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Recognizing Credit Adjustments from Compromise, Waiver and Other Actions of Government Agents

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INTRODUCTION

The budget process has three main phases, each of which is related to the others: (1) formulation of the president's budget; (2) action by the Congress; and (3) execution of enacted budget laws.[1] This briefing paper deals with (3), the execution of enacted budget laws, and places particular emphasis on the collection of debt. The collection of debt is an important role of administrative agencies because the federal government provides direct loans and loan guarantees to support a wide range of activities. Activities of the government include home ownership, education, small business, farming, energy, infrastructure investment, and exports. Also, Government-Sponsored Enterprises (GSEs) operate under Federal charters for the purpose of enhancing credit availability for targeted sectors.[2] At the end of fiscal year 2013, outstanding federal credit totaled $3.153 trillion; outstanding direct loans totaled $947 billion and outstanding guaranteed loans totaled $2,207 billion.[3] Interestingly, the execution of the budget cannot be conducted at the sole discretion of administrative agencies. Indeed, many debt collections require Congressional action.

The purpose of this briefing paper is to analyze the budgetary treatment of federal credit programs, particularly how credit adjustment is recognized in the budget. Since the degree of adjustment depends on the baseline set at the beginning of the budget process, this paper will examine not only the budgetary effect of the debt collection process, but also the budget scoring of credit programs when they are formed. In order to examine credit adjustment most fully, it is necessary to understand agency authority to collect debt, including compromise, waiver, and other actions.

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[1] OFF. OF MGMT. & BUDGET, FISCAL YEAR 2015 ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT 87 [hereinafter OMB, ANALYTICAL PERSPECTIVES], *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/spec.pdf.
[2] *Id*. at 317.
[3] *Id*. at 342 tbl. 20-2.

Therefore, this briefing paper proceeds as follows. First, the paper briefly goes over the process of debt collection. Then, the paper examines Federal Credit Reform Act of 1990, which regulates the budgetary treatment of federal credit. Lastly, the paper analyzes the effect of debt collection on federal budget. The analysis is divided into two parts: the formation of credit programs and credit adjustments.

I. OVERVIEW OF DEBT COLLECTION LEGAL STRUCTURE

A. Duty of Debt Collection

The federal debt collection process is governed by constitutional and common law principles codified and expanded upon by statute.

The first of these principles is found in the Appropriations Clause of the United States Constitution, which reads, "[n]o money shall be drawn from the Treasury, but in consequence of Appropriations made by law."[4] Such appropriations may "be applied only to the objects for which the appropriations were made, except as otherwise provided by law."[5] Only Congress is authorized "to dispose of and make all needful Rules and Regulations respecting … Property belonging to the United States."[6] Thus, administrative agencies cannot use excess funds or authorize expenditures exceeding Congressional appropriations.[7]

Administrative agencies also possess an affirmative statutory duty to pursue the collection of debts owed to the federal government. Under the Federal Claims Collection Act of 1966 (FCCA),[8] agency officials "shall try to collect a claim of the United States Government for money or property arising out of the activities of, or referred to, the agency."[9] Agencies must

[4] U.S. CONST. art. I, § 9, cl. 7.
[5] 31 U.S.C. § 1301(a) (2012).
[6] U.S. CONST. art. IV, § 3, cl. 2.
[7] *See Royal Indem. Co. v. United States*, 313 U.S. 289, 294 (1941); *see also* 31 U.S.C. § 1341(a)(1)(A) (2012) (the Antideficiency Act).
[8] Pub. L. No. 89-508, 80 Stat. 308 (1966).
[9] 31 U.S.C. § 3711(a)(1) (2012).

"aggressively"[10] pursue debt collection and provide an "analysis of costs"[11] related to their efforts. Implicit within this statutory scheme is the understanding that, while agencies are required to vigorously defend the interests of the taxpayers they represent, the costs of collection activities must be measured against reasonable expectations of recovery.

The constitutional rights and statutory duties related to federal debt collection are facilitated by the common law. The federal government possesses a right to sue to "recover funds which its agents have wrongfully, erroneously or illegally paid."[12] This right extends to administrative agencies through delegated authority[13] and includes debts owed by "all persons, including states and localities," as well as foreign sovereigns.[14] The right of administrative agencies to recover debts is uniformly governed by federal judge-made law and is not bound by state statutes, except as noted expressly by Congress.[15]

As debt collection is a legal duty, it is understood that agencies do not possess the authority to forgive or waive indebtedness without establishing a statutory basis.[16] In fact, several cases support the notion that even the mistakes of federal employees will not estop the government from collecting debt.[17] Recently, the Federal Emergency Management Agency (FEMA) attempted to recoup improper disaster assistance payments in accordance with the current legal structure, which compels agencies to collect even that debt incurred from the mistakes of government actors. This caused great controversy and ended up inspiring a law

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[10] 31 C.F.R. § 901.1(a) (2013).
[11] 31 C.F.R. § 901.10(a) (2013).
[12] *United States v. Wurts*, 303 U.S. 414, 415 (1938).
[13] *See*, *e.g.*, *Royal Indem. Co. v. United States*, 313 U.S. 289, 294 (1941); *United States v. Gratiot*, 39 U.S. (14 Pet.) 526, 537-38 (1840).
[14] 31 U.S.C. § 3701 (2012).
[15] *See Clearfield Trust Co. v. United States*, 318 U.S. 36, 367 (1943) (reasoning that the application of state law "would subject the rights and duties of the United States to exceptional uncertainty").
[16] GEN. ACCT. OFF., 3 PRINCIPLES OF FEDERAL APPROPRIATIONS LAW 14-75 (3d. ed., 2008) (citing 67 Comp. Gen. 471) [hereinafter GAO, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW], *available at* http://www.gao.gov/assets/210/203470.pdf.
[17] *Id*. (citing Aetna Casualty & Surety Co. v. United States, 526 F.2d 1127, 1130 (Ct. Cl. 1975) and Lawrence v. United States, 69 Fed. Cl. 550, 557 (2006)).

providing express waiver authority.[18] Enactment of this law was necessary to prevent conflict with the Antideficiency Act which prohibits government agencies from spending or incurring obligations in excess or in advance of available appropriations.[19]

B. Federal Debt Collection Legal History

Federal debt collection law has a unique history. Prior to the enactment of the FCCA, the federal government lacked a consistent policy for federal debt collection.[20] Most collections were handled by a joint collaboration between the Government Accounting Office and the Justice Department.[21] This collaboration proved costly, cumbersome and ineffective.

In 1966, Congress passed the FCCA. This law empowered administrative agencies to handle collection claims under the theory that agencies were more familiar with debts owed to the federal government. In 1982, Congress "increase[d] the efficiency" of the FCCA by passing the Debt Collection Act of 1982 (DCA),[22] which authorized reporting delinquent debts to credit reporting agencies, using administrative offsets, and employing private debt collection contractors.[23] Between 1984 and 1992, Congress established and streamlined a voluntary tax refund offset system that allowed debtors to satisfy federal nontax debts using tax refunds. This system proved successful, and paved the way for the passage of the Debt Collection Improvement Act of 1996 (DCIA). This act institutionalized the process of maximizing collections while minimizing transactions costs by adding various efficiencies to debt recovery and tax offset systems.[24]

C. Definitions of Important Terms

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[18] Disaster Assistance Recoupment Fairness Act of 2011, Pub. L. No.112-74, § 565(b)(2), 125 Stat. 786, 982 (2011) (granting waiver authority to the Administrator of the Federal Emergency Management Agency).
[19] 31 U.S.C. § 1341(a).
[20] *See* S. Rep. No. 89-1331, at 2 (1966).
[21] *Id*.
[22] Pub. L. No. 97-365, 96 Stat. 1749 (1982).
[23] DCA §§ 3, 10, 13, 31 or U.S.C. §§ 952, 951, 484 (2012) respectively.
[24] Pub. L. No. 104-134, § 31001(b), 110 Stat. 1321, 1358 (1996).

Before an administrative agency is authorized to collect a debt, it must determine: (1) whether a "debt" exists, (2) whether this debt is owed by a "debtor," and (3) whether the debt is "delinquent." These definitions inform the actions of agencies, which may include demanding payment from the debtor, assessing interest, penalties and costs, and, if necessary, commencing collections.[25]

1. Debts and Debtors

A debt is "any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States by a person, organization, or entity other than another agency."[26] Debts can arise from a variety of sources, including federal credit programs, overpayments to beneficiaries and fines resulting from violations of law. Debtors often include persons conducting business with the federal government, federal employees and members of the armed forces, states and localities, Indian Nations and foreign sovereigns.

