless they were sold to the Department through an ECASLA program, consolidated into a direct loan, or otherwise satisfied, discharged, or cancelled. As of September 30, 2016 and 2015, total principal



balances outstanding of guaranteed loans held by lenders were approximately \$197 billion and \$220 billion, respectively. As of September 30, 2016 and 2015, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately \$193 billion and \$215 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies. The rates range from 75 to 100 percent of the loan value depending on when the loan was made and the guaranty agency's claim experience.

### FFEL Program Loan Receivables

(Dollars in Millions)

	2016				
	Principal	Accrued Interest	Allowance for Subsidy	Loan Guarantee Liability	Net
FFEL GSL Program (Pre-1992)	\$ 4,087	\$ 5,674	\$ (7,622)	\$ -	\$ 2,139
FFEL GSL Program (Post-1991)	35,645	6,562	(12,398)	-	29,809
Loan Purchase Commitment	23,867	2,090	2,922	-	28,879
Loan Participation Purchase	44,434	3,600	4,347	-	52,381
ABCP Conduit	1,771	265	(374)	-	1,662
<b>FFEL Program Loan Receivables</b>	<b>\$ 109,804</b>	<b>\$ 18,191</b>	<b>\$ (13,125)</b>	<b>\$ -</b>	<b>\$ 114,870</b>

  

	2015				
	Principal	Accrued Interest	Allowance for Subsidy	Loan Guarantee Liability	Net
FFEL GSL Program (Pre-1992)	\$ 4,388	\$ 6,149	\$ (8,162)	\$ (10)	\$ 2,365
FFEL GSL Program (Post-1991)	33,415	5,756	(4,389)	3,398	38,180
Loan Purchase Commitment	26,474	1,981	4,410	-	32,865
Loan Participation Purchase	48,540	3,403	7,573	-	59,516
ABCP Conduit	1,887	240	(349)	-	1,778
<b>FFEL Program Loan Receivables</b>	<b>\$ 114,704</b>	<b>\$ 17,529</b>	<b>\$ (917)</b>	<b>\$ 3,388</b>	<b>\$ 134,704</b>

ECASLA gave the Department temporary authority to purchase FFEL loans and participation interests in those loans. The Department implemented three activities under this authority: loan purchase commitments; purchases of loan participation interests; and a put, or forward purchase commitment, with an Asset-Backed Commercial Paper (ABCP) Conduit. This authority expired after September 30, 2010; as a result, loan purchase commitments and purchases of loan participation interests concluded. However, under the terms of the Put Agreement with the conduit, ABCP Conduit activity ceased operations in January 2014.

The FFEL guaranteed student loan financing account had a negative estimated liability for loan guarantees of \$3.4 billion as of September 30, 2015. This indicated that expected collections on anticipated future defaulted loans was in excess of default disbursements, calculated on a net present value basis. Under GAAP, the negative estimated liability as of September 30, 2015, was classified as a component of credit program receivables on the consolidated balance sheet.

The following schedule provides a reconciliation between the beginning and ending balances of the liability for loan guarantees for the insurance portion of the FFEL program:

### FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)

	2016	2015
<b>Beginning Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>\$ (3,398)</b>	<b>\$ (4,218)</b>
<b>Activity</b>		
Interest Supplement Payments	(830)	(896)
Claim Payments	(6,678)	(6,917)
Fee Collections	1,731	1,926
Interest on Liability Balance	(1,766)	(1,826)
Other	5,648	12,797
<b>Total Activity</b>	<b>(1,895)</b>	<b>5,084</b>
<b>Components of Loan Modification</b>		
Loan Modification Costs	151	-
Modification Adjustment Transfers	24	-
<b>Loan Modification</b>	<b>175</b>	<b>-</b>
<b>Upward/(Downward) Subsidy Re-estimates</b>	<b>6,535</b>	<b>(4,264)</b>
<b>Ending Balance, FFEL Financing Account Liability for Loan Guarantees</b>	<b>1,417</b>	<b>(3,398)</b>
FFEL Liquidating Account Liability for Loan Guarantees	12	10
<b>FFEL Liabilities for Loan Guarantees</b>	<b>\$ 1,429</b>	<b>\$ (3,388)</b>

Other activity includes negative special allowance collections, collections on defaulted FFEL loans, guaranty agency expenses, and loan cancellations due to death, disability, or bankruptcy.

The following schedules provide reconciliations between the beginning and ending balances of the allowance for subsidy for the loan purchase commitment component and the loan participation purchase component of the FFEL program. Loans in these programs are loans acquired by the Department. Acquired loans are reported at their net present value of future cash flows.

### Loan Purchase Commitment Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (4,410)</b>	<b>\$ (5,228)</b>
<b>Activity</b>		
Subsidy Allowance Amortization	644	724
Loan Cancellations	(193)	(274)
Contract Collection Cost and Other	(40)	(40)
<b>Total Activity</b>	<b>411</b>	<b>410</b>
Upward/(Downward) Subsidy Re-estimates	1,077	408
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (2,922)</b>	<b>\$ (4,410)</b>

### Loan Participation Purchase Reconciliation of Allowance for Subsidy

(Dollars in Millions)

	2016	2015
<b>Beginning Balance, Allowance for Subsidy</b>	<b>\$ (7,573)</b>	<b>\$ (8,373)</b>
<b>Activity</b>		
Subsidy Allowance Amortization	1,208	1,362
Loan Cancellations	(355)	(518)
Direct Asset Activities	(74)	(44)
<b>Total Activity</b>	<b>779</b>	<b>800</b>
Upward/(Downward) Subsidy Re-estimates	2,447	-
<b>Ending Balance, Allowance for Subsidy</b>	<b>\$ (4,347)</b>	<b>\$ (7,573)</b>

The following schedule provides FFEL program subsidy expense for the years ended September 30, 2016 and 2015, respectively:

### FFEL Program Subsidy Expense

(Dollars in Millions)

	2016	2015
FFEL Loan Guarantee Program Subsidy Re-estimates	\$ 6,535	\$ (4,264)
Loan Purchase Commitment Subsidy Re-estimates	1,077	408
Loan Participation Purchase Subsidy Re-estimates	2,447	-
<b>FFEL Program Upward/(Downward) Subsidy Re-estimates</b>	<b>10,059</b>	<b>(3,856)</b>
FFEL Guaranteed Loan Program Modification Costs	175	-
<b>FFEL Program Subsidy Expense</b>	<b>\$ 10,234</b>	<b>\$ (3,856)</b>

FFEL guaranteed re-estimated subsidy cost was adjusted upward by \$10.2 billion in FY 2016. The net upward re-estimates in these programs were due primarily to collection rates on defaulted loans which were lower than anticipated.

Subsidy rates are sensitive to interest rate fluctuations; for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL subsidy costs by \$16.6 billion.

FFEL guaranteed re-estimated subsidy cost was adjusted downward by \$3.9 billion in FY 2015. Subsidy costs decreased \$2.1 billion due to updated economic assumptions, including

probabilistic deterministic rates, which reflected historically low commercial paper rates, resulting in substantially higher negative special allowance payments. Subsidy costs decreased \$706 million due to lower deferment rates on consolidated loans that have subsidized components of outstanding debt. The Department pays interest benefits when loans are in deferment, so lower deferment rates mean less interest benefits when loans are in deferment and thus, less interest benefit payments to lenders. Other assumption updates produced offsetting subsidy costs, with the remainder attributable to interest on the re-estimate.

**FY 2016 Modification.** In the FFEL program, private lenders provided loan capital, backed by a federal guarantee on the loans. The federal government provided interest subsidies to lenders and reimbursement to guaranty agencies for most of the costs associated with loan defaults and other loan cancellations. The *Consolidated Appropriations Act, 2016*, increased the guaranty agencies' maximum reinsurance percentage on default claims from 95 percent to 100 percent. State and private nonprofit guaranty agencies provide services that include: insurance payments to lenders for defaults, collection of some defaulted loans, default avoidance activities, and counseling to schools, students, and lenders.

## Other Credit Programs for Higher Education

### Receivables, Net for Other Credit Programs for Higher Education

(Dollars in Millions)

	2016				
	Principal	Accrued Interest	Allowance for Subsidy	Loan Guarantee Liability	Net
Federal Perkins Loans	\$ 385	\$ 242	\$ (178)	\$ -	\$ 449
TEACH Program Loans	698	101	(109)	-	690
HEAL Program Loans	405	31	(99)	-	337
Facilities Loan Programs	1,500	15	(163)	-	1,352
<b>Total</b>	<b>\$ 2,988</b>	<b>\$ 389</b>	<b>\$ (549)</b>	<b>\$ -</b>	<b>\$ 2,828</b>

  

	2015				
	Principal	Accrued Interest	Allowance for Subsidy	Loan Guarantee Liability	Net
Federal Perkins Loans	\$ 356	\$ 222	\$ (168)	\$ -	\$ 410
TEACH Program Loans	642	97	(108)	-	631
HEAL Program Loans	415	28	(127)	(193)	123
Facilities Loan Programs	1,463	14	(169)	-	1,308
<b>Total</b>	<b>\$ 2,876</b>	<b>\$ 361</b>	<b>\$ (572)</b>	<b>\$ (193)</b>	<b>\$ 2,472</b>

**Federal Perkins Loan Program.** The Federal Perkins Loan program provides low-interest loans to eligible postsecondary school students. In some statutorily defined cases, funds are provided to reimburse schools for loan cancellations. For defaulted loans assigned to the Department, collections of principal, interest, and fees, net of amounts paid by the Department to cover contract collection costs, are transferred to Treasury annually.

**TEACH Grant Program.** The Department awards annual grants of up to \$4,000 to eligible undergraduate and graduate students who agree to serve as full-time mathematics, science, foreign language, bilingual education, special education, or reading teachers at high-need schools for four years within eight years of graduation. The maximum lifetime grant for students is \$16,000 for undergraduate programs and \$8,000 for graduate programs. For students failing to fulfill the service requirement, the grants are converted to direct unsubsidized Stafford Loans. Since grants can be converted to direct loans, for budget and accounting purposes, the program is operated as a loan program under the FCRA.

The subsidy rates applicable to the 2016 loan cohort year follow:

### TEACH Subsidy Rates—Cohort 2016

	Interest Differential	Defaults	Fees	Other	Total
Subsidy Rates	6.23%	0.21%	0.00%	6.61%	13.05%

**HEAL Program.** The Department assumed responsibility in FY 2014 for the HEAL program and the authority to administer, service, collect, and enforce the program. The HEAL program is structured as required by the FCRA. A liquidating account is used to record all cash flows to and from the government resulting from guaranteed HEAL loans committed prior to 1992. All loan activity for 1992 and beyond is recorded in corresponding financing accounts.

**Facilities Loan Programs.** The Department also administers the HBCU Capital Financing program. Since 1992, this program has given HBCUs access to financing for the repair, renovation, and, in exceptional circumstances, the construction or acquisition of facilities, equipment, and infrastructure through federally insured bonds. The Department has authorized a designated bonding authority to make loans to eligible institutions, charge interest, and collect principal and interest payments. In compliance with HEA, as amended, the bonding authority maintains an escrow account to pay the principal and interest on bonds for loans in default.

The total amount of support for HBCU programs, along with any accrued interest and unpaid servicing fees, will be capitalized to principal and be reamortized through the original maturity date of June 1, 2037. The Department has approximately \$1.5 billion in outstanding borrowing from the FFB to support loans made to HBCU institutions and \$235 million obligated to support near term lending as of September 30, 2016.

The Department administers the College Housing and Academic Facilities Loan (CHAFL) program, the College Housing Loan program, and the Higher Education Facilities Loan program. From 1952 to 1993, these programs provided low-interest financing to institutions of higher education for the construction, reconstruction, and renovation of housing, academic, and other educational facilities.

