

# Managing Information and Risk: Promising Practices of Federal Financial Programs

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# Table of Contents

Preface.....	ii
Executive Summary .....	1
Table of Acronyms and Abbreviations Used in This Report.....	5
I.    Introduction.....	6
A. Improved Management of Information and Risk.....	6
B. Promising Practices from Ten Agencies.....	8
II.   Developing a Risk Management Culture.....	9
A. Promising Practice: The Enterprise Risk Management Organization.....	10
B. Promising Practice: Executive Dashboard .....	13
III.  Monitoring Portfolio Risk .....	15
A. Promising Practice: The Office of Lender Oversight .....	16
B. Promising Practice: The expanded GPADS risk monitoring system .....	19
IV.  Managing Portfolio Risk .....	22
A. Promising Practice: Asset Management System.....	23
B. Promising Practice: Division of Insurance and Research (DIR) .....	25
V.   Managing Operational Risk .....	28
A. Promising Practice: Applying COTS Software to Loan Underwriting and Monitoring.....	29
B. Promising Practice: Community Programs Application Processing (CPAP) Loan Origination Software .....	31
C. Promising Practice: State-of-the-Art Servicing of VA Vendee Loans .....	33
D. Promising Practice: Real Estate Assessment Center (REAC) .....	35
E. Promising Practice: Debt Collection Program .....	37
VI.  Linking Management to Budgeting and Investment .....	39
A. Promising Practice: Management Information System.....	40
B. Promising Practice: Applying Activity Based Costing to Debt Collection Alternatives.....	42
C. Promising Practice: Investment Planning Process .....	44
VII.  Lessons From the Promising Practices.....	46
VIII. Next Steps.....	49

Appendix A Agencies Participating in the Conference

Appendix B About the Author

# Preface

The demands on Federal credit program managers continue to grow in large part because of the success of these programs in providing billions of dollars in assistance to citizens and businesses. The management of these programs in an era of reduced administrative resources is a tribute to modern technology and the ability of Federal credit managers to innovate by taking best practices from the private sector and from other Federal programs.

Ten years ago the Office of Management and Budget (OMB), the Financial Management Service (FMS) of the Treasury Department, the Chief Financial Officers Council, and the Federal Credit Policy Working Group, cosponsored a “Workshop on Promising Practices.” The success of the conference was due in large part to the expertise that agencies shared on how programs could successfully innovate and adopt modern technology and management techniques from the private sector, as well as from other agencies, to the management of Federal loan portfolios.

The 1996 conference showcased significant improvements in portfolio management and disposition of delinquent debts at selected Federal agencies responsible for managing direct loan and loan guarantee and other programs. The purpose was to provide information to Federal policymakers and managers about promising practices and the expertise that exists in Federal financial programs. As a result of the conference, significant improvements at all stages of the credit management cycle were disseminated across agencies.

As the preface to the report from that conference noted, the practices showcased were those which met key criteria: (1) they had actually been implemented, (2) they had resulted in demonstrated improvements in management, and (3) they had the potential to be adopted or adapted by other Federal agencies with similar program functions and responsibilities.<sup>2</sup>

In the ten years following the 1996 conference, risk management has emerged as a driving force in credit management and budgeting. Federal managers have been challenged to develop and use performance data to improve planning, budgeting, and management of the inherent risks of loan portfolios, including operational risk and default risk. It is time once again to showcase the increasing quality of available tools for program management. The time is especially appropriate because of the Administration’s increasing emphasis on scoring the quality of Federal credit programs and their portfolio management systems. As Federal managers look to improve their practices, it is helpful to look to the achievements of other Federal agencies that have addressed similar operational issues.

This report and the related promising practices conference that took place on February 22, 2006, at the Ronald Reagan Center in Washington, DC, seek to provide that opportunity. We are fortunate to be able to showcase fourteen promising practices in this report.

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<sup>2</sup> Frank R. Kesterman, Director, Risk Assessment and Monitoring Division, Financial Management Service, U.S. Treasury Department, “Preface” to the transcribed proceedings, October 1996.

We wish to express special thanks to Deloitte & Touche USA LLP, a thought leader in information management for the public sector, for sponsoring this conference. We are also grateful to Robert J. Shea, Counselor to the Deputy Director for Management, Office of Management and Budget, for addressing the conference on the topic of, "Federal Credit Programs: The President's Risk Management Improvement Initiative."

Our appreciation goes, above all, to the Federal managers who have been able to improve their management practices significantly in recent years. A comparison of this year's practices with those of 1996 shows a truly impressive leap in capabilities of Federal credit agencies to manage their programs effectively. The benefits for program constituents and taxpayers will be especially substantial as these practices become more widespread among Federal agencies and programs with similar needs.

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# Executive Summary

In 1996 the Office of Management and Budget and the Financial Management Service of the Treasury Department jointly sponsored a workshop on promising practices. Ten years later, on February 22, 2006, officials from 17 Federal agencies and offices came together for a second conference on promising practices, this time sponsored by Deloitte & Touche USA LLP. The amount of progress over the ten years has been truly impressive.

This report presents promising practices for portfolio management in five critical areas: (1) developing a risk management culture, (2) monitoring portfolio risk, (3) managing portfolio risk, (4) managing operational risk, and (5) linking risk management to investment and budgeting.

The essential element of most of these promising practices is that they help Federal program managers to monitor the state of their portfolios and manage them. In some cases, they assist Federal managers in linking management with budgeting and deciding priorities in making investments. All of these practices, as a requirement for consideration, had to be in actual use by a Federal agency. The following practices are presented in this report:

## *Developing a Risk Management Culture*

- *The ED Enterprise Risk Management (ERM) Organization*: Its mission is to enhance the ability of the Office of Federal Student Aid to identify, assess, and manage risk across the entire enterprise. The ERM organization is not responsible for managing risk directly, but rather provides risk management oversight and guidance to other functional areas within Federal Student Aid.
- *The ED Executive Dashboard*: The Office of Federal Student Aid publishes a weekly Executive Dashboard, which is a compilation of the most significant indicators of the agency's performance. Program managers add notes to explain anomalies in any information they submit for the dashboard. Top management discusses dashboard indicators at its weekly meeting.