2. Delinquency

As long as a debtor satisfies his/her obligations on time, a federal agency has no legal duty to collect and the debt has no effect on budget scoring or government financial statements. The federal government must wait before a debt becomes delinquent before it may initiate a debt collection. Delinquent debt "has not been paid by the date specified in [an] agency's initial written demand for payment or applicable agreement or instrument."[27] The delinquency determination is, in some ways, dependent on how a given debt was incurred. A direct loan is generally delinquent if the payment has not been received by the date specified in the loan

[25] 31 U.S.C. § 3711(a) (2012).
[26] 31 U.S.C. § 3701(b)(1) (2012); *see also* 31 C.F.R. § 900.2(a) (2013) (stating that for purpose of federal debt collection, "the terms 'claim' and 'debt' are synonymous and interchangeable").
[27] 31 C.F.R. § 900.2(b) (2013).

agreement.[28] A guaranteed loan is generally delinquent when the debtor breaches an agreement with a private lender, triggering a government purchase.[29] In the case of administrative debts such as fines, fees, penalties, and overpayments, a debt becomes delinquent when payment is not made by the due date specified by an agency's initial demand for payment, which is typically 30 days after an agency mails notice to a debtor.[30]

3. Forms of Payment

Lastly, in order to end a debt collection, the debt has to be paid somehow. Debtor payments may be collected in various forms, including cash,[31] checks, electronic funds transfers[32] such as credit and debit cards and payments in kind.[33]

II. PROCESS OF DEBT COLLECTION

A. Delinquent Debt Collection

1. Demand Letters

Agencies should promptly act on the collection of delinquent debts including defaulted guaranteed loans acquired by the government, using all available tools to maximize collections.[34] The first step in this process is to send written demand to the debtor, unless other action is

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[28] OFF. OF MGMT. & BUDGET, CIRCULAR NO. A-129, POLICIES FOR FEDERAL CREDIT PROGRAMS AND NON-TAX RECEIVABLES 17 (2013) [hereinafter OMB, CIRCULAR A-129], *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/a129/rev_2013/pdf/a-129.pdf. If the contract or agreement provides for a "grace period," then a debt becomes delinquent when payment is not made by the end of the grace period. But the date of delinquency is the payment due date, rather than the end of grace period. U.S. DEP'T OF THE TREASURY, FIN. MGMT. SERV., MANAGING FEDERAL RECEIVABLES 6-4 (2005) [hereinafter FMS, MANAGING FEDERAL RECEIVABLES], *available at* https://www.fms.treas.gov/debt/MFR/ManagingFederalReceivables.pdf.

[29] *Id*. at 17.

[30] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-4.

[31] 31 U.S.C. § 5103 (2012); 31 C.F.R. 900.5 (2013).

[32] 31 C.F.R. § 206.4(a) (2011); see also 31 U.S.C. § 3332(f) (2012) (generally mandating the use of EFT payments).

[33] 31 C.F.R. § 900.5.

[34] OMB, Circular A-129, *supra* note 28, at 18. *See also* Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1358 (1996) (stating the purpose of FCIA is to "maximize collections of delinquent debts owed to the Government by ensuring quick action to enforce recovery of debts and the use of all appropriate collection tools").

necessary to protect the government's interests.[35] Demand letters must include certain information regarding the obligation the debtor owes, and should also include information regarding the nature of the measures considered by the agency, such as the discussion of alternative methods of payment and policies with respect to the use of collections agencies.[36] Additional demand letters may be sent depending on the collection tools used.[37]

2. Repayment Arrangements: Install Payments, Rescheduling, and Compromise

Whenever possible, an agency should try to collect in a single lump-sum payment.[38] Although an agency has various collection tools at its disposal, before using those instruments, an agency must try to resolve a delinquent debt by providing an opportunity for the debtor to enter into a reasonable repayment agreement.[39]

The agency may consider collecting by installments when debtors are financially unable to satisfy all of their debts at once. Repayment agreements, which should "bear a reasonable relation to the size of the debt and the debtor's ability to pay,"[40] cure previous delinquencies, but only to the extent they are followed.[41] Repayment agreements should include acceleration provisions (which render all debt immediately due and payable in the event of default),[42] bolstered by the language "time is of the essence," a phrase interpreted to mean that both parties

[35] 31 C.F.R § 901.2(a) (2013); *see also* FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-13 to -15 (suggesting to contact the debtor within 20 days after delinquency by letter or phone, in an attempt to resolve the non-payment and if it is not resolved by the initial contact, suggesting the agency to notify through a demand letter within 30 days after delinquency).
[36] 31 C.F.R. § 901.2(b), (d); *see also* FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-15 (requiring to include the information that is merely recommended in the Regulations).
[37] *See* 31 C.F.R. Parts 285, 901.2.
[38] 31 C.F.R. § 901.8(a) (2013).
[39] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-20.
[40] 31 C.F.R. § 901.8(b). The payments should be sufficient in size and frequency to liquidate the debt in three years or less. *Id*. It is also expected that the debtor will provide as large an initial lump sum payment as she can afford. FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-21.
[41] *See supra* note 27.
[42] 31 C.F.R. § 901.8(a).

have agreed delays in performance cause material harm and breach of contract.[43]

Rescheduling may also be used to avoid default.[44] It modifies substantive loan terms, typically by extending maturity. Rescheduling may be used when it "is in the government's interests and that recovery of all or a portion of the debt is reasonably assured."[45] As with installment payments, rescheduled debts are not considered delinquent unless the debtor fails to make payment under the specified in the agreement.[46]

It may not always be feasible to collect the full amount of debt owed the government and it may not always be cost-effective to strive for collecting the full value of delinquent debt. Therefore, agencies are authorized to compromise claims to achieve partial collections.[47] Although "compromise" is not explicitly defined by law, the statutory guidance makes clear that "[a]n agency compromises a debt whenever it accepts less than the full amount of the outstanding debt in full satisfaction of the entire amount."[48] If one or more of these four criteria apply, a compromise may be considered:

i. the debtor is unable to pay the full amount in a reasonable time, as verified through credit reports or other financial information;
ii. the Government is unable to collect the debt in full within a reasonable time by enforced collection proceedings;
iii. the cost of collecting the debt does not justify the enforced collection of the full amount; or
iv. there is significant doubt concerning the Government's ability to prove

[43] *See Terra Venture, Inc. v. JDN Real Estate Overland Park, L.P.*, 443 F.3d 1240, 1244 (10th Cir. 2006).
[44] It is also called restructuring, refinancing, and reamortizing. FMS, Workbook for Preparing Treasury Report, 56.
[45] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note, at 6-22. Each agency is expected to establish uniform policies, procedures and criteria for rescheduling and other types of workouts. It should provide for the recognition of gains and losses on rescheduled accounts in accordance with the provisions of OMB guidance. *Id.*
[46] *See supra* note 27.
[47] 31 U.S.C. § 3711(a)(2) (2012).
[48] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-23. Compromise is also refereed to as "settlement." *Id*. at G-4.

its case in court.[49]

Debt collection regulations provide additional information related to these four criteria, but it is possible to summarize them as suggesting compromise when it is most efficient, taking into account the externalities of compromise on all other debtors.[50] However, agencies are allowed to compromise only to the extent that the principal balance of a debt arising from their jurisdiction does not exceed $100,000 or higher amount prescribed by the U.S. Attorney General.[51]

3. Debt Collection Tools

If an agency cannot devise workout by repayment arrangements, it should quickly proceed to the next step of the debt collection process and determine the appropriate debt collection tools. Since it becomes difficult to collect delinquent debts as the debts become older, time is an important aspect of collecting debt.

