

The President's 2019 Budget: Proposals Affecting Credit, Insurance, and Financial Regulators

Summary

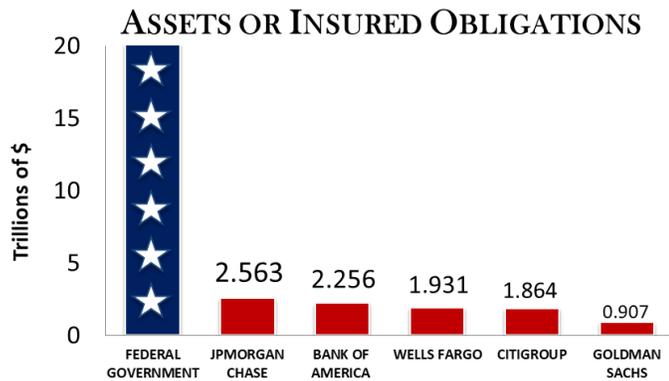
The White House released the President's budget proposal for fiscal year 2019 on February 12, 2018, just days after President Trump signed a bill extending spending caps for military and domestic spending and suspending the debt ceiling. While the new legislation has already established government-wide tax and spending levels for the coming fiscal year, the specific proposals contained in the budget request reflect Administration priorities and may still be considered by the Congress. Here, we consider how such proposals may affect the Federal Government in its role as a lender, insurer, and financial regulator.

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Background

Between its lending and insurance balances in excess of twenty trillion dollars, the U.S. Government has more assets and insured obligations than the five largest U.S. bank holding companies combined.¹ This has led some to characterize the U.S. Government as the world's largest financial institution.



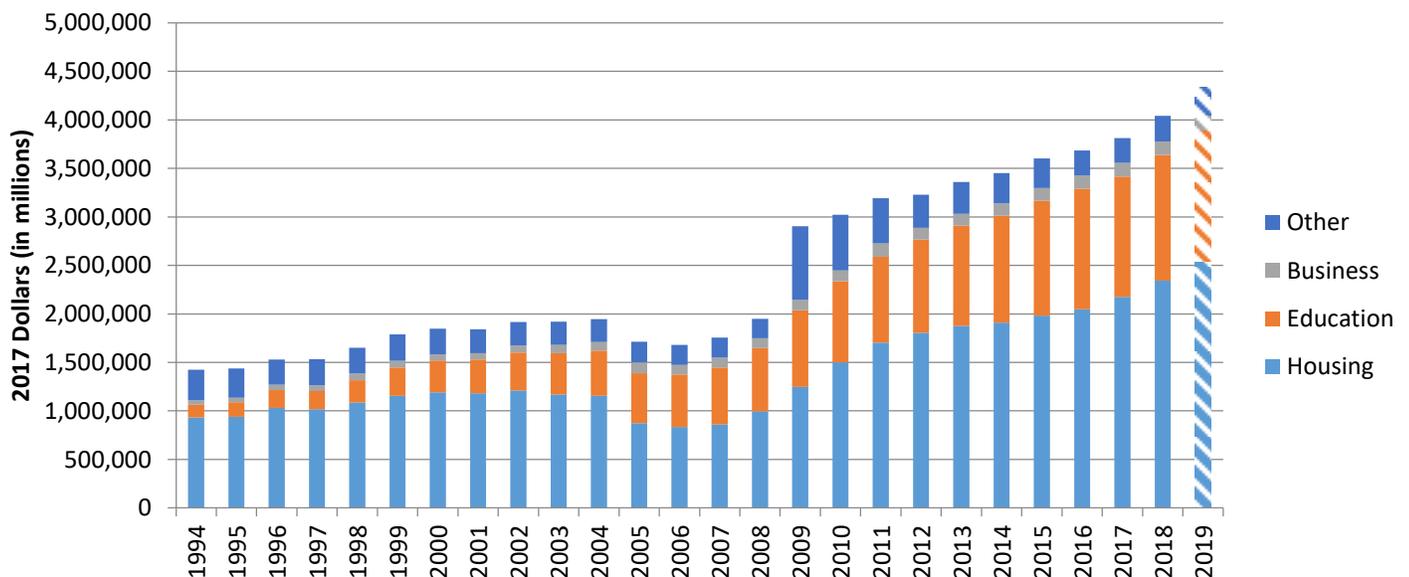
Through various agencies, the US government is deeply involved in the extension of credit and the provision of insurance. Traditional credit programs, in which the Federal Government directly lends or guarantees loans to borrowers, serve a wide range of target populations, from college students to farmers and small business