## *Monitoring Portfolio Risk*

- *The SBA's Office of Lender Oversight (OLO)*: OLO oversees lenders and financial partners that participate in SBA programs. The office monitors the risk profile of SBA's loan portfolio and its lenders. The office conducts off-site analysis and on-site reviews of SBA lenders and the manner in which they implement and comply with program rules and regulations. The office also assesses the quality of the overall SBA loan portfolio and identifies and analyzes trends.
- *Ginnie Mae's Portfolio Analysis Database System (GPADS)*: GPADS collects information about the performance of loans in pools backing mortgage-backed securities (MBSs) that the agency guarantees. The system applies financial ratios and analysis of peer groupings to help the agency monitor risk from the issuers of those MBSs. The system flags issuers and issuer portfolios that fall outside of expected parameters. With the emergence of new forms of risk,

Ginnie Mae expanded the GPADS system to provide new information. GPADS now presents key risk factors through four scored modules and several unscored modules.

### *Managing Portfolio Risk*

- *ExIm Bank's Asset Management System*: The Bank's Asset Monitoring and Restructuring group tracks all loan activity after a loan is approved. Officials add information promptly to reflect any changing circumstances with respect to an outstanding loan. The system incorporates a risk rating methodology that forms the basis for a risk evaluation approach that loan origination officials apply to long term transactions. That approach permits loans to be structured better at the time of origination to address risk. The system maintains all portfolio data in a single place and interfaces with other key systems in the Bank.
- *FDIC's Division of Insurance and Research*: The division monitors and analyzes risks of loss from the institutions for which the FDIC provides deposit insurance. It works with other FDIC units to monitor and analyze economic, financial, regulatory and supervisory trends, and their potential implications for the continued financial health of the banking industry. Working with other offices, the division develops comprehensive solutions to address risk and reports results monthly to the FDIC National Risk Committee. The division tests and reports semiannually on the adequacy of the FDIC insurance funds and forecasts whether the level of insurance premiums should be adjusted.

### *Managing Operational Risk*

- *USDA Rural Business Cooperative Services loan underwriting system*: USDA adopted Moody's commercial-off-the-shelf risk analysis software to review loan applications before approving them. The software collects industry data and permits USDA loan reviewers to compare loan applicants to industry standards, including financial ratios of peers in the same line of business. The software flags unusual information from the loan application and prompts analysis by raising questions about the implications of the data. This enhances uniformity of decisions across states and also allows creation of a data file and easy transmittal by e-mail. USDA also uses the software to check on the quality of lender servicing of guaranteed loans.
- *USDA Community Programs Application Processing (CPAP) loan origination software*: The CPAP software provides a standardized template for origination of rural water direct loans and grants. The standardized information is transferred to a data warehouse which is accessible by staff in field and state offices and in Washington, DC. The template has significantly reduced processing time for rural water loans and grants and permits analysis of the characteristics of the portfolio as a whole.
- *VA performance-based servicing contract*: The VA Loan Guaranty Service uses performance-based contracting to hire a major private sector servicer to service VA direct loans in the Vendee loan program. The servicer is paid out of proceeds of loans serviced, and thus has an incentive to keep them current. The servicer provides complete portfolio information daily as well as special reports. The

performance-based servicing contract helped the Loan Guaranty Service to cope with significant downsizing while improving servicing performance.

- *HUD Real Estate Assessment Center (REAC)*: HUD's REAC compiles annual data on (1) the physical condition, (2) the financial condition, and (3) resident satisfaction with respect to multifamily properties. REAC analyzes the data, develops performance scores, and provides the assessment results to HUD program staff. REAC also performs quality assurance reviews of certified inspectors to improve the quality of physical inspections.
- *ED Debt Collection Program*: The Office of Federal Student Aid relies heavily on private collection agencies (PCAs) to collect on defaulted student loans. PCAs are paid a percentage of the accounts that they recover. The office awards its contracts based heavily on past performance and then applies a balanced scorecard quarterly to assess its contractors' performance. The office has created performance-based competition among its contractors. Contractors compete against each other with the top performers setting the standard against which all others are measured.

### *Linking Management to Investment and Budgeting*

- *The Investment Planning Council (IPC) of the Office of Federal Student Aid*: The IPC consists of the office's top management plus budget officials and other staff. It generally meets weekly. The IPC decides whether to approve proposals, the scope of approved projects, and the timing, consistent with the budget cycle and available funds. Through the IPC, the office manages information technology (IT) initiatives from an enterprise perspective; encourages partnerships; eliminates duplicative and stovepipe projects; and balances benefits against the costs and risks of IT initiatives. Once an initiative is approved by the IPC, the members monitor its progress and take appropriate follow-up action.
- *The Social Security Administration's (SSA) Unified Measurement System (SUMS) and SUMS-Management Cost and Accounting System (SUMS-MCAS)*: The mission of SUMS/MCAS is to improve the quality, consistency and access to information used by managers and analysts throughout SSA to manage work and account for resources. The systems have replaced earlier legacy systems and brought uniformity and accuracy to data collection and management. SSA managers may use the data for tactical purposes, e.g., to manage processes at the 1300 SSA field offices, and for strategic purposes, e.g., to forecast workload and budgets and plan for emerging trends.
- *Debt Management Services (DMS), Treasury Department, Activity-Based Costing of Portfolio Management Activities*: DMS uses an activity-based costing system to allocate costs among activities for purposes of charging annual fees to agencies that refer their debts to FMS for collection. The system assesses the year-over-year marginal costs of major performance indicators and the percentage of collection dollars and collection transactions processed electronically. This and other data are used as part of the budget deliberation process to project future strategic goals, performance measures, and targets.