After sending a demand letter, agencies can use administrative collection tools within 180 days after delinquency.[52] Although agencies are not obliged to, they may transfer debts to the Department of the Treasury's Financial Management Service (FMS) for collection (known as cross-servicing).[53] Administrative offsets are another measure that agencies can take. There are two methods to offset a debtor's payments; one is centralized offset via the Treasury Offset Program (TOP) operated by FMS and the other is non-centralized offset. TOP allows agencies to submit debts to one centralized location for the offset of all eligible Federal payments, including

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[49] 31 C.F.R. § 902.2(a) (2013); FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-23 to -24. Note that it is made clear these four criteria are not requirement for a compromise.
[50] *See* 31 C.F.R. §§ 902.2(b)-(g), 902.3, 902.6.
[51] *Id.*; 31 C.F.R. § 902.1(a) (2013); *see also* 31 C.F.R. § 902.1(b) (stating that unless otherwise provided by law, when the principal balance of a debt exceeds the maximum amount, the Department of Justice has the authority to accept the compromise); 31 C.F.R. § 900.6 (2013) (prohibits from subdividing debts to avoid the monetary ceiling).
[52] 31 C.F.R. § 901.1(d). The statutory guidance tells that an agency should refer the debt to FMS, if a debtor has not resolved the debt within 60 days after the agency's last demand letter. FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-27.
[53] 31 U.S.C. 3711(g)(1) (2012) ; 31 C.F.R. § 285.12 (2013); 31 C.F.R. § 901.1(e) (2013). *See* FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-27 (encouraging agencies to send its delinquent debts to FMS as early as possible).

certain benefit payments, Federal retirement payments, salaries, vendor payments, tax refunds, and other Federal and State payments as allowed by law. [54] Conversely, non-centralized administrative offsets are used when TOP is not appropriate or available.[55] An example of a non-centralized offset is internal offset; it occurs when a creditor agency also makes payments to the delinquent debtor.[56] In the case where a debtor is employed by any organization other than a Federal agency, the agency may initiate proceedings administratively to garnish the wages of the delinquent debtor.[57] The agency may also use the services of private collection agencies to recover delinquent debt.[58] But, in order to collect most efficiently, an agency should, whenever possible, refer debts to FMS for cross-servicing.[59] For a secured debt, if such action is in the best interest of the United States and the debtor was provided reasonable opportunity to cure his/her delinquency, the agency should liquidate security or collateral.[60] In addition to these, agencies should make every effort to refer delinquent debt to the Department of Justice (DOJ) for litigation within one year of the date of delinquency.[61] Statutory guidance gives an example of when it is desirable to refer to DOJ before referring the debt to FMS or taking other debt collection methods.[62]

In addition to these direct measures, there are also indirect measures for the collection of

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[54] 31 U.S.C. 3716 (2012), 31 C.F.R. § 285. 4 (2013) (benefit offset); 26 U.S.C. § 6402(d), 31 U.S.C. § 3720A (2012), 31 C.F.R. § 285.2 (2013) (tax refund offset); 5 U.S.C. § 5514 (2012), 31 U.S.C. § 3716, 5 C.F.R. § 550.1101 (2013), 31 C.F.R. § 285.7 (2013) (salary offset); 31 U.S.C. § 3716, 31 C.F.R. § 285. 5 (2013) (federal retirement offset and vendor offset).
[55] 31 C.F.R. § 901.3(c)(1) (2013).
[56] *See also* 31 U.S.C. § 3711(g)(2)(A)(v) (2012) (exempting a requirement to refer a debt to FMS for cross-servicing).
[57] 31 U.S.C. § 3720D (2012); 31 C.F.R. § 285.11 (2013); 15 U.S.C. 1673(a)(2) (2012).
[58] 31 U.S.C. § 3718 (2012); 31 C.F.R. § 901.5 (2013); 31 C.F.R. § 285.1 (2013).
[59] 31 C.F.R. § 901.5(b) (2013).
[60] 31 C.F.R. § 901.7(a) (2013); FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-54. The statutory guidance discourages taking title to the collateral property and encourages forcing a sale of the collateral to a third party. *Id*. at 6-55.
[61] 31 C.F.R. § 904.1(a) (2013).
[62] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 6-62 (giving an example when the debtor owes a large debt, or an important enforcement principle is at stake).

debts: reporting delinquent debts to credit bureaus,[63] suspension or revocation of eligibility for loans and loan guaranties, licenses, permits, or privileges,[64] and assessing interest, penalties, and administrative costs.[65]

However, for debts that are over 180 days delinquent, agencies must transfer them to FMS for cross-servicing.[66] In other words, once a debt is more than 180 days delinquent, administrative collection of debt is centralized under FMS to increase the efficiency of collection efforts, which was the primary objective of the enactment of the DCIA. Agencies must also refer all delinquent debts to TOP, but for an agency that refers its debts to FMS's cross-servicing program, FMS will submit the referred debts to TOP on behalf of the referring agency.[67]

B. Termination of Collection Action

1. Suspension and Termination

Despite the affirmative duty of agencies to pursue collecting debt, at some point, it becomes more cost effective to cease collection action. Suspension and termination of collection action occur "when it appears that no person liable on the claim has the present or prospective ability to pay a significant amount of the claim or the cost of collecting the claim is likely to be more than the amount recovered."[68] The difference between suspension and termination is that suspension of collection action is a decision to temporarily cease collecting a debt, while termination of collection action is a decision to cease active collection action on a debt.[69] Note that, in both cases, an agency ceases "active collection" but it may pursue "passive collection"

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[63] 31 U.S.C. § 3711(e) (2012); 31 C.F.R. § 901.4 (2013).
[64] 31 C.F.R. § 901.6 (2013).
[65] 31 U.S.C. § 3717 (2012); 31 C.F.R. § 901.9 (2013).
[66] 31 U.S.C. § 3711(g)(1) (2012); 31 C.F.R. § 901.1(e) (2013). *See* 31 C.F.R. § 285.12(c) (2013).
[67] 31 U.S.C. § 3716(c)(6) (2012); 31 C.F.R. § 285.12(g). Since transferring delinquent debts to FMS will satisfy the requirement of notifying, duplicate referral is unnecessary.
[68] 31 U.S.C. § 3711(a)(3). Agencies may terminate or suspend collection on a debt within their jurisdiction when the principal balance of the debt does not exceed $100,000 or any higher amount authorized by the U.S. Attorney General. *Id.*
[69] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 7-1, G-12 to -13.

activities of debt collection. For example, the debt may be maintained in TOP.[70]

Federal regulation prescribes when the agency may suspend collection action:

1. the agency cannot locate the debtor [at the present time];[71]
2. the debtor's financial condition is expected to improve; or
3. the debtor has requested a waiver or review of the debt.[72]

Since it suspends collection action for a while, suspension is only sensible when the prospect of debt collection enhances as times goes by.[73] The first and second criteria are in accord with this rationale, while the third criterion has a slightly different characteristic, as suspension becomes mandatory in certain cases.[74]

Federal regulation also prescribes when agencies may terminate collection activity:

1. the agency is unable to collect any substantial amount through its own efforts or through the efforts of others;
2. the agency is unable to locate the debtor;
3. costs of collection are anticipated to exceed the amount recoverable;
4. the debt is legally without merit or enforcement of the debt is barred by any applicable statute of limitations;
5. the debt cannot be substantiated; or
6. the debt against the debtor has been discharged in bankruptcy.[75]

The first three criteria are relevant where it is not cost effective to collect debt, and the last three criteria are relevant when the debt lacks legal basis to exist, so there is no point in continuing debt collection. The exception to termination of collection activity is that agencies may refer debts for further collection action when a significant enforcement policy is involved, or recovery

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[70] *Id.* at 7-1.
[71] Both suspension and termination has a same criterion of unable to locate the debtor, but the statutory guidance makes clear the difference between these two considering the effect on debt collection. FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 7-12.
[72] 31 C.F.R § 903.2(a) (2013). *See also* FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 7-12 to -13.
[73] FMS, Managing Federal Receivables, *supra* note 28, at 7-11 (illustrating an example where the debtor has been only temporarily laid-off from a permanent job).
[74] 31 C.F.R § 903.2(c).
[75] 31 C.F.R § 903.3(a). *See also* FMS, Managing Federal Receivables, *supra* note 28, at 7-5 to -8.

of a judgment is a prerequisite to the imposition of administrative sanctions.[76] Moreover, both suspension and termination of debt collection can be revisited any time, and neither has any effect on debtors' rights.[77]

2. Write-off, CNC, and Close-out

In addition to legal procedures of debt collections, there are also accounting actions for debt. Write-off of a debt is an accounting action that treats debt as having no value on the agency's financial and management reports.[78] Write-off occurs when the agency determines that the likelihood of collection is less than half, but no later than two years from the delinquency.[79] Write-off is generally mandatory for debt delinquent more than two years, unless documented and justified to OMB in consultation with Treasury.[80] It is assumed that writing off old delinquent debt will reflect a more accurate value of agencies' debts on the books.[81] The decision of termination often coincides with write-off, but write-off may occur before, concurrently with or after the agency determines that collection action should be terminated.[82] Although the decision of suspension or termination and write-off are made for different reasons, the difference between them is very obscure, as the criteria for the decision to suspend or terminate and to write-off overlap. In fact, Treasury is reviewing the definitions for write-off and termination, and evaluating whether they are still valid or need to be changed.[83]

Once debt is written-off, it must be either classified as "currently not collectible" (CNC)