owners. The Federal Government's many insurance functions have a similarly broad reach, covering assets such as bank accounts, pensions, and homes vulnerable to flooding. In fact, in terms of both dollar value and the number of individuals impacted, the Federal Government's insurance activities surpass its credit activities in scale. Though many individual credit and insurance programs are highly specialized in their function, they collectively reach into the lives of most Americans. In addition to acting as a lender and insurer, the Federal Government also plays an active regulatory and oversight role in the financial marketplace.

Traditional Credit Programs

After adjusting for inflation, federal involvement in the credit market remained relatively stable from 1994 until the financial crisis of 2007-2008. During and after that crisis, the government played a countercyclical role and stepped in to fill a void left by the lenders who had either failed or exited the retail lending market. The Budget proposes to keep the current trajectory of loan volume, with traditional credit program balances projected to reach \$4.34 trillion in FY2019.² We highlight Budget proposals for specific credit programs below.

Federal Loans Outstanding (Direct & Guaranteed)



¹ Estimated U.S. Government loan assets and insurance obligations include traditional credit programs, deposit insurance, pension guarantees, farm credit, federal home loan banks, and the guarantees of Fannie Mae and Freddie Mac. Bank holding company data is from the [FFIEC National Information Center](#).

² Data compiled from Budget of the United States Government, Analytical Perspectives, FY1996-2019

Student Loans

The Federal Government has been the primary originator of student loans since 2010, when it transitioned from the Federal Family Loan Education Loan (Guarantee) Program to the Federal Direct Student Loan Program.³ Since then, loan volume has steadily increased and details of the program have evolved. The President's FY2019 budget proposal includes several noteworthy estimates and policy proposals for the coming fiscal year.

The Budget calls for \$163 billion in direct lending for FY2019, which would drive the federal direct loan portfolio above \$1 trillion for the first time in history.⁴ These estimates are accompanied by several major proposed changes for loan repayment options.

There are currently many different repayment plan options for the Direct Student Loan Program, including four income-driven repayment (IDR) plans. The Budget includes a proposal to replace these four options with a new, single IDR plan that would cap monthly payments at 12.5% of monthly income. With the proposed plan, remaining loan balances would be forgiven after 15 years for undergraduate borrowers and after 30 years for graduate borrowers. The proposal also calls for automatic enrollment for severely delinquent borrowers and income verification in conjunction with the Internal Revenue Service.⁵

The Budget proposal also raises the notion of postsecondary institutions sharing a portion of the financial risk associated with student loans, though no specific legislative proposal is included.

Projections in the Budget include several other noteworthy data points. First, student loans are projected to generate budgetary savings in FY2019. Historically, however, estimates have been overly optimistic in this respect. For instance, existing direct loans are now expected to cost \$4 billion more than initial estimates suggested. Second, undergraduate default rates are forecast to drop from about 25% to 16% in the coming fiscal year, an assumption that likely has implications for the projected budgetary savings. Finally, loan servicing costs are expected to exceed \$1 billion in FY2019.

³ Budget of the United States Government, Appendix, Department of Education, "[Federal Direct Student Loan Program Account](#)"

⁴ Ibid.

⁵ Ibid.

Home Mortgages

Historically, the largest federal credit programs have been those related to housing. Today, the single largest housing credit program is the Federal Housing Administration's guarantee of certain single-family mortgages in exchange for a fee. When insured borrowers default on their mortgages, losses are covered out of the Mutual Mortgage Insurance (MMI) fund.

In the President's FY2019 budget proposal, the Department of Housing and Urban Development (HUD) forecasts \$242 billion in single-family mortgage guarantees with a portfolio in excess of \$1.3 trillion by the close of FY2019. Furthermore, the Administration proposes to make available an additional \$158 billion in the event that demand exceeds forecasts.⁶

Accounting for projected outlays, downward reestimates, interest, fees and premiums, and recoveries on defaults, the Budget estimates that single-family mortgage guarantees will generate budgetary savings in FY2019. As with student loans, however, estimates have consistently been overly optimistic in this domain. Single-family loans originated over the past 25 years are now expected to cost \$97 billion more than initially estimated.