## ACKNOWLEDGEMENT

The author wishes to express thanks to the many Federal officials and private sector experts who contributed their time and insights in interviews conducted for this report. Special thanks go to the agency officials who provided feedback on earlier drafts to help ensure that the write-ups in this report are accurate and complete. However, the author bears full responsibility for the contents of this report.

## Table of Acronyms and Abbreviations Used in This Report

CFO	Chief Financial Officer
COSO	Committee of Sponsoring Organizations of the Treadway Commission
COTS	commercial-off-the-shelf
CPAP	Community Programs Application Processing (USDA)
DIR	Division of Insurance and Research (FDIC)
DMS	Debt Management Services of the Financial Management Service (Treasury)
ERM	Enterprise Risk Management
ED	Department of Education
ExIm Bank	Export-Import Bank of the United States
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration (HUD)
FMS	Financial Management Service (Treasury)
FSA	Office of Federal Student Aid (ED)
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
Ginnie Mae	Government National Mortgage Association (HUD)
GPADS	Ginnie Mae Portfolio Analysis Database System
GSA	General Services Administration
HUD	Department of Housing and Urban Development
IT	information technology
IPC	Investment Planning Council (ED)
MBS	mortgage-backed security
NAICS	North American Industry Classification System (formerly the SIC Code System)
OLO	Office of Lender Oversight (SBA)
OMB	Office of Management and Budget
PCA	private collection agency
PMA	President's Management Agenda
RD	Rural Development programs (USDA)
REAC	Real Estate Assessment Center (HUD)
SBA	Small Business Administration
SIC Code	Standard Industrial Classification Code
SSA	Social Security Administration
SUMS	Social Security Unified Measurement System (SSA)
SUMS-MCAS	SUMS-Management Cost and Accounting System (SSA)
USDA	Department of Agriculture
VA	Department of Veterans Affairs (VA)
WEP	Water and Environmental Programs (USDA)

# **I. Introduction**

## **A. Improved Management of Information and Risk**

On the whole, Federal credit agencies have greatly improved their portfolio management practices in recent years. Implementation of the requirements of the Credit Reform Act of 1990 has played a major role in this improvement. Compliance with the act has required agencies to dedicate increasing resources and attention to improving the quality of information about their credit programs. In addition, the act has created an incentive for external constituencies of some credit programs to support lender oversight and other agency activities that can help to keep credit subsidy estimates within acceptable limits.

A second major driver of improved portfolio management has been the dramatic growth of financial management technologies. Automated scoring and underwriting, state-of-the-art servicing, and accurate activity-based costing, are only some of the systems that the private sector has developed and that lend themselves to adoption by Federal credit agencies.

New technologies have enabled a number of Federal credit programs to manage the risks of expanded portfolios of loans and loan guaranties even though the agencies themselves may have been downsized and may have lost staff. To make the transformation and adopt new technologies effectively requires capable agency leadership. This was present at a number of the agencies reviewed for this report, most notably at the ED Office of Federal Student Aid, the VA Loan Guaranty Service, and Debt Management Services of the Treasury Department.

Third, and more recently, the Office of Management and Budget is implementing a new Federal credit initiative that focuses on portfolio management by credit agencies. In 2005 OMB undertook preliminary work to establish a baseline at five major Federal credit agencies: Education (the direct and guaranteed student loan programs), FHA (both single-family and multifamily mortgage insurance), SBA (disaster and Section 7(a) business loans), USDA (Farm Service Agency and Rural Development loans), and VA (direct and guaranteed loans). The baseline review also included the Treasury (Debt Management Services).

Pursuant to the new initiative, OMB scored each agency and program on the familiar red-yellow-green dimensions. Box 1, below, presents the preliminary criteria for “getting to green” under the new initiative. It can be seen that virtually all of the criteria require effective information management and that many address aspects of effective risk management. To the extent that agencies are willing and able to commit management and budget resources to get to green, the portfolio management initiative has the potential to provide major encouragement for improved management of information and risk in Federal credit programs.

**“Getting to Green”**  
**Preliminary Criteria for the New Credit Portfolio Management Initiative**  
**of the President’s Management Agenda**

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An agency is **RED** if, for its major credit programs, it does not:

- Define its target borrower segments clearly, regularly assess whether its borrowers meet that definition and whether such borrowers comprise an acceptable risk that can be managed effectively;
- Establish or verify that partner lenders have established sound lending policies and procedures that are implemented in effective transaction approval processes, loan portfolio management, and loss recovery.
- Establish or verify that partner lenders have established collateral valuation processes with clear policies and procedures ensuring independence in appraisals and valuations, and adequate monitoring of appraisers’ quality and certification;
- Maintain a reasonable level of risk and productivity of taxpayer cash used in lending programs through effective management information reporting, such as indicators of loan volume, exceptions to underwriting standards, concentrations of credit risk, delinquency and default rates, rating changes, problem loans, and chargeoffs and using such information to improve program results;
- Establish mutually agreeable goals that can be justified by comparisons to relevant programs to control the total cost of originating, servicing and liquidating loans and improve the rate of debt recovery; OR
- Comply with all relevant provisions of the Debt Collection Improvement Act of 1996.

An agency is **YELLOW** if, for its major credit programs, it:

- Defines its target borrower segments clearly, regularly assesses whether its borrowers meet that definition and whether such borrowers comprise an acceptable risk that can be managed effectively;
- Establishes or verifies that partner lenders have established sound lending policies and procedures that are implemented in effective transaction approval processes, loan portfolio management, and loss recovery.
- Establishes or verifies that partner lenders have established collateral valuation processes with clear policies and procedures ensuring independence in appraisals and valuations, and adequate monitoring of appraisers’ quality and certification;
- Maintains a reasonable level of risk and productivity of taxpayer cash used in lending programs through effective management information reporting, such as indicators of loan volume, exceptions to underwriting standards, concentrations of credit risk, delinquency and default rates, rating changes, problem loans, and chargeoffs and using such information to improve program results;
- Establishes mutually agreeable goals that can be justified by comparisons to relevant programs to control the total cost of originating, servicing and liquidating loans and improve the rate of debt recovery; AND
- Complies with all relevant provisions of the Debt Collection Improvement Act of 1996.

