Congressional Budget Office

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Answers to Questions for the Record Following a Hearing on the Export-Import Bank Conducted by the House Committee on Financial Services

On June 25, 2014, the House Committee on Financial Services convened a hearing at which Douglas W. Elmendorf, Director of the Congressional Budget Office, testified about CBO's report Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024 *(May 2014), www.cbo.gov/publication/45383.[1] Following that hearing, Congressman Ed Royce submitted questions for the record. This document provides CBO's answers.*

Question: [CBO's] June 2012 report anticipated that for 2013, under fair-value accounting (FVA), the Export-Import Bank (Ex-Im Bank) would show a small negative subsidy. The June 2014 projection indicates that going forward, CBO calculates a positive subsidy of $200 million per year over 10 years, or $2 billion. As I mentioned in my oral questioning of you, I am trying to understand where these differences in numbers originate.

In terms of applying FVA to Ex-Im Bank, what kind of assumptions have you used in terms of defaults/losses? Given the unique scale and duration of Ex-Im Bank's loans, have you used their historical experience? Or have you used commercial bank experience, and if so, why is that assumption appropriate? Also, how do you factor in loss reserves and capital?

Answer: In its analysis, CBO computed subsidy costs for Ex-Im Bank using the bank's projections of defaults and losses, which presumably reflect its historical experience.[2] For example, in its estimates of Ex-Im Bank's long-term loan guarantee program, CBO used a projected default rate of 6.12 percent and an estimated net cost of defaults of 1.91 percent of the initial principal balance, based on Ex-Im Bank's own projections of its cash flows as reported in the Office of Management and Budget's 2015 *Federal Credit Supplement*.[3]

The bank's loss reserves and capital do not directly affect projected gains or losses on the bank's new credit activity. Rather, they *reflect* those projections because Ex-Im Bank determines the amount of capital it holds and the size of its loss reserves based on its expectation of future defaults and losses.

1. Testimony of Douglas W. Elmendorf, Congressional Budget Office, before the House Committee on Financial Services, *Estimates of the Cost of Credit Programs of the Export-Import Bank* (June 25, 2014), www.cbo.gov/publication/45468.

2. See Congressional Budget Office, *Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024* (May 2014), www.cbo.gov/publication/45383.

3. The net cost of defaults (that is, the component of the total subsidy cost that is attributable to default losses) is the present value of the defaults, after recoveries, discounted using the rates specified in the Federal Credit Reform Act. For Ex-Im Bank's projections, see Office of Management and Budget, *Federal Credit Supplement, Fiscal Year 2015* (March 2014), Table 6, www.whitehouse.gov/omb/budget/Supplemental.

Question: What has been the recent experience with collateralization of loans by Ex-Im Bank?

Answer: In general, collateralization (the pledging of assets as security for repayment of a loan) reduces expected losses on a bank's portfolio, but CBO has not specifically examined Ex-Im Bank's experience with loan collateralization. CBO's estimate of subsidy costs does, however, incorporate the bank's updated projections of its losses from loans, which should reflect its recent experience with collateralization.

Question: The direct loan program is required to charge a rate of one percent above Treasuries. After you do the discount calculation required by FVA, would this program be above commercial rates? In 2012 when the CBO showed the program with a surplus, were commercial bank rates higher than today?

Answer: Under fair-value accounting, CBO estimates that Ex-Im Bank's export-financing direct loan program would have a negative subsidy cost. A negative fair-value subsidy cost suggests that Ex-Im Bank is charging rates that are close to or higher than the rates available from commercial banks. That may not actually be the case, however, because CBO's subsidy estimate does not include Ex-Im Bank's administrative expenses, whereas commercial banks' interest rates and fees account for such expenses. Because CBO relied on summary data reported by Ex-Im Bank and did not obtain detailed data on the bank's loan portfolio to make its estimates, providing a more precise comparison of the rates that Ex-Im Bank is likely to charge with those that commercial banks will charge on loans of comparable risk is not feasible.

In June 2012, CBO projected that the aggregate fair-value subsidy cost for Ex-Im Bank's programs would be negative for fiscal year 2013, but in May 2014 it estimated that those programs would have a small positive fair-value subsidy over the 2015–2024 period.[4] That difference stems mainly from CBO's use of a higher discount rate in its 2014 estimates for the long-term loan guarantee program. Although the type of credit and loan maturity associated with the long-term guarantee program did not change, CBO used a higher discount rate in 2014 because the Administration's projections of the default rate and the net cost of defaults had increased. In the 2013 *Federal Credit Supplement*, which was the basis for CBO's 2012 estimates, the Administration reported an expected default rate of 1.35 percent, no recoveries, and a net cost of defaults of 1.29 percent of the initial principal balance for the long-term guarantee program.[5] In the 2015 *Federal Credit Supplement*, which was the basis for CBO's 2014 estimates, the expected default rate increased to 6.12 percent, the recovery rate increased to 66.93 percent, and the net cost of defaults increased to 1.91 percent.[6]

4. CBO's 2012 report did not include an analysis of Ex-Im Bank's export-financing direct loan program because the President's budget request for fiscal year 2013 did not include obligations for that program. The only Ex-Im Bank direct loan program analyzed in CBO's 2012 report was the Tied Aid War Chest. See Congressional Budget Office, *Fair-Value Estimates of the Cost of Federal Credit Programs in 2013* (June 2012), www.cbo.gov/publication/43352; and Congressional Budget Office, *Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024* (May 2014), www.cbo.gov/publication/45383.

5. Office of Management and Budget, *Federal Credit Supplement, Fiscal Year 2013* (February 2012), Table 6, http://go.usa.gov/ddJe.

6. Office of Management and Budget, *Federal Credit Supplement, Fiscal Year 2015* (March 2014), Table 6, www.whitehouse.gov/omb/budget/Supplemental.

Question: The Aircraft Sector Understanding (ASU) requires above-market fees as well as shorter loan durations than are available from private lenders. What has been the impact of the ASU on Ex-Im Bank's aircraft lending and overall demand for loans? Would these changes impact the assumptions for Ex-Im Bank's overall risk exposure?

Answer: CBO did not perform an independent analysis of the potential effects of the ASU. To the extent that the bank's projections of cash flows reflect the impact of the ASU, that experience is incorporated in CBO's estimated subsidy costs.

In general, requiring higher fees and imposing more restrictive loan terms (such as shorter durations or higher collateralization requirements) each have offsetting effects on subsidy costs. Higher fees reduce subsidy costs because increased fee revenues cover more losses, and more restrictive loan terms reduce subsidy costs if those terms reduce defaults or losses. However, higher fees or more restrictive terms could also change the composition of the loans made or guaranteed by driving out the most credit-worthy borrowers, who have better access to private financing. If that happened, losses from defaults might increase, potentially offsetting the benefits of higher fees.