In addition to covering losses from the single-family mortgage program, the Mutual Mortgage Insurance fund also covers losses resulting from government-backed reverse mortgages via the Home Equity Conversion Mortgage (HECM) program. Repeated years of positive budgetary costs associated with the HECM program have led to calls for program reform in order to preserve the fiscal sustainability of the fund and protect the single-family conventional mortgage program. The budget proposal notes that FHA has already raised HECM premiums and lowered the share of equity that homeowners can borrow against and indicates that FHA will implement additional, as yet undefined program changes for FY2019 to keep expected budgetary costs below zero.

Also of note, the proposed Budget would provide the Government National Mortgage Association ("Ginnie Mae") authority to guarantee \$550 billion in new mortgage-backed securities.

⁶ Budget of the United States Government, Appendix, [Department of Housing and Urban Development](#)

Separately from HUD, the Department of Veterans Affairs (VA) facilitates a credit program that assists veterans, active duty personnel, and their families obtain a mortgage by providing a credit guarantee in lieu of a down payment. The government's guarantee typically covers the first 25 percent of losses resulting from default. The President's budget proposal calls for the VA to guarantee \$43 billion in mortgages in FY2019, leading the program's portfolio to approach \$200 billion by the end of the fiscal year. Program participation has reached record levels in recent years, and the Budget projects FY2019 totals to remain close to that mark.⁷

Nevertheless, the cost of the government's loan guarantees is forecast to drop significantly, from \$891 million in FY2017 to \$110 million in FY2019. And in contrast with HUD's guarantee cost estimates, over time and on average, the VA's estimates of loan costs have been accurate.

The President's budget request also includes a legislative proposal to extend several existing key program features involving net value calculation, securitization, the use of VA-acquired properties for homeless veterans, and loan funding fee rates.

Business Loans

The U.S. Government supports lending to businesses through multiple agencies and programs, headlined by the Small Business Administration (SBA) and its flagship 7(a) loan guarantee program. The President's Budget proposes to fund \$43 billion in SBA business lending with the SBA portfolio estimated to approach \$150 billion. Over the past 25 years, SBA lending has cost \$6 billion more than initially estimated.⁸

The Budget also proposes several countercyclical policies designed to maintain SBA operations while ensuring that private lending is not displaced. For instance, the Administration proposes to adjust fees across its business loan guarantee programs to cover anticipated lending and offset administrative costs. It would also provide administrative flexibility that would allow the SBA to increase 7(a) loan levels by 15 percent in the event that demand exceeds the appropriated limit. Other proposals

⁷ Budget of the United States Government, Appendix, [Department of Veterans Affairs](#)

⁸ Budget of the United States Government, Appendix, [Small Business Administration](#)

include increasing the SBA Express program's loan limit from \$350,000 to \$1 million and assessing an annual fee on secondary mortgage guarantees in an effort to sustain the program.

Outside of the Small Business Administration, the President's Budget proposes several other changes that would affect business lending. Citing a lack of evidence of economic growth and decreasing out-migration, the Budget would eliminate direct and guaranteed business and industry loans within the U.S. Department of Agriculture (USDA).⁹ Additionally, the Export-Import Bank (ExIm) is instructed to focus its efforts on market segments in which U.S. support is critical to compete (e.g., areas of national security importance, small- and medium-sized exporters).¹⁰

Development Finance

The President's Budget proposes a merger of the U.S. Agency for International Development's Development Credit Authority (DCA) and the Overseas Private Investment Corporation (OPIC) to create a new Development Finance Institution (DFI). Requested funding for the DFI would support \$4.1 billion in lending and other support. The DFI is intended to encourage the participation of U.S. private sector capital and skills in the economic and social development of emerging markets.¹¹

The Budget proposes a limitation on budget authority of \$80 billion, with total annual commitments capped at \$8 billion, including for insurance activities. Traditionally, OPIC has provided political risk insurance against losses due to expropriation, inconvertibility, and damage from political violence.

The President's Budget requests \$94 million in administrative funding to cover DFI operations as well as the continued administration of legacy OPIC and USAID credit portfolios.