An agency is **GREEN** if, for its major credit programs, it achieves:

- All yellow criteria;
- PART scores of at least 80 on program design for at least 75 percent of its major credit programs, including providing evidence of sufficient public policy outcomes cost effectively;
- Goals related to reaching target borrowers and reducing deviation from risk standards;
- Goals to reduce the total cost of servicing and liquidating loans and improve the rate of debt recovery; AND
- Customer satisfaction ratings that meet or exceed industry standards.

## **B. Promising Practices from Ten Agencies**

This report presents fourteen promising practices of ten Federal agencies with respect to risk management, portfolio monitoring, early warning, and management information. Ten of the practices come from agencies that administer credit programs. In the order of their appearance, they are:

- The Office of Federal Student Aid (FSA) of the Department of Education (ED),
- The Small Business Administration (SBA),
- The Export-Import Bank of the United States (ExIm Bank),
- Rural Development programs of the Department of Agriculture (USDA),
- The Loan Guaranty Service of the Department of Veterans Affairs (VA), and
- The multifamily program of the Federal Housing Administration (FHA) of the Department of Housing and Urban Development.

Four of the practices come from other Federal agencies with financial responsibilities:<sup>3</sup>

- Ginnie Mae (HUD),
- The Social Security Administration (SSA),
- The Federal Deposit Insurance Corporation (FDIC), and
- The Financial Management Service (FMS) of the Treasury Department.

To be included in this report, all of the practices had to meet the criteria set for the 1996 workshop: (1) they must be implemented, (2) they must result in demonstrated improvements in management, and (3) they have the potential to be adopted or adapted by other Federal agencies with similar program functions and responsibilities.

This year's promising practices fall into five critical areas:

- (1) Developing a risk management culture,
- (2) Monitoring portfolio risk,
- (3) Managing portfolio risk,
- (4) Managing operational risk, and
- (5) Linking risk management to investment and budgeting.

It is hoped that Federal credit managers with special needs in these areas will find this report useful in reviewing promising practices of other agencies and in making contact with the managers who designed and implemented them.

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<sup>3</sup> Federal credit agencies, which provide direct loans or loan guarantees, are a subset of other Federal agencies, here called Federal financial agencies, which administer other types of financial programs.

## II. Developing a Risk Management Culture

Effective portfolio management depends on senior management. The private sector understands this well. A recent publication of the Institute of Internal Auditors explains: ,

“Because the control environment represents an organization’s first line of defense to mitigate the risks of financial reporting errors, a strong tone at the top plays a pivotal role. Research continues to prove that companies perform better and last longer when top management makes a commitment to strong internal control and clearly conveys this through their actions.”<sup>4</sup>

The two promising practices in this section relate to the right tone at the top. Theresa Shaw, Chief Operating Officer of the Office of Federal Student Aid came to the office from the private sector, with experience at Sallie Mae, the large student loan company. She brought a number of people with her from Sallie Mae. Together with career Federal ED officials, Ms. Shaw and her management team have instilled private sector practices and the kind of risk management culture found in leading private companies.

This section presents two promising practices from the Office of Federal Student Aid, the Enterprise Risk Management Organization and the Executive Dashboard. The Enterprise Risk Management Organization does not manage enterprise risk directly. Rather, it is charged with promoting effective risk management across the agency.

The Executive Dashboard of the Office of Federal Student Aid helps to promote agencywide attention to risk management by communicating to agency managers, starting with the highest level, critical information needed to gain timely insight into key management indicators and the risks that may need to be addressed. Agencies that adopt both of these promising practices, along with the appropriate supporting processes, will find that they help to establish and maintain a culture of risk management that – at limited cost – can help to protect the agency and its mission against unexpected disruption.

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<sup>4</sup> Putting COSO Theory into Practice," ***Tone at the Top***, The Institute of Internal Auditors, November 2005, p. 2 (PDF). Available at <http://www.theiia.org/download.cfm?file=42122>.

## A. Promising Practice: The Enterprise Risk Management Organization

**Agency:** Office of Federal Student Aid  
U.S. Department of Education

**Overview:** *“Risk Management is the process of measuring or assessing risk and then developing strategies to manage the risk.”* – Presentation by the Enterprise Risk Management Organization, December 2005

*“Enterprise Risk Management is a coordinated, culture-based approach to holistically addressing all of an organization’s risks – including operational, financial, strategic, compliance and reputational risks under one umbrella.”* – Presentation by the Enterprise Risk Management Organization, December 2005

The mission of the Enterprise Risk Management (ERM) organization is to enhance the ability of Federal Student Aid to identify, assess, and manage risk across the entire enterprise. The organization is not responsible for managing risk directly, but rather provides risk management oversight and guidance to other functional areas within Federal Student Aid. The ERM organization is divided into two main areas: (1) a Risk Analysis and Reporting division, and (2) an Internal Review division.

The Risk Analysis and Reporting division is developing an Enterprise Risk Management strategy and will be responsible for guiding the implementation of this strategy. It also performs targeted risk assessments and utilizes various data analysis tools and techniques to help the agency better quantify and manage risk. The Internal Review division monitors Federal Student Aid’s performance in GAO high-risk areas, performs internal reviews, and serves as the Federal Student Aid liaison to the Inspector General and GAO, helping to assure timely and appropriate responses on audit issues.