### Administrative Expenses

Administrative expenses, for the years ended September 30, 2016 and 2015, consisted of the following:

#### Administrative Expenses

(Dollars in Millions)

	2016		2015	
	Direct Loan Program	FFEL Program	Direct Loan Program	FFEL Program
Operating Expense	\$ 721	\$ 465	\$ 653	\$ 442
Other Expense	50	33	28	18
<b>Total</b>	<b>\$ 771</b>	<b>\$ 498</b>	<b>\$ 681</b>	<b>\$ 460</b>

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TAB G

RISK ASSUMED II

Appendix C

HUD Meeting Notes and AFR Direct  
Loans/Loan Guarantees Disclosure Note

OCTOBER 2017

## **Meeting with HUD/FHA – Direct Loans/Loan Guarantees**

HUD HQ - 451 7th Street SW, Room 2226,

August 22, 2017, 9:30-10:30am

### **PARTICIPANTS:**

#### **Federal Accounting Standards Advisory Board (FASAB):**

- Wendy Payne, Executive Director
- Robin Gilliam, Assistant Director, Risk Assumed Project Lead
- R. Alan Perry, Detailee

#### **Department of Housing and Urban Development (HUD) Office of Chief Financial Officer (OCFO):**

- Nita Nigam, Accounting CFO, (ACFO)
- Courtney Timberlake, Deputy CFO
- Sau Lai Chung, Budget Analyst, CFO
- Zoya Kaplan, Director Risk Management Division, CFO
- Van Tran (phone), Acting Deputy ACFO for Financial Management

#### **Federal Housing Administration (FHA) - Office of Housing:**

- Nandini Rao, Associate Deputy Assistant Secretary, Office of Risk Management and Regulatory Affairs (ORMRA)
- Stacey Shindelar, Director, Portfolio Analysis Division, ORMRA
- Arnie Miller, Risk Director, Market Analysis Division, ORMRA
- Roberto Garcia, Acting Director Office OF Risk Management, ORMRA
- Jyoti Athavale, Financial Analyst, Portfolio Analysis Division, ORMRA
- Myrna Gordon (phone) Directory, Financial Analysis & Controls Division, FHA Office of Comptroller

### **INTRODUCTIONS / GENERAL INFORMATION:**

Ms. Gilliam opened the meeting with a brief discussion about the Risk Assumed project history and issuance of SFFAS 51, *Insurance Programs* (phase one), and a brief description of the purpose of the project's second phase.

Ms. Payne noted that FASAB's intention was not to question their numbers, but to understand their ideas for reporting risk in a more effective way regarding direct loans and loan guarantees.

HUD explained that the Federal Housing Administration (FHA) prepares their own set of financial statements (FS) which are then consolidated into the Department's agency financial report (AFR).



The accounting shop is the lead on preparing the financial statement estimates and notes related to direct loans and loan guarantees, with FHA doing the modeling work and projections supporting these estimates.

FHA manages the two program areas: single family forward programs, which include forward loans and reverse mortgages, and multi-family housing programs which include healthcare; hospitals and nursing homes.

The process for estimating changed in the past year. Now all estimations are done internally with independent actuaries validating the numbers. Cash flows are projected using the balancing method. There was a large restatement to the Liability for Loan Guarantees (LLG) due to a better recognition of cash flows on reverse mortgages.

## **QUESTIONS:**

### **1. USERS?**

Congress, industry, and the Congressional Budget Office (CBO) all make inquiries about the HUD/FHA AFR. CBO uses the information to help estimate the cost of new loans and guarantees to provide clarity about the assumptions. Industry also reviews the AFR to determine what direction HUD is taking with its new direct loan and loan guarantee products and provide feedback on the balance of government and industry involvement in the marketplace.

Agencies with similar programs but different borrower pools and characteristics may also be users.

### **2. DRAWBACKS OR OPPORTUNITIES TO IMPROVE CURRENT REPORTING?**

#### **A. DUPLICATED INFORMATION:**

Participants agreed that there is duplicative information between budget and financial statement documents but also different constituents for each. HUD/FHA is interested in determining how much and where the overlap is and how to present key pieces of information to users in an understandable way. Information is presented at a high level about how the programs might perform with the policy efforts going forward.

One participant recommended harmonizing the information between the many documents to communicate the information in a way that the public will understand it. But understanding who the “public” audience is, i.e. accountants and financial managers, versus the general public, will help to determine how to present understandable information.

One participant said it is important to present information to help users understand the government’s long-term cost for credit to evaluate from a policy perspective if the costs are appropriate for the program, characteristics, and risks.

## **B. STREAMLINING / BURDEN REDUCTION:**

Ms. Payne informed the group that OMB briefed FASAB at the June meeting about burden reduction. Burden reduction is not just for the preparer but also for the users who are often burdened by voluminous, duplicative, and/or fragmented financial information. There were two recommendations for the Board at the August meeting as part of the reporting model project: 1) remove the stewardship reporting on stewardship investments; and 2) streamline the MD&A performance section to only reference users to the APR and Summary of Performance Information and focus on a higher level narrative in the MD&A.

We also have a project for developing principles around what disclosures should be required by FASAB and whether there is an additional opportunity to provide principles to guide preparers. A survey is available in September about streamlining disclosure requirements to determine which disclosure requirements are burdensome and bloated. Agencies will have an opportunity to complete the survey anonymously with specifics to help with this burden reduction effort.

FASAB staff asked what they thought about including or removing the subsidy rate information. One participant recommended removing subsidy rates to help streamline the balance between the budget and financial reports.

One participant noted that HUD's credit reform AFR notes are very detailed which could be burdensome to users.

Another participant cautioned that any information added to the AFR in an audited section will create an additional cost burden on programs to support resources needed, such as the preparers, the contractors, and the IG to audit. For example, it is a significant investment of time on the preparer if actuarial tables and complex programs are involved.

Participants wanted to know what the cost-benefit is to presenting the same information in the financial statements versus just providing a link to the source material.

Mr. Perry said that FASAB standards have required financial statements to reference external sources of unaudited information, citing SFFAS 52 as an example.

## **A. FORWARD LOOKING MD&A SECTION:**

Ms. Payne asked if there were any thoughts on appropriate guidelines for presenting information in the forward looking section of the Management's Discussion and Analysis (MD&A) of the AFR.

We were unable to discuss the specifics about the forward looking statement in the FHA MD&A statement because the FHA official with expertise in this area was not available. However, one participant pointed out that the LLG is forward looking. Ms. Payne explained that LLG is the book of business for existing loans which is different from forward looking information that projects future loans based on policy and budget request.

## **B. CONSISTENCY:**

One participant said that agencies' supplemental budget reports are very enlightening since they provide a lot of historical data, going back decades. A reader can assess the performance of original estimates by reviewing how the re-estimates differ in relation to those original estimates. But there are no disclosures about why the re-estimates are so big in the AFR.

To address the lack of consistency in agency reporting the participant recommended standardization similar to SEC reports that provide consistency for specific industries by breaking risk factors down by lines of business.

Another participant said that from a user's point of view: there is a gap that prevents understanding. On the private side, a cash flow statement needs to be done by line of business for the past two to three years. On the federal side we see a subsidy rate which provides past performance with future projections but you cannot see the pieces which are very informative. It would be very informative to the user if it was required to report how a program is performing according to cash flows, and what is projected, even if a little more burdensome to the preparer.

## **C. CONDOLIDATING INFORMATION:**

Another participant said that when information is consolidated it can be pulled out of context and make comparing the budget to AFR challenging. For example, the budget numbers are one cohort going out 40 years while the consolidated numbers like the LLG are audited for every loan that currently exists

## **3. RISK FACTORS - NEW ASSUMPTIONS:**

Ms. Gilliam asked if a change in modeling assumptions is disclosed in the AFR. A participant said the source of the assumptions are included, but not the effect of new assumptions.

Participants added one area that affects everyone is the impact of new assumptions, for example, the president's economic assumptions (PEA). The risks assumed are measured by the different assumptions, including the PEA, which change every year. A change in administration can result in significant changes in the PEA. However, the new administration's PEA are not available to include or disclose because they are not yet been officially released. However, HUD/FHA did a mock model for FY 2016 which showed there would have been an 80% difference for one program in the LLG based on the changes in PEA in 2017.

Mr. Perry asked if they thought it was a significant impairment to the predictive feedback to financial statements to not have the assumptions disclosed.

One participant said that while specifics cannot be disclosed, they can note that "a change in an assumption caused..." Another participant said that LLG's are very sensitive to assumptions, such as housing price depreciations, or interest rate changes; just a 1% interest adjustment changes valuations considerably.

One participant said that disclosing the numbers does not matter as much as disclosing the sensitivity. For example, for the reverse mortgage program, a 1% change in the housing price

appreciation assumption has a significant effect on the financial statement estimates for the program.

Ms. Gilliam asked whether sensitivity analyses are described in the financial statements. Participants replied that it is done for the budget and financial statements. Mr. Perry said that one opportunity for financial statement improvements might be to include discussions about significant estimation factors and assumptions that cause material swings in large estimates.

#### **4. METHODOLOGY - MODEL**

Actuarial models are used for forward mortgages while econometric models are used on the reverse mortgages.

HUD/FHA uses the same model for the AFR as for the budget but with different assumptions. There is one set of assumptions in August/September for the LLGs, and a different set for the budget. The same models are used in general, but OMB has final say over agency models included in the budget. If they do not concur with the way a particular model behaves, OMB can override it because the FCRA gives OMB authority over the subsidy estimates – which have been delegated to the agencies.

Ms. Payne asked that when you consider how sensitive LLG is to risk factors how will HUD, for instance, model a new health care policy that takes effect.

A participant said that an impact analysis is run to see how the policy change will impact the LLG and work with OMB for approval. Ms. Payne asked if the information about a change in specific risk factors (policy changes) is ever discussed in the MD&A.

A participant said that no individual policies are discussed, only processes and performance results are discussed in the MD&A. Pre-decisional policies are taken very seriously but not discussed in MD&A since they many not all pass and be implemented.

Another participant said there is a lot of information in other documents such as budget justifications that discuss “forward looking” changes that are being made and why. Other budget documents, such as the *Analytical Perspectives*, discuss impacts of recent changes to programs, depending on the program, its size, and impact on the overall deficit. A good example of this is the insurance chapter. Information about projections in relation to policy changes is available, however, what is the appropriate document to include that discussion in given the information agencies have and the need to preserve the prerogatives of the Executive Branch on making decisions and putting forth information on policy proposals?

Another participant said that it really comes back to purpose. Others agreed, but wanted to know whether the purpose is to provide disclosures for the stakeholders to evaluate policy alternatives, to show a fair presentation of the current financial status, or both.

## **5. MATERIAL SWINGS**

Ms. Gilliam asked if it would be too burdensome to provide an explanation to explain large material changes in the re-estimate.

One participant said an explanation for the taxpayer and users of the financial statements would be beneficial; however, it is a difficult to produce and there should be a consistent methodology across agencies.

### **REQUEST ADDITIONAL INFORMATION:**

Mr. Perry requested HUD/FHA to provide feedback to FASAB regarding suggestions for improving risk information and disclosures and improving the understandability and conciseness of direct loans reporting.

He noted that it would also be helpful to have the opinion of the auditor as to the effect of removing information from the financial statements and if there is a need for a confirmatory value of an audit for that information. For example, is it important for auditors to audit the subsidy rates in the financial statement notes or can they be backed into and confirmed by using other audited numbers elsewhere in the financial statements?

Mses. Gilliam and Payne, and Mr. Perry thanked HUD/FHA for their time.