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[76] 31 C.F.R § 903.4 (2013).
[77] 31 C.F.R § 900.8 (2013). *See also* OMB, Circular A-129, *supra* note 28, at 22.
[78] FMS, Managing Federal Receivables, *supra* note 28, at 7-2. Since write-off is an only adjustment of accounting records, an agency does not need an approval of the U.S. Attorney General to write-off a debt.
[79] OMB, Circular A-129, *supra* note 28, at 22.
[80] *Id.* at 22. The threshold of two years is based on the studies which showed that even the value of delinquent debt decline over time, more than 70 percent of delinquent debt was over 2 years. *See Federal Credit Policy Working Group Final Report on Write-off Policy* (1998), *available at* http://www.fms.treas.gov/debt/writeoff.pdf.
[81] U.S. DEP'T OF THE TREASURY, FISCAL YEAR 2012 REPORT TO THE CONGRESS: U.S. GOVERNMENT RECEIVABLES AND DEBT COLLECTION ACTIVITIES OF FEDERAL AGENCIES, 22 (2013).
[82] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 7-3, 7-14.
[83] Bureau of the Fiscal Serv., *Answers to Frequently Asked Questions About the Cross-Servicing Program*, https://www.fms.treas.gov/debt/questions_crosserv.html.

or "closed-out," in order to distinguish the debt which the agency continues to collect after write-off.[84] If an agency determines that cost effective collection efforts should continue, debts are classified as CNC and agencies should continue collection action until: i) the debt is paid; ii) the debt is closed out; iii) all collection actions are legally precluded; or iv) the debt is sold, whichever occurs first.[85] However, if the agency determines to cease all collection action, because the debt is legally barred or it is no longer cost effective to pursue collection, the debt should be categorized as close-out. Note that even though close-out is an accounting action, it has an effect on debt collection. In fact, close-out is equivalent to discharging, which has a legal consequence.[86] Therefore, before classifying as close-out, agencies have to take all proper measures to collect debt. Debt remaining that was not able to be collected is regarded as close-out.[87] Agencies must report the discharge of indebtedness to the Internal Revenue Service by filing a Form 1099C[88] and report close-out debts on the Treasury Report on Receivables and Debt Collection Activities (TROR).[89] Note that if a debt is written-off and classified as CNC, it may be reclassified as close-out in the future.

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[84] OMB, Circular A-129, *supra* note 28, at 22. The concept of CNC was developed in order to encourage writing-off old delinquent debt. *Supra note* 80.
[85] *Id.* at 22.
[86] 31 C.F.R § 903.5(a) (20139. *See also* FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at G-6 (defining "discharge" is to satisfy a debt as a legal obligation through the performance of the obligation(s) imposed under the debt instrument, such as to pay the debt in full, or through another action such as a compromise).
[87] 31 U.S.C. § 3711(g)(9) (2012); 31 C.F.R. § 903.5(b). *See also* 31 U.S.C. § 3711(i)(2) (requiring agencies to sell a delinquent nontax debt upon termination of collection action if the Secretary determines such a sale is in the best interests of the United States).

But note that agencies are not limited to the measures in the regulations, and they are encouraged to use all authorized remedies, such as alternative dispute resolutions and arbitration, to the extent that such remedies are not inconsistent with the relevant statutes. 31 C.F.R. § 900.1(c) (2013).

Moreover, compromise, waiver, or dispositions under other statutes are not precluded. 31 C.F.R. § 900.4(c) (2013). In fact, many statutes authorize the government to waive the recovery of indebtedness resulting from various overpayments or erroneous payments subject to certain conditions. GEN. ACCT. OFF., 2 PRINCIPLES OF FEDERAL APPROPRIATIONS LAW 9-130 (3d. ed., 2006) (citing 5 U.S.C. § 8129(c) (2012) (overpayments under Federal Employees Compensation Act), 38 U.S.C. § 5302(d) (2012) (overpayment of veterans' benefits), and 42 U.S.C. § 404(c) (2006 & Supp. V 2011) (Social Security Act)), *available at* http://www.gao.gov/assets/210/202819.pdf. An example in Federal Claims Collection Standards is the waiver of interest and administrative costs imposed on a debt paid within 30 days after delinquency. 31 C.F.R. § 901.9(g) (2013).
[88] 26 U.S.C. § 6050P (2012); 26 C.F.R. § 1.6050p-1 (2013).
[89] 31 C.F.R. § 903.5(c) (2013); *see* also 31 U.S.C. § 3719 (2012).

Likewise, when a debt is being compromised, agencies may have to follow the requirements for termination, write-off, and close-out for the portion of the debt discharged.[90] In most cases, when an agency accepts less than the full amount of the debt, the amount discharged should be written-off as close-out. However, if an agency determines that part of the debt is not owed, it is only required to make an adjustment on the TROR and write-off is unnecessary.[91]

Unless collected in its full amount, the collection of delinquent debt ends when agencies close-out the debts. Debts can be classified as close-out only after both write-off and termination of collection action have taken place.

III. BUDGETARY TREATMENT OF FEDERAL CREDIT

A. The Federal Credit Reform Act of 1990

The Federal Credit Reform Act of 1990 (FCRA), [92] as amended by the Balanced Budget Act of 1997, prescribes the budgetary treatment for Federal credit programs.[93] The purpose of the FCRA is to: (1) measure more accurately the costs of Federal credit programs; (2) place the cost of credit programs on a budgetary basis equivalent to other Federal spending; (3) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries; and (4) improve the allocation of resources among credit programs and between credit and other spending programs.[94]

As the first purpose makes explicit, the primary purpose of the law is to improve the

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[90] FMS, MANAGING FEDERAL RECEIVABLES, *supra* note 28, at 7-23.
[91] *Id.* Moreover, it does not need an approval of the U.S. Attorney General even the principal amount of debt exceeds $100,000.
[92] Pub. L. No. 101-508, 104 Stat. 1388 (1990).
[93] For the analysis of the FCRA, *see* Michael R. Pompeo, *Accrual Accounting for Federal Credit Programs: An Evaluation of the Federal Credit Reform Act of 1990*, 95 TNT 2-89 (1995); Neil Perry & Puja Seam, *Accruals Accounting for Federal Credit Programs: The Federal Credit Reform Act of 1990* 1-4, Harvard Law School Federal Budget Policy Seminar Briefing Paper No. 6 (2005), *available at* http://www.law.harvard.edu/faculty/hjackson/AccrualAccounting_6.pdf.
[94] 2 U.S.C. § 661 (2012).

measurement of the budgetary costs of Federal credit programs.[95] The FCRA accomplishes this objective by estimating the cost, often referred to as the "subsidy cost," of direct loans and loan guarantees rather than relying on cash outlays. This makes the cost of credit programs on a budgetary basis equivalent to other forms of federal spending because, under the FCRA, the lifetime cost is recognized in the year when the loan is approved. In effect, this also achieves the third and fourth purposes of the law, because budgetary equivalency allows analysts to directly compare the costs between federal programs and improves incentives to prioritize the most efficient among them.[96]

The FCRA requires the President's budget to reflect the cost of credit programs[97] and Congress to appropriate the "cost" for budget authority.[98] Therefore, the key here is the estimation of "cost," which is defined as "the estimated long-term cost to the Government of a direct loan or loan guarantee … calculated on a *net present value* basis, excluding administrative costs…"[99] In short, the FCRA changed the budgetary treatment of direct loans and loan guarantees from cash flow basis to projected subsidy cost basis, which is often refereed to as accrual basis.

The Director of Office of Management and Budget (OMB) is responsible for coordinating the estimation of subsidy costs.[100] But the Director of OMB has delegated the authority to agencies to calculate estimates based upon written guidelines, regulations, and other

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[95] *See* Pompeo, *supra* note 93, n. 61 and accompanying text.
[96] CENTER ON FEDERAL FINANCIAL INSTITUTIONS, BUDGETING FOR CREDIT PROGRAMS: A PRIMER 6 (2004) [hereinafter COFFI], *available at* http://www.coffi.org/pubs/Budgeting%20Primer.pdf.
[97] 2 U.S.C. § 661c(a) (2012). The agencies are also provided authority to make direct loan obligations or loan guarantee commitments. 2 U.S.C. § 661d(a) (2012).
[98] 2 U.S.C. § 661c(b).
[99] 2 U.S.C. § 661a(5)(A) (2012) (emphasis added). *See also* 2 U.S.C. § 661a(5)(B) (cost of a direct loan); 2 U.S.C. § 661a(5)(C) (cost of a loan guarantee).
[100] 2 U.S.C. § 661b(a) (2012).

criteria.[101] OMB is to consult the Congressional Budget Office (CBO) in developing these guidelines.[102] Nevertheless, the Director of OMB still retains the responsibility and final approval of subsidy estimates, reestimates, and modification cost estimates.[103] Moreover, even though budget and financial statement are quite similar, differences between them still remain.[104]

B. Mechanism of Refinement of Accrual Accounting

Despite the fact that initial estimates are based upon the best available data, including historical data, and taking into account current and forecasted economic conditions,[105] various reasons may require adjusting estimates. Therefore, the subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements.[106] However, in some cases, these take the form of "modification" rather than "reestimation." These two have different effects on budget scoring, and thus have the possibility to distort the incentive of the agencies. But, for the moment, only the basic concept is dealt with here.