The Enterprise Risk Management organization believes that some of the agency’s business components may be too close to their own data, or may not have the requisite data mining capabilities or analysis skills to effectively evaluate this data. By contrast, the Risk Analysis and Reporting division may be able to use simple but effective tools to provide for better data analysis, which in turn, can enhance assessment, monitoring and problem-solving efforts. As an example, the office is utilizing a “Benford’s Law” analysis to help identify potential improper payments. The Benford’s Law analysis is a statistical analysis to determine whether specific numbers appear with certain expected frequencies.<sup>5</sup> If, for example, certain reported incomes of students or their

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<sup>5</sup> See, e.g., Mark J. Nigrini, “I’ve Got Your Number: how a mathematical phenomenon can help CPAs uncover fraud and other irregularities,” *Journal of Accountancy*, May 1999, available online at <http://www.aicpa.org/pubs/jofa/may1999/nigrini.htm>.

parents consist of amounts that appear with excessive frequencies, then these figures are “flagged” for follow-up to check for possible fraud. Another situation that might be flagged for review occurs when a school reports a rapid increase in enrollments. If an acquisition caused the rapid increase, then the office will need to inquire how well the school is managing that acquisition. If there was no acquisition, then the school may deserve a closer look.

The ERM organization also assists other parts of the Office of Federal Student Aid in addressing internal issues. Thus, in the course of an internal review, it was noted that one of the agency’s offices was entering data manually for a monthly Dashboard report. This manual process was both labor-intensive and subject to human error. ERM was able to devise a way to pull data automatically for the dashboard, thereby reducing errors and improving data quality while saving staff time.

The most important functions of the office relate to its overall mission of enterprise-wide risk management. By taking a view across the entire Office of Federal Student Aid, the organization will help ensure that parts of the agency don’t merely manage risk in their own areas, but also provide information to senior management which will allow them to better manage strategic risk across the enterprise.

#### **Stage of Implementation:**

Federal Student Aid began creating its risk organization in 2005 and continues to build and staff this function. The Risk Analysis and Reporting Division is actively engaged in a number of data analysis and risk assessment efforts. It has received a number of requests from business units of the Office of Federal Student Aid to look at the data that they monitor and to help to drill down to determine if improvements can be made. The Internal Review Division is actively conducting internal reviews, both with respect to participants in FSA programs and within Federal Student Aid itself. It is also working to foster improved relationships with both the Inspector General and GAO. Beginning this year Federal Student Aid’s risk organization will begin implementation of the COSO’s Enterprise Risk Management framework at Federal Student Aid. Sometime soon the agency may establish an ERM Committee to adopt an agencywide ERM strategy and champion its implementation.

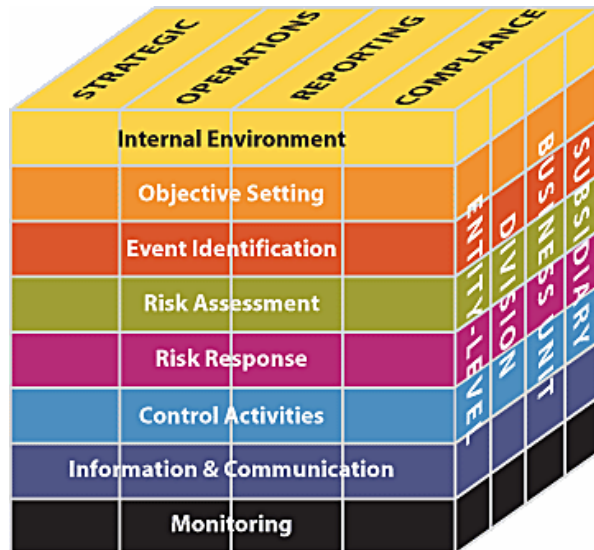
#### **Related Private Sector Business Practices:**

Enterprise risk management is an innovative approach to assessing and reporting on risk that continues to be adopted by more and more public institutions as they strive to improve their ability to more effectively manage the key risks facing them. The primary goal of ERM is to provide management with an integrated view of risk across their organization (enterprise), which, in turn, can enable them to more effectively utilize the organization’s resources in managing risk. Establishing a successful ERM strategy begins with an effective system of internal controls. As a result, ERM is a natural progression for major U.S. companies, nearly all of

which are now subject to the internal control reporting requirements of the Sarbanes-Oxley Act (SOA).

The internal control framework which has been adopted by the overwhelming majority of U.S. companies (subject to the reporting requirement of SOA) was developed by the Committee of Sponsoring Organizations of the Treadway Commission, or "COSO." COSO was formed in 1985, to study the causal factors that lead to fraudulent financial reporting and develop recommendations for public companies and their independent auditors, and for the SEC and other regulators. In 1992 COSO issued a landmark report, *Internal Control-Integrated Framework*. This has essentially become the standard internal control framework for nearly all public companies. In 2004 COSO issued another major report, *Enterprise Risk Management-Integrated Framework*. Many public companies are moving to adopt this framework as part of their enterprise risk management strategies.

The following illustration of the COSO concept of private-sector enterprise risk management makes clear that the management of risk should operate across all levels of the enterprise:



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Information on COSO's Enterprise Risk Management Framework is available at [www.coso.org](http://www.coso.org).

## **B. Promising Practice: Executive Dashboard**

**Agency:** Office of Federal Student Aid (FSA)

**Overview:** FSA publishes a weekly Executive Dashboard, which is a compilation of the most significant indicators of the agency's performance. Key indicators relate to loan applications, program disbursements, direct loan servicing, loan consolidation activity, collections, accounting and program management, budget, project status, overdue control mail, call center performance, and status of internal audits. Information from the Executive Dashboard is discussed by the agency's top management at the weekly meeting of the FSA Management Council. The discussion is brief if metrics and the status quo appear satisfactory; discussion takes longer when potential problems are identified.

Program managers add notes to explain anomalies in any information they submit for the dashboard. The preparation of the information can prompt managers to reflect both on data quality and on possible emerging issues. In addition, the compilation of metrics from across the enterprise helps to prompt standardization of data terms so that managers will deal with common issues.