## HUD – AFR 2016; Section 2: Financial Information

### Note 8: Direct Loans and Loan Guarantees, Non-Federal Borrowers

HUD reports direct loan obligations or loan guarantee commitments made prior to FY 1992 and the resulting direct loans or defaulted guaranteed loans, net of allowance for estimated uncollectible loans or estimated losses.

FHA encourages homeownership through its Single Family Forward programs (Section 203(b), which is the largest program, and Section 234) by making loans readily available with its mortgage insurance programs. These programs insure mortgage lenders against losses from default, enabling those lenders to provide mortgage financing on favorable terms to homebuyers. Multifamily Housing Programs (Section 213, Section 221(d)(4), Section 207/223(f), and Section 223(a)(7)) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, and cooperatives. Healthcare programs (Section 232 and Section 242) enable low cost financing of health care facility projects and improve access to quality healthcare by reducing the cost of capital.

The FHA also insures Home Equity Conversion Mortgages (HECM), also known as reverse mortgages. These loans are used by senior homeowners age 62 and older to convert the equity in their home into monthly streams of income and/or a line of credit to be repaid when they no longer occupy the home. Unlike ordinary home equity loans, a HUD reverse mortgage does not require repayment as long as the home is the borrower's principal residence.

The FHA also administers the HOPE for Homeowners (H4H) program. The program was established by Congress to help those at risk of default and foreclosure refinance into more affordable, sustainable loans.

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**Notes to Financial Statements**

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The allowance for loan losses for the Flexible Subsidy Fund and the Housing for the Elderly and Disabled Program is determined as follows:

**Flexible Subsidy Fund**

There are four parts to the calculation of allowance for loss: (1) loss rate for loans written-off, (2) loss rate for restructured loans, (3) loss rate for loans paid-off, and (4) loss rate for loans delinquent or without repayment activity for 30 years. Loss rates for parts 1 and 3 are based on actual historical data derived from the previous three years. The loss rates for parts 2 and 4 are provided by or agreed to by the Housing Office of Evaluation.

**Housing for the Elderly and Disabled Program**

There are three parts to the calculation of allowance for loss: (1) loss rate for loans issued a Foreclosure Hearing Letter, (2) loss rate for the estimated number of foreclosures in the current year, and (3) loss rate for loans delinquent for more than 180 days. Loss rates for parts 1 and 2 are determined by actual historical data from the previous five years. Loss rate for part 3 is determined or approved by the Housing Office of Evaluation.

Direct loan obligations or loan guarantee commitments made after FY 1991, and the resulting direct loans or defaulted guaranteed loans, are governed by the FCRA and are recorded as the net present value of the associated cash flows (i.e., interest rate differential, interest subsidies, estimated delinquencies and defaults, fee offsets, and other cash flows).

The subsidy rates disclosed pertain only to the current year's cohorts. These rates cannot be applied to the direct loans and guarantees of loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans and loan guarantees reported in the current year result from disbursement of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and re-estimates.

The following is an analysis of loan receivables, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy costs associated with the loans and loan guarantees for FY 2016 and FY 2015:

**A. List of HUD's Direct Loan and/or Guarantee Programs:**

1. FHA
  - a) MMI/CMHI Direct Loan Program
  - b) GI/SRI Direct Loan Program
  - c) MMI/CMHI Loan Guarantee Program
  - d) GI/SRI Loan Guarantee Program
  - e) H4H Loan Guarantee Program

## Notes to Financial Statements

- f) HECM Loan Guarantee Program
- 2. Housing for the Elderly and Disabled
- 3. All Other
  - a) CPD Revolving Fund
  - b) Flexible Subsidy Fund
  - c) Section 108 Loan Guarantees
  - d) Indian Housing Loan Guarantee Fund
  - e) Loan Guarantee Recovery Fund
  - f) Native Hawaiian Housing Loan Guarantee Fund
  - g) Title VI Indian Housing Loan Guarantee Fund
  - h) Green Retrofit Direct Loan Program
  - i) Emergency Homeowners' Loan Program

**B. Direct Loans Obligated Pre-1992 (Allowance for Loss Method)**

(dollars in millions):

2016					
	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans, Net
<b><u>Direct Loan Programs</u></b>					
FHA					
a) MMI/CHMI Direct Loan Program	\$ -	\$ -	\$ -	\$ -	\$ -
b) GI/SRI Direct Loan Program	8	13	(4)	-	17
Housing for the Elderly and Disabled	1,167	14	(10)	-	1,171
All Other			-		
a) CPD Revolving Fund	5	-	(5)	1	1
b) Flexible Subsidy Fund	405	57	(45)	-	417
<b>Total</b>	<b>\$ 1,585</b>	<b>\$ 84</b>	<b>\$ (64)</b>	<b>\$ 1</b>	<b>\$ 1,606</b>
2015					
	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans, Net
<b><u>Direct Loan Programs</u></b>					
FHA					
a) MMI/CHMI Direct Loan Program	\$ -	\$ -	\$ -	\$ -	\$ -
b) GI/SRI Direct Loan Program	14	12	(6)	-	20
Housing for the Elderly and Disabled	1,412	15	(11)	-	1,416
All Other			-		
a) CPD Revolving Fund	5	-	(5)	2	2
b) Flexible Subsidy Fund	428	72	(39)	-	461
<b>Total</b>	<b>\$ 1,859</b>	<b>\$ 99</b>	<b>\$ (61)</b>	<b>\$ 2</b>	<b>\$ 1,899</b>



## Notes to Financial Statements

**C. Direct Loans Obligated Post-1991** (dollars in millions):

	2016				Value of Assets Related to Direct Loans
	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	
<b><u>Direct Loan Programs</u></b>					
FHA					
a) MMI/CHMI Direct Loan Program	\$ -	\$ -	\$ (3)	\$ -	\$ (3)
b) GI/SRI Direct Loan Program	554	1	27	-	582
All Other					
a) Green Retrofit Program	\$ 57	\$ 1	\$ (53)	\$ -	\$ 5
b) Emergency Homeowners' Loan Program	34	-	(35)	-	(1)
c) EHLRP Receipt Account	104	-	-	-	104
<b>Total</b>	<b>\$ 749</b>	<b>\$ 2</b>	<b>\$ (64)</b>	<b>\$ -</b>	<b>\$ 687</b>

  

	2015				Value of Assets Related to Direct Loans
	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	
<b><u>Direct Loan Programs</u></b>					
FHA					
a) MMI/CHMI Direct Loan Program	\$ -	\$ -	\$ (3)	\$ -	\$ (3)
b) GI/SRI Direct Loan Program	103	-	34	-	137
All Other					
a) Green Retrofit Program	\$ 63	\$ 1	\$ (66)	\$ -	\$ (2)
b) Emergency Homeowners' Loan Program	50	-	(50)	-	-
c) EHLRP Receipt Account	133	-	-	-	133
<b>Total</b>	<b>\$ 349</b>	<b>\$ 1</b>	<b>\$ (85)</b>	<b>\$ -</b>	<b>\$ 265</b>

**D. Total Amount of Direct Loans Disbursed (Post-1991)** (dollars in millions):

<b><u>Direct Loan Programs</u></b>	<b><u>Current Year</u></b>	<b><u>Prior Year</u></b>
FHA Risk Sharing Program	\$ 452	\$ 103
All Other		
a) Green Retrofit Program	\$ -	\$ -
b) Emergency Homeowners' Loan Program	-	-
<b>Total</b>	<b>\$ 452</b>	<b>\$ 103</b>

## Notes to Financial Statements

**E. Subsidy Expense for Direct Loans by Program and Component** (dollars in millions):**E1. Subsidy Expense for New Direct Loans Disbursed** (dollars in millions):

<u>Direct Loan Programs</u>	2016				
	Interest		Fees and Other		
	Differential	Defaults	Collections	Other	Total
FHA Risk Sharing Program	\$ (68)	\$ 4	\$ (9)	\$ 21	\$ (52)
All Other					
a) Green Retrofit Program	\$ -	\$ -	\$ -	\$ -	\$ -
b) Emergency Homeowners' Loan Program	-	-	-	-	-
<b>Total</b>	<b>\$ (68)</b>	<b>\$ 4</b>	<b>\$ (9)</b>	<b>\$ 21</b>	<b>\$ (52)</b>

  

<u>Direct Loan Programs</u>	2015				
	Interest		Fees and Other		
	Differential	Defaults	Collections	Other	Total
FHA Risk Sharing Program	\$ (5)	\$ -	\$ (3)	\$ (1)	\$ (9)
All Other					
a) Green Retrofit Program	\$ -	\$ -	\$ -	\$ -	\$ -
b) Emergency Homeowners' Loan Program	-	-	-	-	-
<b>Total</b>	<b>\$ (5)</b>	<b>\$ -</b>	<b>\$ (3)</b>	<b>\$ (1)</b>	<b>\$ (9)</b>

**E2. Modifications and Re-estimates** (dollars in millions):

<u>Direct Loan Programs</u>	2016			
	Total	Interest Rate	Technical	Total
	Modification	Re-estimates	Re-estimates	Re-estimates
FHA Risk Sharing Program	\$ -	\$ -	\$ -	\$ -
All Other				
a) Green Retrofit Program	\$ -	\$ -	\$ (13)	\$ (13)
b) Emergency Homeowners' Loan Program	-	-	-	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (13)</b>	<b>\$ (13)</b>

  

<u>Direct Loan Programs</u>	2015			
	Total	Interest Rate	Technical	Total
	Modification	Re-estimates	Re-estimates	Re-estimates
FHA Risk Sharing Program	\$ -	\$ -	\$ -	\$ -
All Other				
a) Green Retrofit Program	\$ -	\$ -	\$ -	\$ -
b) Emergency Homeowners' Loan Program	-	-	-	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

**E3. Total Direct Loan Subsidy Expense** (dollars in millions):

<u>Direct Loan Programs</u>	Current Year	Prior Year
FHA Risk Sharing Program	\$ (52)	\$ (9)
All Other		
a) Green Retrofit Program	\$ (13)	\$ -
b) Emergency Homeowners' Loan Program	-	-
<b>Total</b>	<b>\$ (65)</b>	<b>\$ (9)</b>

## Notes to Financial Statements

**F. Subsidy Rates for Direct Loans by Program and Component:***Budget Subsidy Rates for Direct Loans*

<u>Direct Loan Programs</u>	2016				
	Interest Differential	Defaults	Fees and Other Collections	Other	Total
FHA Risk Sharing Program	0.0%	2.6%	(7.1%)	0.0%	(4.5%)
All Other					
a) Green Retrofit Program	41.0%	42.6%	0.0%	(1.3%)	82.3%
b) Emergency Homeowners' Loan Program	0.0%	0.0%	0.0%	97.7%	97.7%

  

<u>Direct Loan Programs</u>	2015				
	Interest Differential	Defaults	Fees and Other Collections	Other	Total
FHA Risk Sharing Program	(6.1%)	0.5%	(3.9%)	(1.3%)	(10.8%)
All Other					
a) Green Retrofit Program	41.0%	42.7%	0.0%	(1.3%)	82.3%
b) Emergency Homeowners' Loan Program	0.0%	0.0%	0.0%	97.7%	97.7%

**G. Schedule for Reconciling Subsidy Cost Allowance Balances (Post-1991 Direct Loans)** (dollars in millions):

<u>Beginning Balance, Changes, and Ending Balance</u>	<u>FY 2016</u>	<u>FY 2015</u>
Beginning balance of the subsidy cost allowance	\$ 85	\$ 152
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
a) Interest rate differential costs	(68)	(5)
b) Default costs (net of recoveries)	4	-
c) Fees and other collections	(9)	(3)
d) Other subsidy costs	21	(1)
<b>Total of the above subsidy expense components</b>	(52)	(9)
Adjustments:		
a) Loan modifications	-	-
b) Fees received	1	-
c) Foreclosed properties acquired	-	-
d) Loans written off	(15)	(31)
e) Subsidy allowance amortization	29	1
f) Other	-	(4)
<b>Ending balance of the subsidy cost allowance before re-estimates</b>	48	109
Add or subtract subsidy re-estimates by component:		
a) Interest rate re-estimate	2	-
b) Technical/default re-estimate	33	(24)
Adjustment prior years' credit subsidy reestimates	(19)	-
<b>Total of the above re-estimate components</b>	16	(24)
Ending balance of the subsidy cost allowance	<u>\$ 64</u>	<u>\$ 85</u>