1. Reestimation—permanent indefinite appropriation

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[101] 2 U.S.C. § 661b(b). The detailed guidelines include OMB, Circular A-129, *supra* note 28 and OFF. OF MGMT. & BUDGET, CIRCULAR NO. A-11, PREPARATION, SUBMISSION AND EXECUTION OF THE BUDGET § 185 (2013) [hereinafter OMB, CIRCULAR A-11], *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/a11_current_year/a11_2013.pdf.

[102] 2 U.S.C. § 661b(c).

[103] 2 U.S.C. § 661b(a); FED. ACCT. STANDARDS ADVISORY BOARD, FEDERAL FINANCIAL ACCOUNTING AND AUDITING TECHNICAL RELEASE 6: PREPARING ESTIMATES FOR DIRECT LOAN AND LOAN GUARANTEE SUBSIDIES UNDER THE FEDERAL CREDIT REFORM ACT – AMENDMENTS TO TECHNICAL RELEASE NO. 3 PREPARING AND AUDITING DIRECT LOAN AND LOAN GUARANTEE SUBSIDIES UNDER THE FEDERAL CREDIT REFORM ACT 7 (2004) [hereinafter FASAB, TECHNICAL RELEASE 6], *available at* http://www.fasab.gov/pdffiles/aapctr6.pdf. Agencies are required to use Credit Subsidy Calculator 2 to discount all agency-generated estimates of cash flows to and from the Government. OMB, CIRCULAR A-11, *supra* note 101, §§ 185.2, 185.5. The purpose of this is to ensure government-wide comparability and uniformity. *Id*.

[104] FED. ACCT. STANDARDS ADVISORY BOARD, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS 2: ACCOUNTING FOR DIRECT LOANS AND LOAN GUARANTEES ¶ 17 (July 15, 1993) (stating the effort to be consistent with the budget) [hereinafter FASAB, SFFAS 2], available at http://www.fasab.gov/pdffiles/sffas-2.pdf.

[105] *Id.* ¶ 16. *See also* 2. U.S.C. 661b(d).

[106] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(z) (defining the term "reestimates"); FASAB, SFFA2, *supra* note 104, ¶ 32.

Agencies are required to reestimate the subsidy cost of each cohort[107] of credit programs based upon information about the actual performance or estimated changes in future cash flows of the cohort.[108] The FCRA requires agencies to display the difference between the reestimated cost and the previous cost estimate in two ways. Therefore, agencies make two types of reestimation: "technical reestimates" and "interest rate reestimates."[109] Technical reestimates of the subsidy cost of a cohort of direct loans or loan guarantees are made for all changes in assumptions other than discount rates. The reestimate is made by using updated technical information, including prepayments, defaults, delinquencies, and recoveries, as well as actual interest rates.[110] It must be made immediately after the end of each fiscal year, unless a different plan is approved by OMB.[111] Interest rate reestimates are made to adjust the subsidy cost for the difference between the discount rates estimated at the time of formulation and the actual interest rates.[112] As opposed to technical reestimates, interest rate reestimates must be made when a cohort is at least 90 percent disbursed.[113]

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[107] "Cohort" refers to the fiscal year's direct loan obligations or loan guarantee commitments of a particular credit program. OMB, CIRCULAR A-11, *supra* note 101, § 185.3(c).

[108] 2 U.S.C. § 661b(d); OMB, CIRCULAR A-11, *supra* note 101, § 185.3(z). If a cohort is divided into risk categories, each risk category within a cohort must be reestimated separately. OMB, CIRCULAR A-11, *supra* note 101, § 185.6(a). "Risk categories" refer to subdivisions of a cohort of direct loans or loan guarantees into groups that are relatively homogeneous in cost. *Id.*§ 185.3(aa).

[109] 2 U.S.C. § 661c(f) (2012) (calling each as "a change in program costs" and "a change in net interest"); OMB, CIRCULAR A-11, *supra* note 101, §§ 185.3(z), 185.6(a). In the Credit Program Supplementary Tables, they are noted as "change due to interest rates" and "change due to technical assumptions." *See, e.g.*, OFFICE OF MGMT. & BUDGET, FISCAL YEAR 2015 FEDERAL CREDIT SUPPLEMENT, BUDGET OF THE UNITED STATES GOVERNMENT 25-74, *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/cr_supp.pdf.

[110] OMB, CIRCULAR A-11, *supra* note 101, § 185.6(a), (c) (explaining the two methods for calculating technical reestimates, the traditional approach and the balances approach, but dollar reestimates is made by the latter); FASAB, SFFAS 2, *supra* note 104, ¶ 32.

Factors considered at the time of estimations are estimated defaults, prepayments, fees, penalties, and expected actions by the Government and the borrower within the terms of the loan contract. OMB, CIRCULAR A-11, *supra* note 101, § 185.3(g)

[111] 2 U.S.C. § 661b(d) (2012); OMB, CIRCULAR A-11, *supra* note 101, § 185.6(a).

[112] OMB, CIRCULAR A-11, *supra* note 101, § 185.6(a): *see also Id*. § 185.6(b) (explaining the procedures to calculate interest rate reestimates), § 185.6(d) (explaining the calculation of interest on reestimate, which is the interest that would have been earned or paid if the reestimate amount had been included in the original estimate).

[113] *Id.* § 185.6(a). Agency may voluntarily reestimate the interest rate more often and some programs are required to calculate at the end of each year. *Id.*

Generally speaking, a reestimate will be either an upward reestimate or a downward reestimate. In an upward reestimate, reestimated amounts must be obligated and outlaid from the program account to the financing account.[114] The FCRA provides permanent and indefinite budget authority for this purpose.[115] But the obligation must be recorded separately in the program and financing schedule. This provision is intended to avoid penalizing agencies for revising their initial subsidies.[116] In contrast, downward reestimate indicates that excessive subsidy has been paid to the financing account. Lastly, note that there are different requirements for recording reestimates in the budget and the financial statements.[117]

2. Modification—new appropriation

As opposed to reestimation, modification has a definition in the FCRA: "any Government action that alters the estimated cost of an outstanding direct loan … or an outstanding loan guarantee … from the current estimate of cash flows."[118] As in the case of reestimation, modifications of a direct loan or loan guarantee change subsidy costs. But the biggest difference from reestimation is that permanent indefinite authority is not provided to modifications, and an appropriation for the subsidy cost increased by the modification is necessary.[119] The subsidy cost is the excess of net present value of remaining pre-modification cash flows over that of

[114] For three budgetary accounts—program, financing, and liquidating accounts—set up in the FCRA, *see* 2 U.S.C. §§ 661a(6)-(8); Perry & Seam, *supra* note 93, at 9-10. If a cohort is divided into risk categories, all increases or decreases in subsidy cost will be netted against each other in the same cohort. OMB, CIRCULAR A-11, *supra* note 101, § 185.3(f).

[115] 2 U.S.C. § 661c(f) (2012).

[116] GEN. ACCT. OFF., CREDIT REFORM: GREATER EFFORT NEEDED TO OVERCOME PERSISTENT COST ESTIMATION PROBLEMS 3 (1998) [hereinafter GAO, CREDIT REFORM], *available at* http://www.gao.gov/assets/230/225437.pdf; CONG. BUDGET OFF., CREDIT SUBSIDY REESTIMATES, 1993-1999 5 (2000) [hereinafter CBO, CREDIT SUBSIDY REESTIMATES], *available at* http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/24xx/doc2413/credit%20subsidy.pdf.

[117] OMB, CIRCULAR A-11, *supra* note 101, § 185.6(a); FASAB, TECHNICAL RELEASE 6, *supra* note 103, at 19.

[118] 2 U.S.C. § 661a(9) (2012). *See also* OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s).

[119] 2 U.S.C. § 661c(e).

remaining post-modification cash flows.[120]

There are two kinds of modifications; direct modifications and indirect modifications. Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets (with or without recourse).[121] Altering existing contracts includes forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Indirect modifications are actions that change the cost by legislatively altering the way in which an outstanding portfolio of direct loans or guaranteed loan is administered.[122] These include new methods of debt collection, such as using tax refunds to repay loans and restrictions on debt collections.[123] Therefore, modifications do not include an action anticipated or permitted to the government. The restriction here is that the assumption must be in the documented baseline subsidy estimate, and must be approved by OMB.[124] Distinctions between reestimation and modification are examined more thoroughly in the following part.