The head of the FSA Enterprise Performance Management Group reports that, in addition to the time spent by managers in the separate business units, his office spends perhaps one person-day a week preparing the dashboard report, plus clerical help.

The Enterprise Performance Management Group also prepares a monthly project scorecard, which provides management with easy-to-read indicators of schedule, cost, quality, scope, and the elapsed time compared to the period of performance specified in a contract. (FSA administers most of its work through contractors). Similar to the Executive Dashboard, FSA managers actively use the Project Scorecard as a management tool. Project scorecards are considered as a part of the weekly meetings of the FSA Investment Committee (discussed below).

Each performance category is scored with a green, yellow, or red indicator of the degree of risk in terms of schedule to completion, cost, and other issues. A second page of the scorecard goes into more detail, including major issues, corrective actions taken, needed management support, accomplishments over the past month, and activities upcoming over the next month, along with information about the responsible officials, business unit, and contractor.

### **Stage of Implementation:**

FSA inaugurated its Executive Dashboard in summer 2003. It took perhaps 2-3 months to get the project started. The project began with a one-page summary of key program performance indicators, which soon grew into a several page report as managers sought to be informed about additional indicators.

The FSA Enterprise Risk Management Organization (discussed above) identifies areas of risk and investigates data anomalies, with a special focus on identifying areas of fraud, waste, or abuse in the program. One likely result of these activities may be the addition of data elements to the Executive Dashboard that better highlight relevant risk factors. Given that the Executive Dashboard has now grown beyond the vision of a one-page summary of the most critical indicators, one wonders whether FSA would find it useful to add a one page cover sheet to each weekly report that flags the most important information, as a way to return to the original concept.

**Related Private Sector Business Practices:**

An increasing number of firms maintain executive dashboards, to allow access by senior managers at any time to screens that indicate credit quality and other metrics, both by customer and by product. In contrast to the SFA Executive Dashboard, many company dashboards are maintained in electronic form so that managers across the enterprise can query the information and drill down as necessary to obtain more detailed information. It is the combination of a sound process for management oversight, backed by appropriate information technologies, that makes these companies effective at managing their credit and operational risks.

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### III. Monitoring Portfolio Risk

Once an agency has established a risk management culture, the next step is to devise effective systems for monitoring portfolio risk. The two promising practices in this section suggest different approaches, both effective, to monitoring portfolio risk.

The Small Business Administration established the Office of Lender Oversight (OLO) in 1999. Once again, the tone at the top made the difference. The SBA Associate Deputy Administrator for Capital Access, Charles Tansey, was a former banker who had helped his home state of Rhode Island resolve financial institution failures. He came into his SBA position during the prosperous years of the mid and late 1990s. Because of his background, however, he realized that the good times would not last forever. If the SBA were to be effective at providing credit to small businesses that did not qualify for credit from the private sector on similar terms (the statutory requirement), then it would need to monitor and manage the risks in its portfolio of loan guarantees. The result was the establishment of SBA's Office of Lender Oversight, to monitor SBA's participating lenders and the performance of the loans that they originate and service.

Ginnie Mae's development of the Ginnie Mae Portfolio Analysis Database System (GPADS) arose because of the efforts of top managers as well. Ted Foster, the Ginnie Mae official in charge of GPADS today, spoke at the 1996 Promising Practices Workshop about the precursor system to GPADS. He explained:

"In 1989, we had a portfolio of about \$ 200 billion and \$ 11 billion of those defaulted back to Ginnie Mae. This is not a circumstance that we like to have. [And] really we had no collective process for identifying someone who may be a problem in the future. So we sat down and said, okay, what we really need is a coherent automated system that can identify the folks that are most likely to be a problem in the future. Through that process, we developed the [precursor system to GPADS]."<sup>6</sup>

This sensitivity to the consequences of risk has stayed with many Ginnie Mae officials. Over time, Mr. Foster's Office of Mortgage-Backed Securities became aware of new forms of risk that GPADS was not measuring. The response was the development of enhancements to GPADS that monitor a range of risks. Some of the enhancements developed into performance scores, while others became reports that Ginnie Mae now tracks through its portfolio monitoring systems.

Agencies that seek to improve their portfolio monitoring capabilities can benefit from studying these promising practices and consulting with the relevant officials at SBA and Ginnie Mae.

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<sup>6</sup> Theodore B. Foster, Promising Practices Workshop, October 1, 1996, transcript, pp. 62-63.

## A. Promising Practice: The Office of Lender Oversight

**Agency:** Small Business Administration

**Overview:** The Office of Lender Oversight oversees lenders and financial partners that participate in SBA programs and evaluates SBA's loan programs. The office develops and implements plans, operating procedures, and standards to effectively determine, analyze and monitor the risk management profile of SBA's loan portfolio and its lenders.

The office conducts off-site analysis and on-site reviews of SBA lenders and the manner in which they implement and comply with program rules and regulations. The office also analyzes the quality of the SBA loan portfolio, risk indicators, and related trends. This allows the office to assess the performance of SBA lenders, the portfolio, and portfolio segments.

OLO uses credit scores provided by Dun & Bradstreet and validated annually by Fair Isaac, to score the SBA loans in the portfolios of each participating lender. Lenders then are rated on a scale of 1 to 5, with the top-performing lenders rated 1. These ratings are based on the historical performance of the lender's portfolio and the future expected performance of the lender as indicated by the credit scoring metrics.

By placing lenders into peer groupings, OLO is able to detect concentrations of risk. For example, OLO has found the SBA loans originated and serviced by lenders with the weakest risk ratings (a 4 or 5 rating) amount to \$ 7.7 billion; of this amount ninety-five percent is accounted for by just 43 lenders. This determination allows SBA to focus its scarce resources on on-site reviews of the lenders that pose the greatest risk to the agency. The roughly ninety percent of SBA lenders that are smaller and less active, and whose SBA loans amount to only about 16 percent of the total, in dollar terms, can be monitored solely off-site.