## Notes to Financial Statements

**H. Defaulted Guaranteed Loans from Pre-1992 Guarantees (Allowance for Loss Method)** (dollars in millions):

2016					
	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan and Interest Losses	Foreclosed Property, Net	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FHA					
MMI/CMHI					
a) Single Family	\$ 21	\$ -	\$ (5)	\$ 7	\$ 23
b) Multi Family	-	-	-	-	-
c) HECM	-	-	-	-	-
GI/SRI					
a) Single Family	\$ -	\$ -	\$ (3)	\$ 9	\$ 6
b) Multi Family	1,780	230	(817)	1	1,194
c) HECM	4	2	(5)	(2)	(1)
<b>Total</b>	<b>\$ 1,805</b>	<b>\$ 232</b>	<b>\$ (830)</b>	<b>\$ 15</b>	<b>\$ 1,222</b>
2015					
	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan and Interest Losses	Foreclosed Property, Net	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FHA					
MMI/CMHI					
a) Single Family	\$ 22	\$ -	\$ (7)	\$ 7	\$ 22
b) Multi Family	-	-	-	-	-
c) HECM	-	-	-	-	-
GI/SRI					
a) Single Family	\$ -	\$ -	\$ (4)	\$ 9	\$ 5
b) Multi Family	1,946	234	(808)	1	1,373
c) HECM	4	2	(5)	(2)	(1)
<b>Total</b>	<b>\$ 1,972</b>	<b>\$ 236</b>	<b>\$ (824)</b>	<b>\$ 15</b>	<b>\$ 1,399</b>

## Notes to Financial Statements

**I. Defaulted Guaranteed Loans from Post-1991 Guarantees** (dollars in millions):

2016					
Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property, Gross	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	
FHA					
MMI/CMHI					
a) Single Family	\$ 10,320	\$ 5	\$ (7,327)	\$ 2,817	\$ 5,815
b) Multi Family	-	-	-	-	-
c) HECM	4,472	2,350	(1,580)	36	5,278
GI/SRI					
a) Single Family	\$ 350	\$ -	\$ (241)	\$ 73	\$ 182
b) Multi Family	735	-	(365)	1	371
c) HECM	3,595	1,830	(1,279)	132	4,278
H4H					
a) Single Family	\$ 5	\$ -	\$ (5)	\$ 1	\$ 1
All Other					
a) Indian Housing Loan Guarantee	-	-	-	37	37
b) Native Hawaiian Housing Loan Guarantee	-	-	-	(1)	(1)
<b>Total</b>	<b>\$ 19,477</b>	<b>\$ 4,185</b>	<b>\$ (10,797)</b>	<b>\$ 3,096</b>	<b>\$ 15,961</b>

2015					
Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property, Gross	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	
FHA					
MMI/CMHI					
a) Single Family	\$ 8,802	\$ -	\$ (7,053)	\$ 3,130	\$ 4,879
b) Multi Family	-	-	-	-	-
c) HECM	2,182	992	(790)	10	2,394
GI/SRI					
a) Single Family	\$ 292	\$ 1	\$ (233)	\$ 94	\$ 154
b) Multi Family	655	-	(272)	1	384
c) HECM	3,106	1,517	(1,172)	101	3,552
H4H					
a) Single Family	\$ 4	\$ -	\$ 2	\$ 1	\$ 7
All Other					
a) Indian Housing Loan Guarantee	-	-	-	31	31
b) Native Hawaiian Housing Loan Guarantee	-	-	-	(1)	(1)
<b>Total</b>	<b>\$ 15,041</b>	<b>\$ 2,510</b>	<b>\$ (9,518)</b>	<b>\$ 3,367</b>	<b>\$ 11,400</b>

	<b>2016</b>	<b>2015</b>
Total Credit Program Receivables and Related Foreclosed Property, Net	<u>\$19,476</u>	<u>\$14,965</u>

## Notes to Financial Statements

**J. Guaranteed Loans Outstanding** (dollars in millions):**J1. Guaranteed Loans Outstanding** (dollars in millions):

<u>Loan Guarantee Programs</u>	<u>2016</u>	
	<u>Outstanding Principal, Guaranteed Loans, Face Value</u>	<u>Amount of Outstanding Principal Guaranteed</u>
FHA Programs		
a) MMI/CMHI Funds	\$ 1,207,833	\$ 1,097,974
b) GI/SRI Funds	127,737	115,318
c) H4H Program	91	83
All Other	7,862	7,856
<b>Total</b>	<b>\$ 1,343,523</b>	<b>\$ 1,221,231</b>

  

<u>Loan Guarantee Programs</u>	<u>2015</u>	
	<u>Outstanding Principal, Guaranteed Loans, Face Value</u>	<u>Amount of Outstanding Principal Guaranteed</u>
FHA Programs		
a) MMI/CMHI Funds	\$ 1,168,560	\$ 1,065,896
b) GI/SRI Funds	123,399	112,063
c) H4H Program	98	92
All Other	7,321	7,317
<b>Total</b>	<b>\$ 1,299,378</b>	<b>\$ 1,185,368</b>

**J2. Home Equity Conversion Mortgage Loans Outstanding** (dollars in millions):

<u>Loan Guarantee Programs</u>	<u>2016 Current Year Endorsements</u>	<u>Cumulative</u>	
		<u>Current Outstanding Balance</u>	<u>Maximum Potential Liability</u>
FHA Programs	\$ 14,612	\$ 104,648	\$ 148,097

  

<u>Loan Guarantee Programs</u>	<u>2015 Current Year Endorsements</u>	<u>Cumulative</u>	
		<u>Current Outstanding Balance</u>	<u>Maximum Potential Liability</u>
FHA Programs	\$ 15,890	\$ 105,471	\$ 149,645

## Notes to Financial Statements

*J3. New Guaranteed Loans Disbursed (dollars in millions):*

<u>Loan Guarantee Programs</u>	2016	
	<u>Outstanding Principal, Guaranteed Loans, Face Value</u>	<u>Amount of Outstanding Principal Guaranteed</u>
FHA Programs		
a) MMI/CMHI Funds	\$ 221,841	\$ 219,866
b) GI/SRI Funds	12,224	12,168
c) H4H Program	-	-
All Other	980	979
<b>Total</b>	<b>\$ 235,045</b>	<b>\$ 233,013</b>

  

<u>Loan Guarantee Programs</u>	2015	
	<u>Outstanding Principal, Guaranteed Loans, Face Value</u>	<u>Amount of Outstanding Principal Guaranteed</u>
FHA Programs		
a) MMI/CMHI Funds	\$ 213,125	\$ 211,322
b) GI/SRI Funds	11,366	11,311
c) H4H Program	-	-
All Other	1,008	1,008
<b>Total</b>	<b>\$ 225,499</b>	<b>\$ 223,641</b>

**K. Liability for Loan Guarantees (Estimated Future Default Claims, Pre-1992) (dollars in millions):**

<u>Loan Guarantee Programs</u>	2016		
	<u>Liabilities for Losses on Pre-1992 Guarantees, Estimated Future Default Claims</u>	<u>Liabilities for Loan Guarantees for Post- 1991 Guarantees (Present Value)</u>	<u>Total Liabilities For Loan Guarantees</u>
FHA Programs	\$ -	\$ (2,360)	\$ (2,360)
All Other	-	303	303
<b>Total</b>	<b>\$ -</b>	<b>\$ (2,057)</b>	<b>\$ (2,057)</b>

  

<u>Loan Guarantee Programs</u>	2015		
	<u>Liabilities for Losses on Pre-1992 Guarantees, Estimated Future Default Claims</u>	<u>Liabilities for Loan Guarantees for Post- 1991 Guarantees (Present Value)</u>	<u>Total Liabilities For Loan Guarantees</u>
FHA Programs	\$ 7	\$ 13,177	\$ 13,184
All Other	-	289	289
<b>Total</b>	<b>\$ 7</b>	<b>\$ 13,466</b>	<b>\$ 13,473</b>

## Notes to Financial Statements

**L. Subsidy Expense for Post-1991 Guarantees:*****L1. Subsidy Expense for Loan Guarantees (dollars in millions):***

		2016			
<u>Loan Guarantee Programs</u>	<u>Endorsement Amount</u>	<u>Default Component</u>	<u>Fees Component</u>	<u>Other Component</u>	<u>Subsidy Amount</u>
FHA					
a) MMI/CMHI Funds, Excluding HECM	\$ 221,841	\$ 5,586	\$ (16,461)	\$ 1,791	\$ (9,084)
b) MMI/CMHI Funds, HECM	14,612	844	(945)	-	(101)
c) GI/SRI Funds	12,224	181	(661)	-	(480)
d) H4H Program	-	-	-	-	-
All Other	-	12	-	-	12
<b>Total</b>	<b>\$ 248,677</b>	<b>\$ 6,623</b>	<b>\$ (18,067)</b>	<b>\$ 1,791</b>	<b>\$ (9,653)</b>

  

		2015			
<u>Loan Guarantee Programs</u>	<u>Endorsement Amount</u>	<u>Default Component</u>	<u>Fees Component</u>	<u>Other Component</u>	<u>Subsidy Amount</u>
FHA					
a) MMI/CMHI Funds, Excluding HECM	\$ 213,125	\$ 5,685	\$ (18,707)	\$ -	\$ (13,022)
b) MMI/CMHI Funds, HECM	15,890	991	(1,055)	-	(64)
c) GI/SRI Funds	11,366	191	(703)	-	(512)
d) H4H Program	-	-	-	-	-
All Other	-	8	-	-	8
<b>Total</b>	<b>\$ 240,381</b>	<b>\$ 6,875</b>	<b>\$ (20,465)</b>	<b>\$ -</b>	<b>\$ (13,590)</b>

***L2. Modification and Re-estimates (dollars in millions):***

		2016		
<u>Loan Guarantee Programs</u>	<u>Total Modifications</u>	<u>Interest Rate Re-estimates</u>	<u>Technical Re-estimates</u>	<u>Total Re-estimates</u>
FHA				
a) MMI/CMHI Funds	\$ -	\$ -	\$ (7,897)	\$ (7,897)
b) GI/SRI Funds	-	-	(225)	(225)
All Other	-	-	(28)	(28)
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (8,150)</b>	<b>\$ (8,150)</b>

  

		2015		
<u>Loan Guarantee Programs</u>	<u>Total Modifications</u>	<u>Interest Rate Re-estimates</u>	<u>Technical Re-estimates</u>	<u>Total Re-estimates</u>
FHA				
a) MMI/CMHI Funds	\$ -	\$ -	\$ (2,247)	\$ (2,247)
b) GI/SRI Funds	-	-	(1,618)	(1,618)
All Other	-	-	(12)	(12)
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (3,877)</b>	<b>\$ (3,877)</b>



## Notes to Financial Statements

*L3. Total Loan Guarantee Subsidy Expense (dollars in millions):*

<u>Loan Guarantee Programs</u>	<u>Current Year</u>	<u>Prior Year</u>
FHA		
a) MMI/CMHI Funds	\$ (17,082)	\$ (15,333)
b) GI/SRI Funds	(704)	(2,130)
c) H4H Program	-	-
All Other	\$ (17)	\$ (4)
Total	<u>\$ (17,803)</u>	<u>\$ (17,467)</u>