⁹ Budget of the United States Government, Appendix, Department of Agriculture, "[Rural Business Program Account](#)"

¹⁰ Budget of the United States Government, Appendix, Other Independent Agencies, "[Export-Import Bank of the United States](#)"

¹¹ Budget of the United States Government, Appendix, [Department of State and Other International Programs](#)

Insurance & Other Activities

In addition to the approximately \$4 trillion in outstanding loan balances from traditional credit programs, the government backs trillions of dollars in insurance and other forms of federal financial support. The figure below highlights some of the most significant forms of federal insurance and related activities.

For instance, the Federal Deposit Insurance Corporation (FDIC) has supported public confidence in the banking system since the Great Depression by insuring bank deposits of up to a certain balance, currently \$250,000 for most cases. The FDIC estimates that it is currently insuring just over \$7 trillion in deposits.¹² Though not as sizable as deposit insurance, several other key insurance programs are featured in the President's Budget as well.

Fannie Mae & Freddie Mac

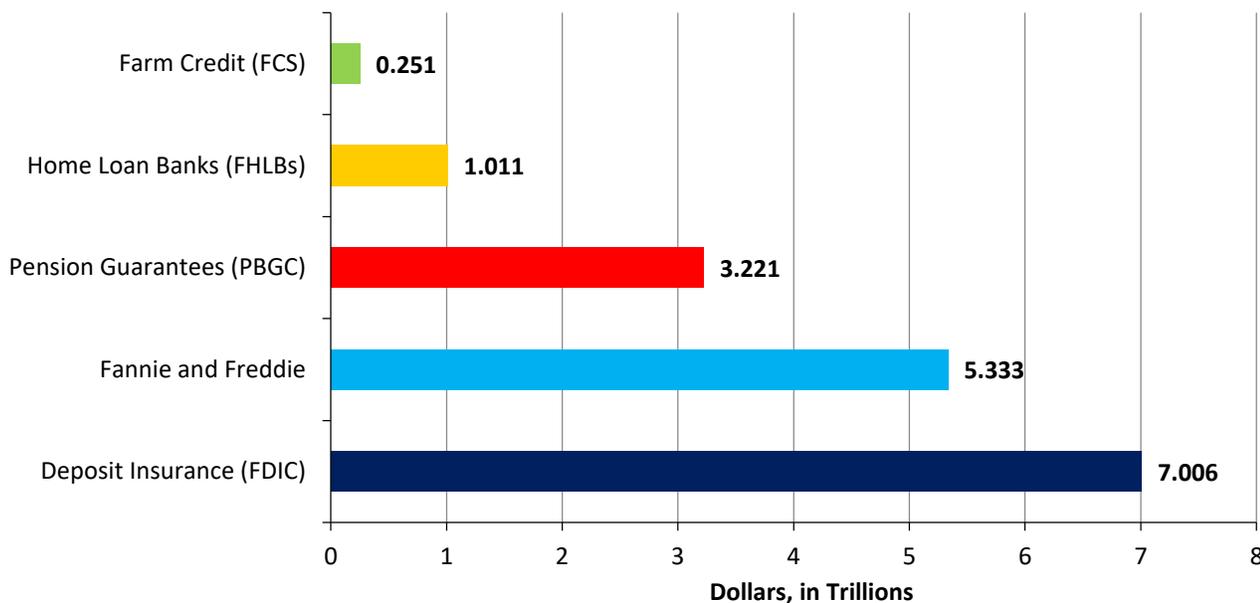
Many homeowners are likely to have had the terms of their mortgage shaped by Fannie Mae or Freddie Mac, government-sponsored enterprises that support the secondary mortgage market by guaranteeing the timely payment of principal and interest on mortgage-backed securities even if the borrower of the underlying loan

defaults. Long thought to have an "implicit guarantee" of a government bail-out should they fail, Fannie and Freddie were indeed taken over by the Federal Government in 2008 and formally placed into conservatorship. While the Congress considers how to resolve the status of these GSEs moving forward, the Federal Government is responsible for the more than \$5 trillion in outstanding mortgages guaranteed by Fannie and Freddie.¹³

The President's FY2019 Budget proposes to increase guarantee fees at Fannie Mae and Freddie Mac by 0.10 percentage points for single-family mortgage acquisitions from 2019 through 2021 and extend the 0.20 percentage point fee for acquisitions through 2023. Although no formal legislative reform proposal is included, the Administration reports its intent to work with the Congress to facilitate a sustainable housing finance system.¹⁴