IV. Effect of Debt Collection on the Federal Budget

A. Ex Ante—Estimation

1. Risk of "Underestimation" in Original Estimate

As the bill was being debated, the FCRA was controversial for the fact that it entailed the

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[120] OMB, CIRCULAR A-11, *supra* note 101, § 185.7(a). Since the subsidy cost is calculated by Treasury rate which is different from cohort discount rate, modification adjustment transfer has to be made to adjust the book value. *Id.* § 185.3(u) (defining "modification adjustment transfer").

[121] 2 U.S.C. § 661a(9) (second sentence); OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s); FASAB, SFFAS 2, *supra* note 104, ¶ 42. These actions are regarded as modifications unless they are considered reestimates or workouts, or are permitted under the terms of existing contracts. *Id*. What this suggest is that reestimate should be considered first, before considering whether it corresponds to modification.

[122] 2 U.S.C. § 661a(9) (third sentence); OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s); FASAB, SFFAS 2, *supra* note 104, ¶ 43.

[123] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s); FASAB, SFFAS 2, *supra* note 104, ¶ 43.

[124] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s). For example, modifications would not include routine administrative workouts (*see Id*. § 185.3(ab)) of troubled loans or loans in imminent default. *Id*. § 185.3(s). *See also* FASAB, TECHNICAL RELEASE 6, supra note 103, at 14 note 8 (providing historical justification for the interpretation that modifications do not include routine administrative workouts, despite the fact that the statute does not explicitly states that).

risk of "gaming" subsidy estimates.[125] Estimating subsidy costs *ex ante* is a very complex process, requiring agencies to consider numerous factors. Of course, it is impossible to foresee what will happen in the future. Nevertheless, initial estimations have great political importance in the budget process and for that reason may incentivize agencies to underestimate subsidy costs. Moreover, the FCRA is also criticized for the structural problem of "underestimating" subsidy costs.

a. Ignoring Market Risk?

Under the FCRA, subsidy costs are calculated on a net present value basis. Estimating the cost of credit programs on this basis shifts the recognition of lifetime costs upfront, but does not change the net budgetary cost for the federal fisc.[126] In order to estimate the value of credit programs, the FCRA uses a discount rate defined as "the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."[127]

Even though net present value basis seems reasonable, estimation using a maturity-matched Treasury rate is often criticized for ignoring the cost of risk. In fact, there are proposed legislations to incorporate the cost of risk in the budget scoring of federal credit programs.[128] This method is often referred as a "fair-value approach."[129] The cost of risk at issue here is the cost that the private market would demand for similar loans or loan guarantees made by the

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[125] Pompeo, *supra* note 93, n. 84 and accompanying text
[126] RICHARD KOGAN ET AL., CTR. ON BUDGET & POL'Y PRIORITIES, HOUSE BILL WOULD ARTIFICIALLY INFLATE COST OF FEDERAL CREDIT PROGRAMS 3 (2013), *available at* http://www.cbpp.org/cms/index.cfm?fa=view&id=3661.
[127] 2 U.S.C. §§ 661a(5)(A), (E).
[128] The most recent legislation which attempts to take risk premium into account is Budget and Accounting Transparency Act of 2014, H.R. 1872, 113th Cong. (2014) (requiring to recognize the cost of federal credit programs on fair-market value basis). *See also* RICHARD KOGAN ET AL., *supra* note 126 (criticizing the bill). There are actually some statutes which consider the cost of risk, for example, the Troubled Asset Relief Program.
[129] *See, e.g.*, CONG. BUDGET OFF., FAIR-VALUE ACCOUNTING FOR FEDERAL CREDIT PROGRAMS (2012), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-05-FairValue_Brief.pdf.

federal government.[130] This additional cost is often referred to as a "risk premium," which is a compensation for bearing undiversifiable market risk.[131] According to this argument, the FCRA systematically understates the cost of credit programs because it overestimates the value of direct loans[132] and underestimates the cost of loan guarantees.[133] For example, one study shows that an estimation which incorporates risk premiums into the cost of new credit programs in fiscal year 2013 would have a $56 billion budgetary impact.[134] The main rationale for incorporating the cost of risk into estimates of the cost of federal credit program is to provide a comprehensive measure which is on equal footing with other noncredit transactions, so that it becomes possible to measure costs on an equal basis.[135]

At first sight, there seems to be wide support for risk adjustment for estimating credit programs. But, recently, an argument opposing the idea of incorporating the cost of market risk has been presented.[136] In contrast to the argument of the majority, it argues that only the fiscal

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[130] *See also infra* note 136.

[131] A world in which investors are risk averse, there is a reward for assuming risk. Therefore, an expected rate of return equals to the time premium added by risk premium. Therefore, if r is risk-free rate of return, then market value V of a future payment with expected value of E[x], is as follows:

$$V = \frac{E[x]}{1 + r + risk\ premium}$$

Compared to zero risk premium assumed in FCRA, considering risk premium will lower the value because denominator increases.

[132] In the case of risky loans, discount rate is too low because it does not take into account of risk premium. As a consequence of overstating the loans, the amount that has to be covered in loan guarantee is understated.

[133] CONG. BUDGET OFF., ESTIMATING THE VALUE OF SUBSIDIES FOR FEDERAL LOANS AND LOAN GUARANTEES 3 (2004) [hereinafter CBO, ESTIMATING THE VALUE OF SUBSIDIES], *available at* https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/57xx/doc5751/08-19-creditsubsidies.pdf; Deborah Lucas & Marvin Phaup, *Reforming Credit Reform*, 28 PUB. BUDGET & FIN. 90, 91 (2008).

[134] CONG. BUDGET OFF., FAIR-VALUE ESTIMATES OF THE COST OF FEDERAL CREDIT PROGRAMS IN 2013 5-6 (2012) [hereinafter, CBO, FAIR-VALUE ESTIMATES], *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-28-FairValue.pdf.

[135] CBO, ESTIMATING THE VALUE OF SUBSIDIES, *supra* note 133, at 4; Lucas & Phaup, *supra* note 133, at 97: Deborah Lucas & Marvin Phaup, *The Cost of Risk to the Federal Government and Its Implications for Budgeting*, *in* MEASURING AND MANAGING FEDERAL FINANCIAL RISK 29, 40 (Deborah Lucas ed., 2009). *See also* FIN. ECONOMISTS ROUNDTABLE, ACCOUNTING FOR THE COST OF GOVERNMENT CREDIT ASSISTANCE (2012), *available at* http://fic.wharton.upenn.edu/fic/Policy%20page/FER%20Statement%202012%2010-16-12%20final.pdf.

[136] David Kamin, *Risky Returns: Accounting for Risk in the Federal Budget*, 88 IND. L.J. 723, 726 (2013). Note that cost of risk at here means "the amount that the private market would demand to bear such uncertainty because private market participants give greater weight to bad outcomes than good ones." *Id*. at 731. *See also* RICHARD KOGAN ET AL., *supra* note 126 (citing the article above); PAUL N. VAN DE WATER & JOAN HUFFER, CTR ON BUDGET

effect on the budget should be considered, and the shift of risk itself should not be considered.[137] The underlying idea of this counterargument is that the "purpose of the budget is as a means of measuring and controlling the federal government's fiscal position."[138] Therefore, it opposes any proposal for risk adjustment which would add an extra amount to recorded budget cost that is not relevant to fiscal position.

One important thing to note is that subsidy costs incorporating risk premiums usually exceed actual outlays.[139] Therefore, opponents of the current treatment of the FCRA admit that adjustment has to be made to match actual cash flows, and propose to amortize the risk premium over the life of the loan.

These two arguments have different views with regard to the purpose of budget scoring. The proponents of fair-value accounting favor a comprehensive measure which allows comparison with other federal activities. In contrast, the proponents of using Treasury rates regard the budget as a tool for measuring the fiscal position of the federal government and separate budgeting from cost-benefit analysis. Therefore, the controversy over selecting appropriate discount rates has implications for which purpose the FCRA, and, more generally, the budget, should serve. It may also suggest that achieving four purposes simultaneously is too difficult to achieve.[140]

However, in conclusion, incorporating market risk would not require any change in

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& POL'Y PRIORITIES, HOUSE "BUDGET TRANSPARENCY" BILL WOULD MAKE BUDGET MORE OPAQUE (2013) (calling a new proposal "loss-aversion penalty" or "variability penalty"), *available at* http://www.cbpp.org/files/6-18-13bud.pdf; OMB, ANALYTICAL PERSPECTIVES, *supra* note 1, at 37-40.

[137] Kamin, *supra* note 136, at 757-758. It also argues that budgeting is different from cost-benefit analysis which takes into account all cost and benefits to society, including welfare effects of shifting risks. *Id*. at 771.