**M. Subsidy Rates for Loan Guarantees by Programs and Component:***Budget Subsidy Rates for Loan Guarantees for FY 2016 Cohorts*

<u>Loan Guarantee Program</u>	<u>Default</u>	<u>Fees and Other Collections</u>	<u>Total</u>
<b>FHA Programs</b>			
MMI/CMHI			
Single Family - Forward	2.3%	(6.1%)	(3.8%)
Single Family - HECM	5.8%	(6.5%)	(0.7%)
Single Family - Refinancing	10.0%	(10.0%)	0.0%
Multi Family - Section 213	0.0%	0.0%	0.0%
GI/SRI Funds			
Apartments - NC/SC	2.4%	(5.2%)	(2.7%)
Apartments - NC/SC04/01/2016	1.9%	(4.3%)	(2.4%)
Apartments - Refinance	0.3%	(5.0%)	(4.7%)
Apartments Refinance - 04/01/16	0.3%	(3.9%)	(3.6%)
Healthcare			
MM - FHA Full Insurance - Health Care	4.0%	(7.4%)	(3.4%)
MF- - Hospitals	3.2%	(6.5%)	(3.2%)
H4H Programs			
Single Family - Section 257	0.0%	0.0%	0.0%
<b>All Other Programs</b>			
CDBG, Section 108(b)	0.0%	0.0%	0.0%
Loan Guarantee Recovery	50.0%	0.0%	50.0%
Indian Housing (weighted average)	0.6%	0.0%	0.6%
Native Hawaiian Housing	0.5%	0.0%	0.5%
Title VI Indian Housing	11.5%	0.0%	11.5%

## Notes to Financial Statements

*Budget Subsidy Rates for Loan Guarantees for FY 2015 Cohorts*

<u>Loan Guarantee Program</u>	<u>Default</u>	<u>Fees and Other Collections</u>	<u>Total</u>
<b>FHA Programs</b>			
MMI/CMHI			
Single Family - Forward	2.7%	(9.9%)	(7.2%)
Single Family - HECM	6.2%	(6.6%)	(0.4%)
Single Family - Refinancing	10.1%	(10.1%)	0.0%
Multi Family - Section 213	0.0%	0.0%	0.0%
GI/SRI			
Multifamily			
Apartments	2.5%	(6.2%)	(3.7%)
Apartments Refinance	0.3%	(5.0%)	(4.7%)
Healthcare			
Residential Care	3.8%	(8.0%)	(4.2%)
Hospitals	2.6%	(7.1%)	(4.5%)
H4H			
Single Family - Section 257	0.0%	0.0%	0.0%
<b>All Other Programs</b>			
CDBG, Section 108(b)	2.4%	0.0%	2.4%
Loan Guarantee Recovery	50.0%	0.0%	50.0%
Indian Housing (weighted average)	1.3%	0.0%	1.3%
Native Hawaiian Housing	0.6%	0.0%	0.6%
Title VI Indian Housing	11.2%	0.0%	11.2%

## Notes to Financial Statements

**N. Schedule for Reconciling Loan Guarantee Liability Balances (Post-1991 Loan Guarantees)** (dollars in millions):

<b>Beginning Balance, Changes, and Ending Balance</b>	<b>2016</b>	<b>2015</b>
Beginning balance of the loan guarantee liability	\$ 15,571	\$ 32,919
Add: subsidy expense for guaranteed loans disbursed during the reporting years by component:		
(a) Interest supplement costs	-	-
(b) Default costs (net of recoveries)	6,623	6,875
(c) Fees and other collections	(18,067)	(20,465)
(d) Other subsidy costs	1,791	-
Total of the above subsidy expense components	\$ (9,653)	\$ (13,590)
Adjustments:		
(a) Loan guarantee modifications	-	-
(b) Fees Received	14,029	13,288
(c) Interest supplemental paid	-	-
(d) Foreclosed property and loans acquired	11,165	13,561
(e) Claim payments to lenders	(22,445)	(26,642)
(f) Interest accumulation on the liability balance	(177)	580
(g) Other	828	364
Ending balance of the loan guarantee liability	\$ 9,318	\$ 20,480
Add or Subtract subsidy re-estimates by component:		
(a) Interest rate re-estimate	-	-
(b) Technical/default re-estimate	(3,549)	(3,877)
(c) Adjustment of prior years credit subsidy re-estimates	(6,272)	(1,032)
Total of the above re-estimate components	(9,821)	(4,909)
<b>Ending balance of the loan guarantee liability</b>	<b>\$ (503)</b>	<b>\$ 15,571</b>
Less: unrealized Ginnie Mae claims from defaulted loans	\$ (1,554)	\$ (2,098)
<b>Ending balance of the loan guarantee liability</b>	<b>\$ (2,057)</b>	<b>\$ 13,473</b>

**O. Administrative Expenses** (dollars in millions):

<b>Loan Guarantee Program</b>	<b>2016</b>	<b>2015</b>
FHA	\$ 586	\$ 557
All Other	-	-
<b>Total</b>	<b>\$ 586</b>	<b>\$ 557</b>

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RISK ASSUMED II

Appendix D

SBA Meeting Notes and AFR Direct  
Loans/Loan Guarantees Disclosure Note

OCTOBER 2017

**SBA Meeting Notes  
Direct Loans and Loan Guarantees  
August 23, 2017**

**PARTICIPANTS:**

**FASAB:**

- Wendy Payne, Executive Director
- Robin Gilliam, Assistance Director, Risk Assumed Project Lead
- R. Alan Perry, Detailee

**SBA:**

- Dorrice Roth, Deputy CFO
- Kris (Krzysztof) Fizyta, Financial Program Specialist, Office of Financial Analysis and Modeling
- John Kushman, Director OFA, Financial Reporting
- Ed Senseney (on Phone) Director of Office of Financial Analysis and Modeling

Ms. Gilliam opened the meeting with a brief discussion about the Risk Assumed project history and issuance of SFFAS 51, *Insurance Programs* (phase one), and a brief description of the purpose of the project's second phase. Staff is researching how risk is reported and if there are better ways to disclose risk around the direct loans/loan guarantees. She noted that they were not there to question their numbers, but to gather information and ideas to help determine the scope of this project.

**DISCUSSION**

**1. WHO ARE THE PRIMARY USERS OF DIRECT LOAN / LOAN GUARANTEE INFORMATION IN THE AFR?**

**OCFO email Response:**

The "Informed Public."

**Additional discussion:**

Mr. Fizyta said he has received questions from the press about how much SBA programs cost and he would refer them to AFR footnote 6.i. While he thinks the information is clear, he points out that it is important for users to understand basic FCRA terms first.

Mr. Senseney said that footnote 6 is the largest in the AFR and quite extensive, with a lot of output from the reestimates and explanations of variances. SBA acknowledged that it is a very complicated footnote even for those that have been working with it for years. For example, during a brown bag lunch held by SBA there were a lot of different perspectives on how to look at and present this information. To understand footnote 6,

and especially 6.i, users need a general understanding of the federal credit reformed act (FCRA). However, few people understand what re-estimates are and their purpose. And then trying to explain the difference between upward/downward estimates and the budgeted subsidy rates is also difficult. He estimates that 80% of users do not understand this.

Ms. Roth agreed and suggested that a FCRA task force could be useful in determining what and how to present more meaningful information without imposing undue burden on preparers.

She added that it is very difficult to determine what information is useful when it is hard to identify the users. Agencies experience some level of frustration when more and more compliance is added to accommodate users, when no one seems to have a good understanding of the user community. Time and resources are also expended to explain to stakeholders that large reestimates are not error corrections.

Participants agreed that reporting and disclosure are based on compliance with FASAB guidance and A-136, but there is a little more discretion in the MD&A where they can talk about program results.

## **2. GENERAL INFORMATION:**

Ms. Gilliam asked for an explanation about loans **approved vs. disbursed**.

Participants explained that there is a difference between loans approved and loans disbursed. Disbursements can take several years based on disbursement criteria. Mr. Kushman said a portion of their portfolio is revolving lines of credit that may never be used depending on the borrower's need for the money. For example, in the disaster loan program insurance may cover losses and/or they decide not to rebuild. As a result, SBA approves more loans than are disbursed. Approved loans are maintained on SBA's books until cancelled.

## **3. REDUCING BURDEN OF REPORTING – RECOMMENDATIONS TO IMPROVE AFRs:**

### **OCFO email Response:**

- a. One possibility would be to move the disclosure to GFRS from statements and make the disclosure available to the public.
- b. In the place of the detail, substitute a discussion of agency lending programs, why programs are reestimated, cost to the taxpayer and benefits to citizens.

Additional discussion:

Ms. Gilliam noted that Statement of Federal Financial Accounting Standards (SFFAS) 2 mirrors the law. She inquired whether SBA staff saw any opportunities to streamline the related disclosures while still complying with the law.

Ms. Payne informed the group that OMB briefed FASAB at the June meeting about burden reduction. Burden reduction is not just for the preparer but also for users who are often burdened by voluminous, duplicative, and/or fragmented financial information. There were two recommendations for the Board at the August meeting as part of the reporting model project: 1) remove the stewardship reporting on stewardship investments; and 2) streamline the MD&A performance section to only reference users to the Annual Performance Reports (APR) and Summaries of Performance Information and focus on a higher level narrative in the MD&A.

We also have a project for developing principles around what disclosures should be required by FASAB and whether there are additional opportunities to or needs for providing principles and/or guidance to preparers. A survey is available in September about streamlining disclosure requirements to determine which disclosure requirements are burdensome and bloated. Agencies and the public will have an opportunity to complete the survey anonymously with specifics to help with this burden reduction effort.

Ms. Gilliam invited attendees to complete the current general survey and add specifics about FCRA disclosures. She asked if a survey with specific questions geared toward FCRA reporting would be helpful. Participants said yes. She informed them she would forward the survey to SBA upon its release.

Mr. Senseney said that because of the tight timeframes to complete the footnote and answer all the auditing questions there is no time to think strategically, operationally or practically about how to streamline and improve the footnote. Mr. Fizyta recommended 1–2 pages that explains at a high level what re-estimate means, and why agencies do it every year.

Mr. Perry said some of that information was in Note 1. Ms. Roth agreed, but only if users know to look there. For example, a journalist does not know to look at note 1. They have to peruse everything to find what they are looking for. Mr. Kushman added there are 140 pages of information to peruse.

Ms. Gilliam asked if they thought subsidy rates could be excluded from the AFR due to duplication with budget report. Ms. Roth said it would be helpful if it was only in the budget. She is concerned that more and more information is being required in the AFR/MD&A when it is also required in other reports.

#### **4. FORWARD-LOOKING INFORMATION:**



Ms. Payne noted that A-136's goal is a standardized format across the government. A lot of the content is driven by OMB. Mr. Kushman agreed adding that note 6.e relates to an A-136 requirement for the Liability for Loan Guarantees and reports everything that is appropriate for SBA.

Ms. Payne asked if, in relation to the heavy focus on re-estimate, there was a place or forum where SBA discusses forward-looking information and what the key risks are for the direct loan and loan guarantee programs. Participants were not aware of reporting any forward-looking information. Mr. Kushman noted the economic factors, which are often determined by OMB, drive costs of the program.

Mr. Fizyta said that SBA's reestimates take into account what happened in the past while calculating the future cash flows for the remaining portfolio. The estimation models combine historical performance with loan characteristics and macroeconomic factors to project future performance.

## **5. SENSITIVITY ANALYSIS:**

Ms. Payne asked about **sensitivity analyses**. Mr. Fizyta said they do sensitivity analyses for internal purposes to see on how the models are behaving and performing. Analysts have an idea as to what to expect, so if there are unexpected results, sensitivity analysis helps them to determine if there is a problem with the model or program. Participants said they do not report sensitivity analyses in the financial statements. They agreed that while they could be helpful information to users it would also be a burden to produce.