Despite their conservatorship, Fannie Mae and Freddie Mac continue to be treated as non-budgetary entities, so no formal budgetary estimates for FY2019 are included in the President's Budget. However, the Budget does estimate that senior preferred stock purchase agreement

Federally Backed Credit Outstanding, June 2017



¹² FDIC Quarterly Banking Profile

¹³ Budget of the United States Government, Appendix, [Government-Sponsored Enterprises](#)

¹⁴ Budget of the United States Government, Analytical Perspectives, [Credit and Insurance](#)

draws will increase by about \$4.7 billion for Fannie Mae and by about \$0.4 billion for Freddie Mac in 2018 as a result of tax reform.¹⁵

Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC) insures defined benefit pension plans, whose liabilities currently exceed \$3 trillion.¹⁶ When a pension plan fails, PBGC takes it over and makes payments to retirees up to the statutory maximum guaranteed benefit.

PBGC operates both a multi-employer program and a single-employer program. The multi-employer program protects approximately 10 million people in 1,400 plans. The program is currently at risk of becoming insolvent by 2025, so the President's Budget proposes a new variable rate premium (VRP) and exit premium, which are expected to raise an additional \$16 billion over ten years. As done in the single-employer program, the VRP would require plans to pay premiums based on underfunding up to a certain cap. The exit premium would be set at ten times the amount of the VRP cap and would be imposed on employers that withdraw from the plan, though PBGC would have the authority to waive the fee. The Administration estimates that this additional revenue will be sufficient to keep the multiemployer plan solvent for the next twenty years.¹⁷

Meanwhile, the single-employer program protects 30 million workers and retirees in 22,500 plans. The single-employer plan is currently underfunded as well, but its financial position is projected to improve in light of several premium increases in recent years.

PBGC is designed to be financed by premiums paid by plans or companies, investment income, and assets from terminated plans rather than by general tax revenues. Nevertheless, the Budget contains some information about its financial position. Notably, the Corporation's combined liabilities exceeded assets by \$76 billion at the close of FY2017. For FY2019, \$445 million were requested for administrative expenses.

¹⁵ The Budget states that the change is "due to an accounting-related write-down of deferred tax assets resulting from the enactment of tax reform legislation." Budget of the United States Government, Appendix, "[Government-Sponsored Enterprises](#)"

¹⁶ Federal Reserve Financial Accounts of the United States, [Private Pension Funds Defined Benefit Plans](#)

¹⁷ Budget of the United States Government, Appendix, Department of Labor, "[Pension Benefit Guaranty Corporation](#)"

CDFI Fund

The Community Development Financial Institutions (CDFI) Fund works to extend access to financial services and affordable credit to underserved populations by investing in and assisting community development banks, credit unions, loans funds, and venture capital funds.

The CDFI Fund's Bond Guarantee Program (BGP) is a primary means of pursuing that mission, as it enables credit and investment activity in underserved communities by providing a source of long-term, low-cost capital. The President's FY2019 Budget makes a substantial commitment to the BGP, proposing to reauthorize the program with an annual guarantee level up to \$500 million. As before, the BGP is projected to operate at no budgetary cost for new issuances. The Budget also calls for continued support of the New Markets Tax Credit Program, which incentivizes private sector investment in economically distressed communities. The Budget requests \$14 million in administrative funding for the BGP and New Markets Tax Credit Program.¹⁸

Other CDFI Fund programs, however, are subject to elimination. The budget proposal would eliminate new program funding for the Bank Enterprise Award Program, CDFI Program, the Native American CDFI Assistance Program, and the Healthy Food Financing Initiative.