[138] *Id*. at 727.

[139] Lucas & Phaup, *supra* note 133, at 105-106. An example would be as follows: "A loan with a one-year maturity disbursed at the beginning of the fiscal year. The loan has an estimated subsidy cost of $100 under FCRA, but a cost of $120 if the risk premium is included." Under the FCRA, if realized losses are as anticipated, the outlay matches the expected fiscal effect. However, if the subsidy cost of the loan includes a $20 market risk premium, if realized losses are as anticipated, there would be increase of revenue by $20, because the actual outlay is only $100. *Id*. at 106. *See also* Kamin, *supra* note 136, at 758 (suggesting to monetize the utility gained from a risk shift).

[140] *See* 2 U.S.C. 661 (2012).

reestimation as long as risk premiums are offset somehow.[141]

b. Incentives: Permanent Indefinite Appropriation

The FCRA, as noted, provides permanent and indefinite appropriation for reestimation. It is almost impossible to estimate subsidy costs precisely beforehand, since it requires that various factors such as future economic growth, income, inflation, and other economic factors be considered.[142] As a result, automatic appropriation creates a "built-in incentive"[143] for agencies to underestimate subsidies for discretionary spending. Although mandatory programs are not constrained by appropriations, mandatory programs may also have incentives to underestimate in order to become less politically salient and avoid becoming a target for spending cuts under PAYGO rules.[144] One study concluded that it was not clear whether agencies were responding to these incentives; however, this conclusion was drawn because the data used was not very reliable and other economic factors may have played a role.[145]

Still, there are several factors that discourage agencies to underestimate. One is that, as the interaction between agencies and OMB is a continuous relationship rather than a single interaction, agencies may try to achieve benefits in the long run rather than seeking short-term, one-time benefits.[146] But on the other hand, agencies may be inclined to underestimate credit programs which only exist for one fiscal year. In addition to that, employees of an agency may engage in myopic behavior without considering the benefit of the agency as a whole.

2. Other Reasons

There are other reasons that may lead agencies to understate the initial estimation. One

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[141] Lucas & Phaup, *supra* note 133, at 106.
[142] CBO, CREDIT SUBSIDY REESTIMATES, *supra* note 116, at 5.
[143] GAO, CREDIT REFORM, *supra* note 116, at 4.
[144] CBO, CREDIT SUBSIDY REESTIMATES, *supra* note 116, at 6.
[145] GAO, CREDIT REFORM, *supra* note 116, at 10.
[146] *See* CBO, CREDIT SUBSIDY REESTIMATES, *supra* note 116, at 6.

argument is that an estimation of cost which omits administrative expenses understates the cost. In contrast to the subsidy cost, the FCRA treats administrative expenses differently and they are included on a cash basis as discretionary spending.[147] The rationale for excluding future administrative costs was to avoid advance appropriations of federal salaries and expenses, because it may weaken Congressional control of agencies.[148] However, whether administrative expenses are included in subsidy costs or not does not generally change the degree of reestimation or modification. Thus, as in the choice of discount rates, whether it underestimates the cost depends on the view of ideal budget scoring. But in some cases, there is an overestimation by including administrative costs in subsidy costs. For instance, in the Federal Family Education Loan (FFEL), a guaranteed student loan program, private administrative cost is included as a subsidy cost.[149] Nonetheless, since the payment for this cost is proportionate to the amount of principal, it probably does not affect reestimation, but may distort the choice between direct loan and loan guarantee.[150]

Lastly, when agencies are uncertain about their estimations, they may become conservative and inclined to underestimate.[151]

B. Ex post—Reestimation or Modification

1. Reestimation or Modification

There are various measures that government agencies can take collecting federal debts. However, each measure has a different impact on the federal budget. Some measures need appropriations because they are considered as modifications and others do not need appropriation

[147] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(a).
[148] Lucas & Phaup, *supra* note 133, at 100.
[149] *Id.* at 101. *See, e.g.,* 34 C.F.R. 682.404(i) (2013) (loan processing fee), 34 C.F.R. 682.404(h) (account maintenance fee).
[150] But student loan programs are mandatory programs, it may not have any effect. *See* 2 U.S.C. 661c(c)(1) (2012).
[151] CBO, CREDIT SUBSIDY REESTIMATES, *supra* note 116, at 6.

because they are considered as reestimations. Therefore, it is useful to recognize the consequences of each action.

Some of the debt collection action have impact on budgetary scoring because it may either change technical assumption which requires technical reestimate[152] or alter the estimated cost of an outstanding direct loan or loan guarantee which requires indirect modification.[153] It is important to note that modifications do not include debt collection action that is assumed at the formation, as long as the assumption is documented and has been approved by OMB.[154] At the point of estimation, there are many factors that affect the expected cash flow of credit programs and they are called "forecast assumptions."[155] In fact, the statutory guidance requires to include all anticipated actions of relevant parties permitted by current law that can alter the cash flow.[156] Moreover, it also requires to document assumptions made to estimate the cost.[157] However, the statutory guidance permits the difficulty distinguishing reestimation and modification and it has to be judged case-by-case basis.[158]

Having this in mind, it is possible to generally classify the debt collection action into reestimation effects or modification effects. Most of the actions are regarded as routine workouts, thus not regarded as modification.[159] Therefore, individual repayment arrangements including compromise will not be regarded as modification, as long as the action is part of routine

[152] *See supra* note 109-110 and accompanying text.
[153] *See supra* note 121-123 and accompanying text.
[154] *See supra* note 124 and accompanying text.
[155] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(k) (defining the term "forecast assumptions"). The factors includes Forecast assumptions include: default rates, timing of defaults, delinquency rates, late fees, proceeds from the sale of collateral or acquired defaulted loans, income from (and costs of managing) foreclosed collateral and acquired defaulted guaranteed loans, reschedulings, prepayments, loan asset sales proceeds and costs, and disbursement rates.
[156] OMB, CIRCULAR A-11, *supra* note 101, § 185.3(s).
[157] *Id*.
[158] *Id*.
[159] *Id*. *See also Id*. at § 185.3(ac) (defining workouts as "plans that offer options short of default or foreclosure for resolving troubled loans or loans in imminent default, such as deferring or forgiving principal or interest, reducing the borrower's interest rate, extending the loan maturity, or postponing collection action."). Note that foreclosure is not included in workout.

workouts or not considered at estimate of subsidy cost. Agencies also possess numerous debt collection tools. But these debt collection tools do not directly alter the terms of existing contracts, therefore it is unlikely to be classified as modification.

After these debt collection activities, agencies may either suspend or terminate collection of debt. Since suspension is a unilateral action by the agency, it is only subject to reestimation. But termination requires agencies to sell a delinquent debt if that is cost effective. Sale of debt is considered as modification, unless the sale is taken into account of at the estimation of subsidy cost.[160] Close-out, or discharging, is the last measure that agencies can take after employing all the possible methods for collection. Discharging a debt requires termination and if it ends up with forbearance, it may be regarded as modification.

Even though the modification can take place for a single loan, since many of the factors are presumably considered when subsidy cost is estimated, it is unlikely that modification will be made for a single loan by an individual government collection action. In fact, write-off can take place without causing any budgetary or legal effect and the agency may have less incentive to take actions that involves modification.

2. Shifting of Baseline

Debt collection may take various forms but so long as it does not involve indirect modification which takes a form of new enactment, many of the measures taken by agencies can be regarded as reestimation rather than modification. Since agencies have incentive to acquire permanent and indefinite appropriation, they have incentive to regard the action as reestimation. In order to be regarded as reestimation, various factors must be considered at the initial estimation which probably raises the cost of credit programs, as a result, taking in many factors may be disadvantageous for agencies to receive the initial appropriation. But the advantage of

[160] *Id*. § 185.8(d).

receiving permanent and indefinite appropriation since then may be more beneficial for the agency in the long term.

Since technical reestimation usually takes place every year and continuous reestimation results in shifting of "baseline." In case of collecting delinquent debt, agency may first try to workout such as terminating collection of debt which doesn't require appropriation, but may increase the cost by reestimation. As a consequence, in the end, when debtor gets the waiver for the debt, cost may be already reflected in prior reestimation and may not require further action. Even in the case when agency decides to amend the law which would change the cost of the program and thus requires appropriation, continuous reestimation may have made the cost of modification lower.

A study by GAO, which was conducted shortly after the FCRA was enacted, revealed that of the five domestic lending agencies examined, only one of them had modification which was a situation originated from changes in law.[161] Interestingly, it suggests that agencies are consulting OMB when the situation is uncertain.[162] This is quite similar to what was anticipated but since this research was done right after the enactment it could have changed since then.