SBA incorporates information generated by OLO into its decision processes through two committees. The Portfolio Analysis Committee, consisting of representatives of OLO and of the Office of Financial Assistance, which is responsible for increasing lender participation in SBA programs, and chaired by SBA's Chief Operating Officer, meets monthly to assess trends in the portfolio. The Lender Oversight Committee, consisting of representatives of the two offices and a range of senior SBA officials, also chaired by the Chief Operating Officer, meets twice a quarter, and as needed, to review the budget, staffing and operations of OLO and to approve the office's enforcement recommendations.

## **Stage of Implementation:**

The SBA established the Office of Lender Oversight in 1999 and appointed its first Director in 2000. The office has increased its staff and has contracted with a private firm to obtain access to a comprehensive data warehouse that permits OLO to implement an internal risk-rating process. OLO has begun to conduct risk-based compliance reviews of lenders. The GAO has stated that “The loan monitoring service SBA obtained under contract...includes an infrastructure that appears to be on par with best practices, including a strong management information system, quality data, and human capital.”

SBA received authority in 2005 to permit the agency to assess lenders in the Section 7(a) business loan program for the costs of oversight. SBA is in the process of issuing regulations to implement this change.

OLO has developed and will shortly implement a lender portal that will allow lenders to view their own risk ratings and peer group comparisons, along with numerous performance and credit risk ratios. It is expected that feedback from this process will prompt improved reporting of data by lenders. OLO is also looking at ways to include in lender ratings a component that scores the quality of information that lenders provide to the agency. OLO is also working to develop appropriate policies and practices with respect to enforcement and other actions to address risk.

## **Related Private Sector Business Practices:**

Financial guaranty companies and large lenders monitor and analyze the credit quality of each loan and apply metrics to assess the quality and expected performance of their own loan portfolios and of portfolios that they may guarantee or acquire from business partners. This is essential so that they can avoid assuming unexpected levels of risk from partners who engage in unsound origination or servicing practices.

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Information on OLO is available at [www.sba.gov](http://www.sba.gov).

Janet A. Tasker, "Managing Risk at SBA: Office of Lender Oversight," February 22, 2006

The most recent GAO report on OLO is: *Small Business Administration: New Service for Lender Oversight Reflects Some Best Practices, but Strategy for Use Lags Behind*, GAO-04-610, June 2004.

## **B. Promising Practice: The expanded GPADS risk monitoring system**

**Agency:** Ginnie Mae

**Overview:** GPADS provides Ginnie Mae with information about the state of the portfolio of mortgages in each pool that Ginnie Mae guarantees. Pool information, including delinquency and default rates, is updated monthly. Through use of financial ratios and analysis of peer groupings, Ginnie Mae can use GPADS to focus on issuers of Ginnie Mae-guaranteed mortgage-backed securities and issuer portfolios that fall outside of expected parameters.

GPADS provides a portfolio overview, reproduced on the next page. It also provides information on the worst-performing issuers, and presents screens that profile each issuer. The issuer profile includes basic corporate information, portfolio composition, delinquency statistics, and new origination activity. It also presents performance scores, data on the issuer's portfolio composition, and trend information for key risk variables.

As Ginnie Mae identified new forms of risk, it expanded the GPADS analysis to provide information beyond the original delinquency data. Four scored modules have been added to reflect, (1) the risk of the issuer's portfolio, (2) the issuer's compliance with laws and regulations, (3) the issuer's financial strength, and (4) whether the loans are actually insured and/or guaranteed by the government. GPADS allows users to drill down to greater levels of detail. For example, the portfolio module shows the portfolio score, trend information, and related analysis. It compares the issuer's delinquency statistics to a peer group and Ginnie Mae norms. The module also displays the 100 loans in the issuer's portfolio that have the greatest delinquency.

Non-scored modules provide information on loan liquidations and anomalies in issuers' data reports, each issuer's concentration of loans in each state, and economic factors relating to each state. A part of GPADS also permits management queries and generates periodic reports. GPADS information has been made available to issuers through an easily accessible web-interface.