Mr. Senseney said SBA models are forward-looking and have a predictive nature that includes the president's economic assumptions (PEA). However, forecasts and predictions are only as good as the risk factors which are also estimated and can be unstable. Therefore, predictions/forecasts are limited in their usefulness.

## **6. RISK FACTORS:**

### **OCFO email Response:**

- a. SBA considers an array of risk factors when estimating subsidy costs. Some of the key risks include: assumption methodology, data integrity, coding accuracy, and correctly modeling the program structure.
- b. OMB provides general guidance on preparing subsidy estimate in a controlled environment. SBA designed a custom controls process that incorporates OMB's general guidance; however, [it] is more specific and tailored to SBA's models and the risks inherent to the subsidy estimate process.

### **Additional discussion:**

Participants noted that SBA's significant risk factors include unemployment, GDP, and interest rates included at various levels in different models.

## **7. METHODOLOGY:**

### **OCFO Response:**

SBA primarily uses either a logit model or historical average methodology to estimate subsidy cost. The approach used varies for each product/program. The approach depends on the size of the program being modeled, the robustness of historical data, and the factors that can attribute to varied performance over time.

8. **SUBSIDY REESTIMATES:** What accounts for wide swings in subsidy reestimates each year? What information do you think users would benefit most from? For example, items such as the dollar amount difference and percentage change; narrative explanation; a reconciliation showing key causes of the change; trends....?

### **OCFO email Response:**

- a. Reestimates vary every year based on differences in actual program performance versus what was previously estimated, changes in actual and estimated macroeconomic conditions, and changes in model methodologies.
  - b. Users would likely benefit most from a narrative explanation of the change that points to key factors that drove the reestimate, such as difference between actual and estimate loan performance, or changes in estimated macroeconomic conditions. It would be useful as well to provide dollar amount and or percentage changes for drivers of the cost, such as the default rate.
9. **When would material swings in subsidy estimates warrant discussion in MD&A? In those cases, what matters should be discussed?**

### **OCFO email Response:**

All material changes should be discussed in order to aid the user's understanding.

## NOTE 6 CREDIT PROGRAM RECEIVABLES AND LIABILITY FOR LOAN GUARANTIES

### A. Loan Program Descriptions and Accounting

#### LOAN PROGRAM DESCRIPTIONS

The SBA provides guaranties that help small businesses obtain bank loans and licensed companies to make investments in qualifying small businesses. The SBA also makes loans to microloan intermediaries and provides a direct loan program that assists homeowners, renters, and businesses to recover from disasters.

#### MAJOR DIRECT LOAN AND LOAN GUARANTY PROGRAMS

Program group	Program type	Program
Disaster	Direct	Disaster Assistance Loans
Business	Guarantied	7(a) Loan Guaranty
Business	Guarantied	504 Certified Development Company
Business	Guarantied	Small Business Investment Company Debentures
Business	Direct	7(m) Microloan

SBA's Disaster Assistance Loan program makes direct loans to disaster victims under four categories: (1) loans for homes and personal property; (2) physical disaster loans to businesses of any size; (3) economic injury loans to small businesses without credit available elsewhere; and (4) economic injury loans to eligible businesses affected by essential employees called up to active duty in the military reserves. The maximum interest rate is 4 percent for loan applicants without credit available elsewhere and 8 percent for applicants with credit available elsewhere.

SBA's business loan programs include its flagship 7(a) Loan Guaranty program, in which the SBA guarantees up to 90 percent of the principal amount of loans made by banks and other lending institutions to small businesses not able to obtain credit elsewhere.

The Section 504 Certified Development Company program guarantees 100 percent of the principal and interest payments on debentures issued by development companies that make small business loans secured primarily by real estate.

The Small Business Investment Company Debentures program guarantees principal and interest payments on securities issued by investment capital firms, which in turn make investments in small businesses.

The 7(m) Microloan program provides direct loans to non-profit intermediaries, which use these funds to make loans up to \$50,000 to eligible small businesses.

#### CREDIT SUBSIDY MODELING

The SBA estimates future cash flows for direct and guarantied loans using economic and financial credit subsidy models. These estimated cash flows are used to develop the subsidy funding required under the Federal Credit Reform Act of 1990. The SBA has developed a customized credit subsidy model for each of its major loan guaranty programs.

SBA's models vary in the specific methodologies employed to forecast future program cash flows. In general, however, models for all major credit programs use historical data as the basis for assumptions about future program performance and then translate these assumptions into nominal cash flow estimates by applying rules about program structure. Nominal cash flow forecasts are discounted using the Office of Management and Budget's Credit Subsidy Calculator that has both forecasted and actual Treasury interest rates.

Historical data is used as the basis for program performance assumptions. The historical data undergoes quality review and analysis prior to its use in developing model assumptions.

Key input to the subsidy models varies by program. Input includes items such as:

- Contractual terms of the loan or guaranty such as loan amount, interest rate, maturity, and grace period
- Borrower characteristics
- Loan origination methods
- Economic indicators such as gross domestic product growth and unemployment rate
- Loan performance assumptions, for example: conditional purchase and prepayment rates, and recovery rates
- Loan fee rates

## SUBSIDY FUNDING UNDER THE FEDERAL CREDIT REFORM ACT

FCRA requires that the credit subsidy costs of direct loans and loan guaranties be expensed in the year loans are disbursed. The credit subsidy cost is the net present value of expected cash inflows and outflows over the life of a guaranteed loan, or the difference between the net present value of expected cash flows and the face value of a direct loan. The cost expressed as a percentage of loans disbursed is termed the subsidy rate. The SBA receives appropriations annually to fund its credit programs based on the subsidy rate that applies to the credit program level approved by Congress. The SBA records subsidy expenses when loans are disbursed. In accordance with FCRA, subsidy costs are reestimated annually.

## CREDIT PROGRAM RECEIVABLES AND RELATED FORECLOSED PROPERTY, NET

FCRA governs direct loans made after FY 1991. FCRA direct loans are valued at the present value of expected future cash flows, discounted at the interest rate of marketable Treasury securities. The subsidy allowance represents the difference between the outstanding loans receivable balance and the net present value of the estimated cash flows of the loans over their remaining term. The subsidy allowance is subtracted from the outstanding loans receivable balance to obtain the net loans receivable balance.

Guaranteed loans purchased by the SBA upon borrower default are established as loans receivable and are valued in a similar manner as direct loans under FCRA.

Direct loans and defaulted guaranties made prior to FCRA are valued at the current receivable balance net of an allowance for uncollectible amounts calculated using historical loss experience.

The SBA advances payments semiannually to honor SBA's timely payment requirement of principal and interest due for debentures in SBA's Section 504 Certified Development Company and Small Business Investment Company programs. The advances are liquidated by receipt of the payments due from borrowers in these programs. Advance balances are reported as Other Loans Receivable.

Interest receivable is comprised of accrued interest on loans receivable and purchased interest related to defaulted guaranteed loans. Interest income is accrued at the contractual rate on the outstanding principal amount and is reduced by the amount of interest income accrued on non-performing loans in excess of 90 days delinquent. Purchased interest is carried at cost. A 100 percent loss allowance is established for all purchased interest on non-performing loans.

Foreclosed property is comprised of real and business-related and personal property acquired through foreclosure on direct loans and defaulted loan guaranties. Properties acquired as a result of defaulted loans committed after FY 1991 are shown at recoverable value which is adjusted to the present value of expected future cash flows for financial statement presentation through the allowance for subsidy. Other foreclosed property is shown at the appraised value. At September 30, 2016, SBA's foreclosed property was \$24.2 million related to 86 loans. The properties had been held for an average of 1,187 days. At September 30, 2015, foreclosed property was \$30.4 million related to 87 loans. The properties had been held for an average of 1,106 days.

## VALUATION METHODOLOGY FOR THE LIABILITY FOR LOAN GUARANTIES UNDER FCRA

FCRA also governs loan guaranties made after FY 1991. A liability for outstanding guaranties is included on SBA's Balance Sheet. The liability for guarantied loans committed after FY 1991 is based on the net present value of their expected future cash flows including guaranty fee inflows and the net cash outflows of defaulted guarantied loans purchased by SBA.

## VALUATION METHODOLOGY FOR PRE-FCRA LIABILITY FOR LOAN GUARANTIES

The SBA values pre-credit reform direct and defaulted guarantied loans by estimating an allowance for loan losses. This allowance is offset against gross loan receivables to obtain SBA's expected net collections from these assets. The SBA establishes a 100 percent allowance for pre-credit reform direct and guarantied loans that are past due more than 180 days. A liability is also established for active pre-credit reform loan guaranties. The liability is estimated based on historical experience.

## B. Credit Program Receivables and Related Foreclosed Property, Net

(Dollars in Thousands)

<b>As of September 30, 2016</b>	<b>Pre-1992 Loans</b>	<b>Post-1991 Loans</b>	<b>Total</b>
<b>Direct Business Loans</b>			
Business Loans Receivable	\$ 2,011	\$ 173,528	\$ 175,539
Interest Receivable	2,745	405	3,150
Foreclosed Property	3,113	—	3,113
Allowance	(4,687)	(13,128)	(17,815)
<b>Total Direct Business Loans</b>	<b>3,182</b>	<b>160,805</b>	<b>163,987</b>
<b>Direct Disaster Loans</b>			
Disaster Loans Receivable	1,931	5,992,848	5,994,779
Interest Receivable	196	34,337	34,533
Foreclosed Property	—	1,874	1,874
Allowance	(203)	(939,342)	(939,545)
<b>Total Direct Disaster Loans</b>	<b>1,924</b>	<b>5,089,717</b>	<b>5,091,641</b>
<b>Defaulted Guaranteed Business Loans &amp; Other Loans Receivable</b>			
Defaulted Guaranteed Business Loans	1,512	3,941,186	3,942,698
Other Loans Receivable (see note below)	—	222,318	222,318
Interest Receivable	9,042	37,845	46,887
Foreclosed Property	1,868	17,303	19,171
Allowance	(4,723)	(3,299,090)	(3,303,813)
<b>Total Defaulted Guaranteed Business Loans &amp; Other Loans Receivable</b>	<b>7,699</b>	<b>919,562</b>	<b>927,261</b>
<b>Total Credit Program Receivables &amp; Related Foreclosed Property, Net</b>			<b>\$ 6,182,889</b>
<b>As of September 30, 2015</b>	<b>Pre-1992 Loans</b>	<b>Post-1991 Loans</b>	<b>Total</b>
<b>Direct Business Loans</b>			
Business Loans Receivable	\$ 5,631	\$ 167,569	\$ 173,200
Interest Receivable	2,277	528	2,805
Foreclosed Property	3,110	—	3,110
Allowance	(6,672)	(11,562)	(18,234)
<b>Total Direct Business Loans</b>	<b>4,346</b>	<b>156,535</b>	<b>160,881</b>
<b>Direct Disaster Loans</b>			
Disaster Loans Receivable	2,907	6,314,459	6,317,366
Interest Receivable	145	32,947	33,092
Foreclosed Property	—	1,601	1,601
Allowance	(555)	(1,087,238)	(1,087,793)
<b>Total Direct Disaster Loans</b>	<b>2,497</b>	<b>5,261,769</b>	<b>5,264,266</b>
<b>Defaulted Guaranteed Business Loans &amp; Other Loans Receivable</b>			
Defaulted Guaranteed Business Loans	5,634	5,492,503	5,498,137
Other Loans Receivable (see note below)	—	226,571	226,571
Interest Receivable	6,698	73,858	80,556
Foreclosed Property	2,019	23,628	25,647
Allowance	(8,691)	(4,744,622)	(4,753,313)
<b>Total Defaulted Guaranteed Business Loans &amp; Other Loans Receivable</b>	<b>5,660</b>	<b>1,071,938</b>	<b>1,077,598</b>
<b>Total Credit Program Receivables &amp; Related Foreclosed Property, Net</b>			<b>\$ 6,502,745</b>

Note: Other Loans Receivable includes payments advanced by the SBA against future reimbursements in the SBIC and 504 Guaranty programs.