Flood Insurance

The Federal Emergency Management Agency (FEMA) provides flood insurance to homeowners and businesses located in floodplains through the National Flood Insurance Program (NFIP). The Budget estimates that there were about 4.9 million NFIP policies in over 22,200 communities at the end of 2017, totaling approximately \$1.25 trillion in insurance.¹⁹

The President's Budget reports FEMA's intention to improve the financial position of NFIP by raising premiums for policyholders to more closely reflect the actuarially sound cost of insuring property in a floodplain. In addition, the budget request includes a legislative

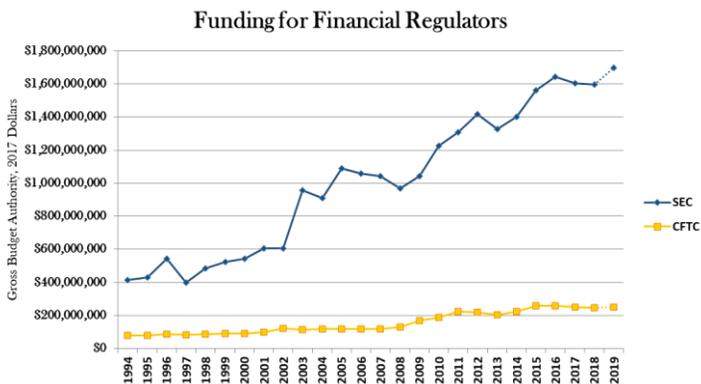
¹⁸ Budget of the United States Government, Appendix, Department of the Treasury, "[Community Development Financial Institutions Fund Program Account](#)"

¹⁹ Budget of the United States Government, Appendix, Department of Homeland Security, "[National Flood Insurance Program](#)"

proposal for a means-tested subsidy program that would help low-income policyholders afford the higher rates. Under current policy, discounts and subsidies are provided based on factors such as building age, location, and risk mitigation efforts taken by the property owner or community. The legislative proposal would replace these criteria with income-related eligibility exclusively.

Financial Regulatory Agencies

The Federal Government provides active oversight of the financial services industry through several regulatory agencies. For instance, the U.S. Securities and Exchange Commission (SEC) regulates securities markets and the U.S. Commodity Futures Trading Commission (CFTC) oversees derivatives markets. The figure below illustrates the funding levels of these two key regulators since 1994.²⁰



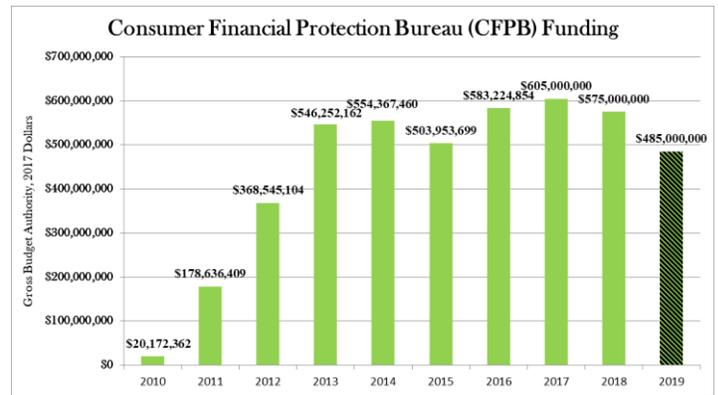
In constant-dollar terms, funding for the SEC has increased steadily since 1994. While less sizable in absolute terms, growth of CFTC’s funding over the period is considerable as well, exceeding 200% in growth. The Budget proposes to fund the CFTC at \$250 million and proposes fees that would allow the Commission to spend an additional \$32 million in 2019. The fees would be designed to support market access, liquidity and efficiency in derivatives markets.

The Consumer Financial Protection Bureau (CFPB), created by the Dodd-Frank Act in the wake of the 2007-2008 financial crisis, is another key federal regulator, policing consumer financial products and services. As shown in the figure below, the Bureau’s funding has remained relatively stable since its startup phase.²¹

²⁰ Data compiled from Budget of the United States Government, Appendix, Other Independent Agencies, FY1996-2019

²¹ Ibid.

However, the Administration’s budget proposes major changes for the CFPB’s funding mechanism moving forward.



Under current law, the Bureau receives its funding from the Federal Reserve, so it is not subject to the Congressional appropriations process. The President’s Budget proposes to reduce the Bureau’s mandatory funding, reducing levels from an estimated \$605 million in FY2017 to \$485 million in FY2019, and also to subject the CFPB to the normal appropriations process beginning in 2020.

The Budget also calls for a similar move for the Office of Financial Research (OFR) within the U.S Department of the Treasury. In addition to transitioning OFR to the normal appropriations process, the Budget also proposes to reduce its funding by about 20% and to cut its workforce by 78 FTEs.²²

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²² Budget of the United States Government, Appendix, Department of the Treasury, “Financial Research Fund”