C. Example: Student Loan Program

To see how modifications and reestimations are taking place in federal credit programs, it would be better to see an example.[163] As far as debt collection is concerned, student loan has an important position. At the end of fiscal year 2012, Department of Education's outstanding receivables totaled $643.3 billion, 69.1 percent of the government's total receivables. Federal

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[161] GEN. ACCT. OFF., FEDERAL CREDIT REFORM ACT: INFORMATION ON CREDIT MODIFICATIONS AND FINANCING ACCOUNTS 4 (1993), *available at* http://www.gao.gov/assets/220/218575.pdf.
[162] *Id*. at 5. *See also* OMB, Circular A-11, *supra* note 101, § 185.3(s) (encouraging agencies to consult OMB when it is unclear whether debt collection action constitutes a modification or a reestimate).
[163] Ideally it would be better to compare various programs how debt collection processes of agencies are affected by the budgetary treatment. But data in Appendix of the Budget of the U.S. Government, only shows the amount of credit programs combined with the amount of modification, it is difficult to know the relationship between reestimation and modification.

Direct Student Loans ($596.0 billion) and Defaulted Guaranteed Student Loans ($47.0 billion) accounted for more than 99 percent of total receivables.[164] Furthermore, student loan is one of the few federal credit programs, which separate the effect of modification.

The Federal student loan programs provide students and their families with loans to help meet postsecondary education costs. Student loan is provided through permanent and indefinite budget authorities for budget purposes and it does not require annual congressional appropriations. The Federal Family Education Loan (FFEL) program and the Direct Loan (DL) program are student loan programs, but FFEL ceased making new loans as of July 1, 2010. Tables 1 and 2 show the amount of new loan subsidy made, and amount of reestimation and modification for each program.

Since 2005, modifications took place both upwards and downwards several times, but basically all of them were as a result of a new enactment or a regulatory change.[165] For example, the net downward modification in FFEL in fiscal year 2008 of almost $2.5 billion reflects enactment of the College Cost Reduction and Access Act (CCRAA), which reduced lender exceptional performance and guaranty agency account maintenance fees and retention fees. The net upward modification in DL in fiscal year 2008 also reflects CCRAA provisions creating a new income based repayment plan and new public service loan forgiveness program. Similarly, net large downward modification in FFEL in fiscal year 2009 reflects the enactment of the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). Recent large net downward modification in FFEL in fiscal year 2014 is also a result of the Bipartisan Budget Act of 2013 which reduced FFEL guaranty agency default collection fees.

On the other hand, most of the reestimations seem to be made due to the changes of

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[164] U.S. DEP'T OF THE TREASURY, *supra* note 81, at 7.
[165] Interestingly, from 1996 to 2004, as far as the data shows, modification did not take place.

interest rates and forecasted assumptions. For example, large net downward reestimation in FFEL in fiscal year 2009 is due primarily to a major decrease in the OMB-provided discount rate and a substantial reduction in FFEL Consolidation loan volume. Likewise, the net downward reestimation in FFEL in fiscal year in 2013 is due to the same reason. Note that these are all net reestimations. Therefore, for example, net downward reestimation in FFEL in fiscal year 2013 also includes upward reestimation of $1.5 billion by reflecting the ECASLA programs. The net upward reestimation in DL in fiscal year 2007 is due primarily to "updated loan model assumptions" related to collections on defaulted loans.[166]

As far as student loan programs are concerned, the data is too insufficient to conclude that the agency is inclined to use reestimation rather than taking debt collection activities which requires modification. However the fact those substantial amounts of modifications are made is true.[167] although the fundamental driving factor is unclear as loan programs are influenced by many factors including macroeconomic effects.[168] Nevertheless, especially for recent years, as far as DL is concerned, large amount of gross reestimations are taking in both upward and downward ways, resulting in fairly stable size. The implication here is that reestimations may be only signifying the adjustments of various factors considered when loans are formed, without any intention of abusing.

The caveat here is that student loan programs are mandatory spending, which are not subject to the constraint of appropriation.[169] Therefore, other discretionary programs may have different result and further examination is necessary.

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[166] Though it is not clear, loan model assumptions seems to coincide with "forecast assumptions" in the statutory guidance. *See supra* note 155.
[167] In DL, form fiscal year 2003 to 2007, more than a billion of dollar is reestimated every year, even though the nominal amount of modifications are made during this period.
[168] If microeconomic effects were the biggest reason, direction of reestimation would probably be the same. However, at least Tables 1 and 2 do not present coherent direction of reestimation.
[169] 2 U.S.C. 661c(c)(1) (2012).

Table 1 Federal Direct Student Loans (DL)

FY	New Loan Subsidy ($000s)	Net Reestimate		Net Modification		Total Net Subsidy ($000s)
		$000s	%	$000s	%	
1996	241,022	$2,698	1.1%	$0	0%	243,720
1997	354,204	($82,157)	-23.2%	$0	0%	272,047
1998	91,169	$172,693	189%	$0	0%	263,862
1999	(378,211)	($360,880)	95.4%	$0	0%	(739,091)
2000	(1,068,700)	($2,442,286)	229%	$0	0%	(3,510,986)
2001	(1,039,009)	$481,223	-46.3%	$0	0%	(557,786)
2002	(721,929)	$0	0%	$0	0%	(721,929)
2003	(366,395)	$4,590,922	-1253%	$0	0%	4,224,527
2004	(169,375)	$2,626,597	-1551%	$0	0%	2,457,222
2005	1,071,040	$1,228,912	115%	$49,172	4.6%	2,349,124
2006	1,806,576	$4,377,453	242%	$7,291	0.4%	6,191,320
2007	264,613	$3,717,583	1405%	$0	0%	3,982,196
2008	(652,452)	$584,519	-89.6%	$4,143,273	-635%	4,075,340
2009	(5,828,418)	$119,364	-2.0%	$0	0%	(5,709,054)
2010	(8,632,537)	($2,583,230)	29.9%	$0	0%	(11,215,767)
2011	(21,759,701)	($5,689,291)	26.1%	$0	0%	(27,448,992)
2012	(27,100,852)	$5,566,331	-20.5%	$0	0%	(21,534,521)
2013	(30,032,763)	($8,151,717)	27.1%	$0	0%	(38,184,480)
2014	(21,585,226)	$6,793,632	-31.5%	$0	0%	(14,791,594)

Table 2 Federal Family Education Loans (FFEL)

FY	New Loan Subsidy ($000s)	Net Reestimate		Net Modification		Total Net Subsidy ($000s)
		$000s	%	$000s	%	
1996	2,951,085	$595,000	20.2%	$0	0%	3,546,085
1997	3,191,020	$98,058	3.1%	$0	0%	3,289,078
1998	1,981,291	$0	0.0%	$0	0%	1,981,291
1999	3,485,386	($153,134)	-4.4%	$0	0%	3,332,252
2000	3,530,135	$776,000	22.0%	$0	0%	4,306,135
2001	3,068,290	($4,727,793)	-154%	$0	0%	(1,659,503)
2002	4,311,738	$0	0%	$0	0%	4,311,738
2003	6,411,438	($2,979,866)	-46.5%	$0	0%	3,431,572
2004	9,601,615	($3,620,994)	-37.7%	$0	0%	5,980,621
2005	11,129,929	$1,043,588	9.4%	$147,516	1.3%	12,321,033
2006	17,273,789	$9,084,333	52.6%	$1,709,540	9.9%	28,067,662
2007	6,850,098	($3,159,611)	-46.1%	$0	0.0%	3,690,487
2008	(502,986)	$989,951	-197%	($2,464,349)	489.9%	(1,977,384)
2009	(14,208,513)	($15,952,714)	112%	($2,640,420)	18.6%	(32,801,647)
2010	(1,701,415)	($7,402,633)	435%	$0	0%	(9,104,048)
2011	0	($24,492,931)	-	$0	-	(24,492,931)
2012	0	($15,164,122)	-	$152,957	-	(15,011,165)
2013	0	($6,843,641)	-	$0	-	(6,843,641)
2014	0	($1,655,679)	-	($4,020,363)	-	(5,676,042)

CONCLUSION

Because the process of debt collection, especially compromise or waiver, may be equivalent to providing subsidies to private parties, ceding full budgetary control to federal agencies is not ideal. The biggest reason for this is the disparate treatment of credit adjustments. On the one hand, permanent and indefinite appropriations are provided for reestimations. On the other hand, modifications require new appropriations. Underlying this disparity is a great tension between the power of Congress, which has a democratic foundation, and the discretion of federal agencies, which increase efficiency of administration. This tension may require additional attention. Through enhanced public disclosure, agencies can facilitate public access to debt collection activities and improve the quality of future discussions related to the federal budget.