## C. Loans Disbursed and Outstanding Loan Obligations

(Dollars in Thousands)

### DIRECT LOANS

<b>New Loans Disbursed During the Year Ended September 30,</b>	<b>2016</b>	<b>2015</b>
Business Direct Loan Program	\$ 33,594	\$ 25,917
Disaster Loan Program	401,121	294,066
<b>Total Direct Loans Disbursed</b>	<b>\$ 434,715</b>	<b>\$ 319,983</b>

<b>Outstanding Loan Obligations as of September 30,</b>	<b>2016</b>	<b>2015</b>
Business Direct Loan Program	\$ 42,839	\$ 43,991
Disaster Loan Program	851,495	116,667
<b>Total Direct Loan Obligations</b>	<b>\$ 894,334</b>	<b>\$ 160,658</b>

### GUARANTIED LOANS

<b>New Loans Disbursed During the Year Ended September 30,</b>	<b>2016</b>	<b>2015</b>
Total Principal Disbursed at Face Value	\$ 26,971,386	\$ 24,933,967
Total Principal Disbursed Guaranteed by the SBA	21,294,900	19,775,428

<b>Outstanding Loan Obligations as of September 30,</b>	<b>2016</b>	<b>2015</b>
Business Guaranteed Loan Programs	\$ 16,766,201	\$ 16,070,177

<b>Loans Outstanding as of September 30,</b>	<b>2016</b>	<b>2015</b>
Total Principal Outstanding at Face Value	\$ 113,113,553	\$ 105,662,573
Total Principal Outstanding Guaranteed by the SBA	93,764,878	88,337,969

SBA's guaranteed loan servicing agent provides data to the SBA on the unpaid principal balance of guaranteed loans within a precision of less than 1 percent due to timing.

## D. Subsidy Cost Allowance Balances

(Dollars in Thousands)

<b>For the Years Ended September 30,</b>	<b>2016</b>	<b>2015</b>
<b>Post-1991 Business Direct and Purchased Guaranteed Loans</b>		
<b>Beginning Balance of Allowance Account</b>	<b>\$ 4,756,184</b>	<b>\$ 6,174,526</b>
Current Year's Subsidy (see 6G for breakdown by component)	4,000	4,068
Loans Written Off	(1,927,638)	(2,110,027)
Subsidy Amortization	(2,208)	(2,207)
Allowance Related to Guaranteed Loans Purchased This Year	182,476	404,131
Miscellaneous Recoveries and Costs	299,146	286,654
Balance of Subsidy Allowance Account before Reestimates	3,311,960	4,757,145
Technical Assumptions/Default Reestimates	258	(961)
<b>Ending Balance of Allowance Account</b>	<b>\$ 3,312,218</b>	<b>\$ 4,756,184</b>
<b>Post-1991 Disaster Direct Loans</b>		
<b>Beginning Balance of Allowance Account</b>	<b>\$ 1,087,238</b>	<b>\$ 1,230,152</b>
Current Year's Subsidy (see 6G for breakdown by component)	48,397	33,908
Loans Written Off	(111,340)	(118,547)
Subsidy Amortization	(4,987)	(6,621)
Miscellaneous Recoveries and Costs	77,684	66,110
Balance of Subsidy Allowance Account before Reestimates	1,096,992	1,205,002
Technical Assumptions/Default Reestimates	(157,650)	(117,764)
<b>Ending Balance of Allowance Account</b>	<b>\$ 939,342</b>	<b>\$ 1,087,238</b>

## E. Liability for Loan Guaranties

(Dollars in Thousands)

For the Years Ended September 30,	2016	2015
<b>Pre-1992 Business Loan Guaranties</b>		
<b>Beginning Balance of Liability for Loan Guaranties</b>	<b>\$ 14</b>	<b>\$ 70</b>
Adjustment to Expected Losses, Guaranties Outstanding	(7)	(56)
<b>Ending Balance of Liability for Loan Guaranties</b>	<b>7</b>	<b>14</b>
<b>Post-1991 Business Loan Guaranties</b>		
<b>Beginning Balance of Liability for Loan Guaranties</b>	<b>1,661,502</b>	<b>2,044,439</b>
Current Year's Subsidy (see 6G for breakdown by component)	26,292	55,102
Fees	1,247,356	1,219,836
Interest Accumulation Factor	76,294	91,231
Claim Payments to Lenders	(847,342)	(1,126,127)
Adjustment Due to Reestimate & Guaranteed Loan Purchases	664,866	721,995
Miscellaneous Recoveries and Costs	11,358	43,720
Balance of Liability for Loan Guaranties before Reestimates	2,840,326	3,050,196
Technical Assumptions/Default Reestimates	(468,828)	(1,388,694)
<b>Ending Balance of Liability for Loan Guaranties</b>	<b>2,371,498</b>	<b>1,661,502</b>
<b>Total Ending Balance of Liability for Loan Guaranties</b>	<b>\$ 2,371,505</b>	<b>\$ 1,661,516</b>

## F. 2016 Subsidy Rates by Program and Component

LOAN PROGRAM	Total Subsidy	Financing	Default	Other	Fee
<b>Guaranty</b>					
7(a)	0.00%	0.00%	4.21%	0.00%	-4.21%
504 CDC	0.00%	0.00%	7.32%	0.73%	-8.05%
504 Refi	0.00%	0.00%	7.62%	0.72%	-8.34%
SBIC Debentures	0.00%	0.00%	6.68%	0.08%	-6.76%
<b>Direct</b>					
Disaster	12.10%	2.56%	13.64%	-4.10%	0.00%
Microloan	8.87%	7.41%	1.60%	-0.14%	0.00%

The subsidy rates in Table F pertain only to loans obligated in the current year. These rates cannot be applied to the loans disbursed during the current year to yield the subsidy expense because loans disbursed during the current year include loans obligated in prior years. Subsidy expenses reported in Table G result from the disbursement of loans obligated in the current year as well as in prior years, and include reestimates.



## G. Subsidy Expense by Component

(Dollars in Thousands)

For the Years Ended September 30,	2016	2015
<b>Business Loan Guaranties</b>		
Interest	\$ -	\$ 2
Defaults	228,080	509,812
Fees	(221,728)	(483,888)
Other	19,940	29,176
Subsidy Expense Before Reestimates and Loan Modifications	26,292	55,102
Reestimates	(468,828)	(1,388,694)
<b>Total Guaranteed Business Loan Subsidy Expense</b>	<b>\$ (442,536)</b>	<b>\$ (1,333,592)</b>
<b>Business Direct Loans</b>		
Interest	\$ 2,585	\$ 2,126
Defaults	693	544
Other	722	1,398
Subsidy Expense Before Reestimates	4,000	4,068
Reestimates	258	(961)
<b>Total Business Direct Loan Subsidy Expense</b>	<b>\$ 4,258</b>	<b>\$ 3,107</b>
<b>Disaster Direct Loans</b>		
Interest	\$ 10,943	\$ 9,435
Defaults	54,571	39,804
Other	(17,117)	(15,331)
Subsidy Expense Before Reestimates	48,397	33,908
Reestimates	(157,650)	(117,764)
<b>Total Disaster Direct Loan Subsidy Expense</b>	<b>\$ (109,253)</b>	<b>\$ (83,856)</b>

## H. Administrative Expense

The SBA received appropriations to administer its credit programs, including the making, servicing and liquidation of its loans and guaranties. Amounts expensed in the Statement of Net Cost are:

(Dollars in Thousands)

For the Years Ended September 30,	2016	2015
Disaster Direct Loan Programs	\$ 212,265	\$ 172,624
Business Loan Programs	151,692	146,778
<b>Total Administrative Expense</b>	<b>\$ 363,957</b>	<b>\$ 319,402</b>

## I. Credit Program Subsidy Reestimates

Reestimates are performed annually, on a cohort-by-cohort basis. The purpose of reestimates is to update original program cost estimates to reflect actual cash flow experience as well as changes in forecasts of future cash flows. Forecasts of future cash flows are updated based on additional information about historical program performance, revised expectations for future economic conditions, and enhancements to cash flow projection methods. Financial statement reestimates were performed using a full year of performance data for FY 2016 for SBA's large loan programs and with nine months of actual and three months of projected performance data for the Secondary Market Guaranty, Microloan, and the small loan programs.

## BUSINESS GUARANTIED LOAN PROGRAMS

Net subsidy reestimates for the business guarantied loan programs follows:

(Dollars in Thousands)

For the Years Ended September 30,	2016	2015
7(a)	\$ (163,406)	\$ (268,899)
7(a) - Recovery Act	19,218	46,109
7(a) - Jobs Act	10,184	(8,605)
Dealer Floor Plan	(167)	(450)
504 CDC	(617,004)	(795,992)
504 CDC - Recovery Act	(46,505)	(105,987)
504 CDC - Jobs Act	(10,369)	(25,946)
504 CDC - Debt Refinancing	(24,683)	(72,831)
504 First Mortgage Loan Pooling - Recovery Act	3,686	(7,254)
SBIC Debentures	(156,544)	(154,625)
SBIC Participating Securities	(40,499)	(76,888)
Secondary Market Guaranty Program	546,107	84,477
ARC - Recovery Act	(1,387)	(8,877)
All Other Guaranty Loan Programs	12,541	7,074
<b>Total Guarantied Loan Program Subsidy Reestimates</b>	<b>\$ (468,828)</b>	<b>\$ (1,388,694)</b>

The 7(a) Loan Guaranty program, SBA's flagship and largest program had a net downward reestimate in FY 2016 of \$163.4 million. The reestimate is primarily due to lower than expected purchases in cohorts 2011 through 2016, partially offset by lower than expected recoveries in cohorts 2013 through 2015. Cohorts 2007 through 2010 experienced higher than projected purchases in FY2016, which were offset by higher than expected recoveries for those cohorts. The FY 2016 cohort experienced a slight upward reestimate due to increased loss projections as compared to the original loss projections.

The 7(a) Recovery Act program had a net upward reestimate in FY 2016 of \$19.2 million. The reestimate is primarily due to higher than expected purchases in FY 2016, partially offset by higher than expected recoveries. FY 2016 loan performance contributed to updated model assumptions, which resulted in decreased recovery projections.

The 7(a) Jobs Act cohort had a net upward reestimate in FY 2016 of \$10.2 million. The reestimate is due to higher than expected purchases and lower than expected recoveries in FY 2016. FY 2016 loan performance contributed to updated model assumptions, which resulted in decreased recovery projections.

The Dealer Floor Plan program had a net downward reestimate of \$0.2 million due to better than projected performance during FY 2016.

The 504 Certified Development Company program had a net downward reestimate of \$617.0 million. The reestimate is primarily due to better than projected FY 2016 loan performance across all but one cohort. Although some cohorts had higher than expected purchases, these higher than expected losses were offset by higher than expected recoveries. FY 2016 loan performance contributed to updated model assumptions which resulted in decreased purchase and increased recovery rate projections. The remainder of the reestimate was due to decreased loss projections for the 2016 cohort as compared to the original loss projections.

The 504 Recovery Act program had a net downward reestimate of \$46.5 million. The reestimate is mostly due to better than projected FY 2016 loan performance. Actual purchases in the 504 Recovery Act program were less than half of the purchases projected for FY 2016.

The 504 Jobs Act program had a net downward reestimate of \$10.4 million. The reestimate is mostly due to better than projected FY 2016 loan performance. Actual purchases in the 504 Jobs Act program were less than half the purchases projected for FY 2016.

The 504 Debt Refinancing program had a net downward reestimate of \$24.7 million. The reestimate is mostly due to better than projected FY 2016 loan performance. Actual purchases in the 504 Debt Refinancing program were less than projected for both cohorts, while actual recoveries were more than projected for both cohorts. The FY 2016 loan performance contributed to revised assumptions which resulted in decreased purchase and increased recovery rate projections. Newly reauthorized in FY 2016, this amount includes a downward reestimate of \$0.2 million for the 2016 cohort reflecting decreased loss projections compared to the original loss projections.

The Section 504 First Mortgage Loan Pooling program had a net upward reestimate of \$3.7 million. The majority of the reestimate is due to lower than projected recoveries in FY 2016. Faster than projected repayment of principal also contributed to a reduction in projected on-going fee revenue.

The SBIC Debentures program had a net downward reestimate of \$156.5 million. The primary driver of the reestimate was better than projected loan performance in FY 2016. No new purchases were recorded in FY 2016 for any cohort, while actual recoveries were greater than projected, specifically in the 2003 and 2009 cohorts. Additionally, updated performance expectation of the 2016 cohort contributed to the downward reestimate.

The SBIC Participating Securities program had a net downward reestimate of \$40.5 million. The downward reestimate was due to better-than-expected loan performance in FY 2016, particularly for the 2004 cohort. The main driver of the downward reestimate was lower purchases and higher recoveries than projected in FY 2016. The better-than-projected recoveries and purchases were partially offset by lower reimbursements of prioritized payments in FY 2016.

The Secondary Market Guaranty program had a net upward reestimate of \$546.1 million. The upward reestimate was larger than expected in part due to reconciliation procedures instituted in FY 2016 related to the available cash positions between the trustee and fiscal agent accounts. The reconciliation procedures between fiscal agent and trustee, while materially reconciled in total, reduced the cash available balance category to cover future MRF liabilities and in turn resulted in an upward reestimate.

The America's Recovery Capital program had a net downward reestimate of \$1.4 million. The majority of this reestimate is due to lower than projected purchases and higher than expected recoveries in FY 2016 for both cohorts.

The New Market Venture Capital program had a net upward reestimate of \$12.5 million. The upward reestimate was driven by higher purchases than expected in FY 2016 with no additional forecasted recoveries.

## BUSINESS DIRECT LOAN PROGRAMS

Net subsidy reestimates for business direct loan programs follows:

*(Dollars in Thousands)*

For the Years Ended September 30,	2016	2015
7(m) Microloan	\$ 224	\$ (542)
7(m) Microloan - Recovery Act	82	1,491
Intermediary Lending Pilot Program	(41)	(1,885)
All Other Direct Loan Programs	(7)	(25)
<b>Total Direct Loan Program Subsidy Reestimates</b>	<b>\$ 258</b>	<b>\$ (961)</b>

The 7(m) Direct Microloan program had a net upward reestimate of \$0.2 million. The upward reestimate is partially due to higher projected purchases and lower recoveries in the current year. These projections are partially offset by an increase in projected prepayments.

The 7(m) Direct Microloan Recovery Act program had a net upward reestimate of \$0.1 million. The upward reestimate is primarily due to a decrease in projected recoveries in future years for both cohorts. This is partially offset by a decrease in projected defaults.

The Intermediary Lending Pilot program had a net downward reestimate of \$0.04 million. The slightly downward reestimate was primarily due to lower projected defaults for future years for both the 2011 and 2012 cohorts. The lower projected defaults were partially offset by lower projected recoveries.

### DISASTER DIRECT LOAN PROGRAM

Net subsidy reestimates for the disaster direct loan programs follows:

*(Dollars in Thousands)*

For the Years Ended September 30,	2016	2015
Disaster	\$ (157,650)	\$ (117,764)
<b>Total Disaster Direct Loan Program Subsidy Reestimates</b>	<b>\$ (157,650)</b>	<b>\$ (117,764)</b>

The Disaster Assistance program had a net downward reestimate of \$157.7 million. Most Disaster cohorts (except for the 2015 and the 2016 regular cohorts) experienced downward reestimates as a result of better than expected performance in FY 2016 and revised performance assumptions. The 2015 cohort experienced a downward reestimate due to updated present value factors applied to projected cash flows, as well as revised performance assumptions. The 2016 cohort is the only cohort that experienced an upward reestimate. The reestimate is due to the actual average borrower's interest rate being lower than the original projected average borrower's interest rate.

TAB G

RISK ASSUMED II

Appendix E

GAO Meeting Notes

OCTOBER 2017

**GAO**  
**Credit Subsidy Cost Estimates**  
**August 3, 2017, Room 5U09 – 10:00 – 11:00am**

Participants

Robin Gilliam, Assistant Director, Federal Accounting Standards Advisory Board (FASAB)

Alan Perry, FASAB detailee

Marcia Carlsen, Federal Credit Reform Act (FCRA) expert, Government Accountability Office (GAO)

FASAB staff met with Ms. Marcia Carlsen to discuss the findings in [GAO-16-41 CREDIT REFORM: Current Method to Estimate Credit Subsidy Costs is More Appropriate for Budget Estimates than Fair Value \(FV\) Approach](#).

**DISCUSSION**

**General Review of Accounting for the FCRA:**

The government is required to keep reserves on hand for the cost of direct loan and loan guarantee (DL/LG) programs.

These “subsidy costs” are the net present value of projected cash flows based on the Department of the Treasury (Treasury) rate, which is locked in at the time of loan disbursement for each cohort (same year, similar loans). Costs to the government are reestimated annually based on a variety of risk factors, such as the borrower’s interest rate, which is not locked, loan performance, and default, prepayment, and loss rates for each cohort. The subsidy is then adjusted upward or downward by comparing the reestimates to the balance in the Financing Account. This is referred to as a balances approach.

If the cost to the government for the direct loans or loan guarantees is an upward reestimate, the program will receive that amount in appropriations. If it is a downward reestimate, then money must be returned to Treasury.

**For Example:**

1. Annual Subsidy Reestimate:	\$100
Financing Account Balance:	<u>70</u>
Upward Reestimate	<u>\$ 30 [Add'l appropriation received]</u>
2. Annual Subsidy Reestimate:	\$ 60
Financing Account Balance:	<u>70</u>
Downward Reestimate	<u>\$ 10 [Returned to Treasury]</u>

## How to Measure the Subsidy?

According to report GAO-16-41, the current method to estimate credit subsidy costs is more appropriate for budget estimates than the FV approach because risk is already captured in the cash flows. On the other hand, the Congressional Budget Office (CBO) has issued a number of reports estimating the difference between the current FCRA method and calculating the subsidy using FV. In the past, CBO has supported FV as a measurement. For example, in its Budgetary Estimates for the Single-Family Mortgage Guarantee Program of the Federal Housing Administration Report, September 2014, CBO states, “The fair-value approach to estimating the cost of federal loans and loan guarantees provides a more comprehensive measure of cost, in CBO’s view, because it incorporates the cost of market risk.”

CBO’s methodology for calculating FV appears to be inconsistent with generally accepted accounting principles. Because CBO does not have access to the actual cash flows, it uses the published agency subsidy rates and adjusts them to FV. The problem with FV is that it inflates the discount rate. Since the risk is already accounted for in the cash flows, CBO’s methodology appears to double-count risk.

A good example of this is the Troubled Asset Relief Program (TARP) which, under the Emergency Economic Stabilization Act of 2008, estimated the cost of troubled assets using the FV method.<sup>1</sup>

In 2009, the TARP Capital Purchase Program (CPP) disbursed \$204.6 billion for direct loans made. Due to measuring subsidies at FV, the net lifetime downward re-estimates were \$73.6 billion.<sup>2</sup> This means that TARP had to reimburse Treasury \$73.6 billion. Subsidy rate is another indicator that using FV for TARP over-estimated the risk; the “original subsidy rate” for CPP was 26.99 (an estimated cost of \$26.99 per \$100). Today, the CPP “current reestimated rate” is -3.46.

Another note about CBO is that there were two groups. One group supported the FV measurement of direct loans and loan guarantees, while the other group was opposed to it. Most of the proponents are no longer with CBO. FASAB staff was referred to Ms. Sue Irving of GAO for a better understanding of this situation.

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<sup>1</sup> Per 12 U.S.C. § 5232 “the cost of troubled assets and guarantees of troubled assets shall be calculated by adjusting the discount rate in section 502(5)(E) (2 U.S.C. 661a(5)(E))—Federal Credit Reform Act—for market risks...

<sup>2</sup>Office of Management and Budget, Fiscal Year 2017 *Federal Credit Supplement*, Table 7.

## Discussion Questions:

1. Who do you believe are the primary users of the financial information provided in direct loan and loan guarantee notes in agency financial statements?

Ms. Carlsen: Users are limited to auditors, inspector general, and agencies.

2. Are there any drawbacks or opportunities to improve current direct loan and loan guarantee reporting, including presentation methods used in financial statement notes?

Ms. Carlsen: It is very burdensome for agencies to continue to measure by cohort when for one program there is a new cohort every year and that can add up to an extraordinary amount to manage. For example, 60 programs could require 1600 cohorts / cash flows to manage.

She recommends recording by cohort for the first five-ten years to capture default vulnerability years, then net together into one.

Another item of concern is reporting the subsidy rates in the financial reports. Per Ms. Carlsen, the Federal Credit Supplement Budget of the U.S. Federal Government includes subsidy rates per program. Therefore, she recommended removing subsidy rates from the financial reports with a reference to the budget reports. Staff noted, however, that the budget reports are not audited, which might explain why that information is included in the agency financial reports.

3. What risk factors should agencies consider when estimating subsidy costs? Should these risk factors be limited to what the Office of Management and Budget (OMB) prescribes?

Ms. Carlsen explained that OMB does not prescribe risk factors, just the cash flow model for agencies to interpret and implement. Risks are captured in the cash flow projections as the effects of defaults, recoveries, prepayments, etc.

4. Are methodologies consistent among agencies to estimate subsidy costs? Which methodologies do you prefer?

Ms. Carlsen said that methodologies are determined by agencies and may be different for each of their programs depending on size and complexity. Agencies will take different program nuances into account for their cash flows.

5. What accounts for wide swings in subsidy reestimates each year? What information regarding these reestimates do you think would most benefit users? For example, would users benefit from items such as the dollar amount difference and percentage



changes; narrative explanations; reconciliations showing key causes of the changes; trends?

Ms. Carlsen noted that standards already require discussion of reasons for reestimates.

Staff noted that each reestimate line is currently being discussed, and FASAB is considering recommending amending the standards to only present material changes. By including a more comprehensive presentation [extend chart to include amount and percentage changes], users could see material changes that management can discuss?. Ms. Carlsen did not disagree.

6. When would material swings in subsidy estimates warrant discussion in Management's Discussion and Analysis (MD&A)? In those cases, what matters should be discussed?

Ms. Carlsen said that reestimates should continue to be discussed in agency financial reports' MD&A.

However, she noted that the consolidated financial report of the U.S. Government should present at a higher level of information. There is no discussion about DL/LG, but possibly there should be if they are material enough. The TARP note seems to be boiler plate, changing little from one year to the next. It should be eliminated due to a lack of materiality at the current time.

#### **Recommended follow up actions:**

- Ms. Carlsen directed our attention to the following GAO report:  
[GAO-16-269](#) CREDIT PROGRAMS: *Key Agencies Should Better Document Procedures for Estimating Subsidy Costs*.
- Staff noted that they reached out to talk to the Department of Housing and Urban Development / Federal Housing Administration, Department of Education, and Small Business Administration. Ms. Carlsen also recommended including the Department of Agriculture.