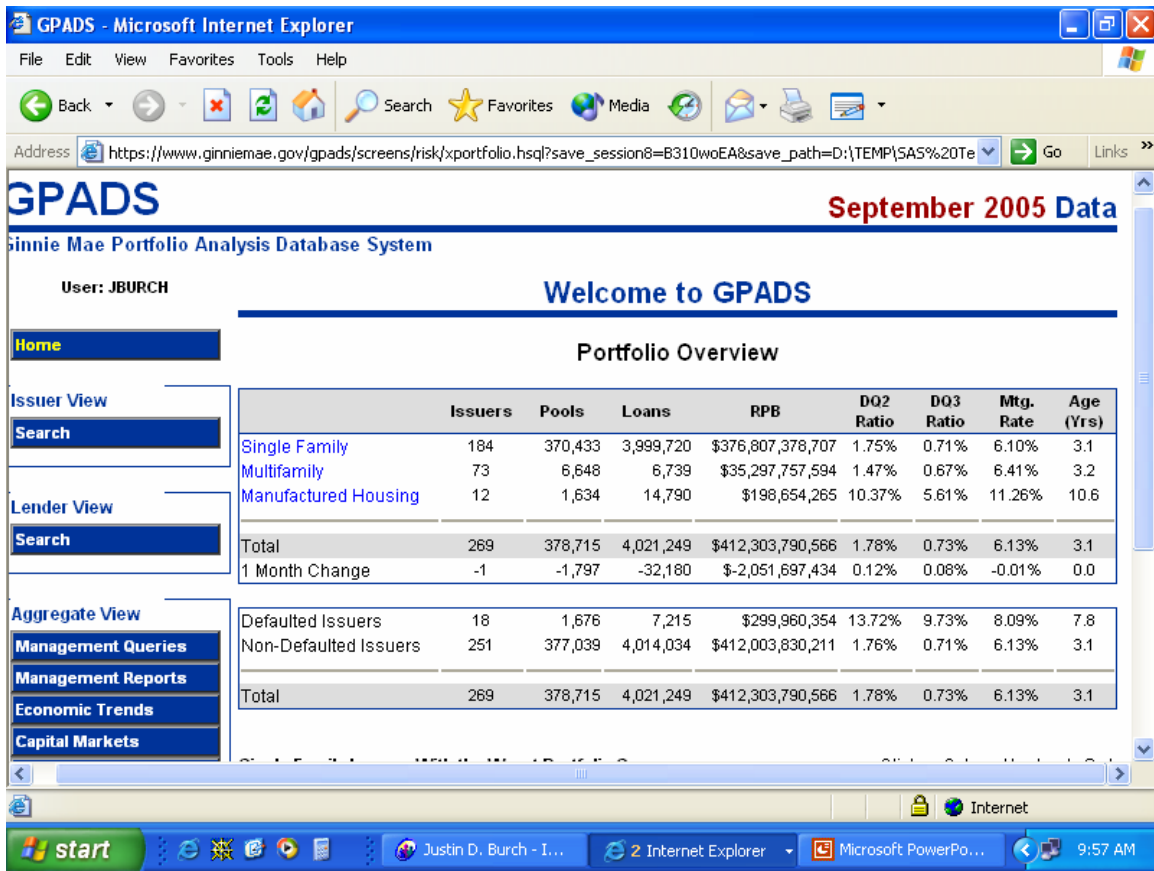


Figure 1 – Ginnie Mae Portfolio Overview

**Stage of Implementation:**

Ginnie Mae invested in its Mortgage-Backed Security Information System (MBSIS) in 1989. Its issuer portfolio monitoring system became operational shortly thereafter as a database system that downloaded MBSIS information monthly and analyzed the data to provide a comprehensive view of each issuer’s portfolio and the aggregate Ginnie Mae portfolio. Ginnie Mae developed GPADS in the late 1990s as an enhanced issuer portfolio monitoring system.

In 2005 Ginnie Mae expanded GPADS to encompass substantial additional information about issuer performance. Part of the insight that drove development of the expansion was recognition of the importance of an expanded range of potential risks. For example, Ginnie Mae found that issuer defaults often arose from problems not related to the issuers’ Ginnie Mae portfolios. This meant that the agency needed to know more about the ongoing financial strength of issuers and to monitor that as a potential risk factor.

Ginnie Mae is currently developing additional enhancements including loan-level scoring (to help predict loans that are likely to default), improved ability to query loan-level data, and expanded regional

economic analysis of factors that could affect loan and issuer performance.

**Related Private Sector Business Practices:**

Financial guaranty companies and large lenders monitor and analyze the credit quality of each loan and apply metrics to assess the quality and expected performance of the portfolios that they guarantee. This is essential so that they can avoid assuming unexpected levels of risk from partners who engage in unsound origination or servicing practices.

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Information on GPADS is included in a number of Ginnie Mae documents:

Ginnie Mae, "GPADS – Ginnie Mae's Portfolio Analysis Database System," February 22, 2006

Ginnie Mae, "Ginnie Mae's Portfolio Analysis Database System Reengineered for Success," draft, October 12, 2004

## IV. Managing Portfolio Risk

It is not enough merely to monitor portfolio risk. Agencies need to establish a linkage between risk monitoring and the rest of the agency so that action can be taken in response to a warning signal. The risk monitoring function cannot be a stepchild of the agency compared to the generally more popular function of extending credit in furtherance of the agency's mission.

The Division of Insurance and Research of the FDIC and the Asset Management System of the ExIm Bank represent two different approaches to building risk management into an agency's day-to-day practices. In each case, the agency developed its promising practice to bridge the gap between the parts of the agency concerned with individual portfolio elements and management that needed the capacity to review the larger portfolio and make policy, budget, or other decisions.

George French of the FDIC Division of Insurance, as it was then called, spoke to the promising practices workshop in 1996. He described how the FDIC created the division in 1995 to "bridge the gap" between FDIC's field staff and analysts in Washington. The field staff examined the financial condition of individual banks, while the analysts assessed risks to the portfolio as a whole and calculated the adequacy of the FDIC's insurance fund to absorb losses to the extent that risks materialized.<sup>7</sup> The division has since expanded its analysis to incorporate regional economic conditions and conduct stress tests of the likely impact of economic and other events on the adequacy of the insurance fund.

ExIm Bank's Asset Management System similarly fills the gap between loan- and aggregate-level information. The responsible office, the bank's Asset Management Division, combines loan-level information from many sources to provide other parts of the agency and top management with a comprehensive picture of the portfolio and relevant trends. The system also helps with management of individual loans as well. It provides valuable information about why a particular loan is facing a decline in credit quality. An ExIm Bank official reports that the experience of generating a composite portfolio report has helped agency officials to improve data definitions, especially with respect to credit quality, to catch problem loans earlier and generally to ask more of the right questions about potential issues.

The lesson of these promising practices, once again, is that risk management is most useful when it becomes an integral part of the agency's processes.

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<sup>7</sup> George French, Federal Deposit Insurance Corporation, Promising Practices Workshop, October 2, 1996, transcript, pp. 6-9.

## A. Promising Practice: Asset Management System

**Agency:** Export-Import Bank of the United States

**Overview:** ExIm Bank's Asset Management System tracks all activity after the ExIm Board of Directors approves a loan. The system is managed by the Asset Monitoring and Restructuring group of the Asset Management Division of the Bank. Division analysts add information to the loan file on virtually any changing circumstances with respect to an outstanding loan, including any site visits or other contact, relevant analyses, or changes in loan terms. The analyst makes these additions promptly after the activity or change in status occurs.

If an analyst determines that a loan exhibits declining credit quality, for example because of a drop in the risk rating of a particular borrower or of the country where the loan has been made, the loan may be placed on credit watch status. Analysts assess credit risk by reviewing expected future cashflows from each loan, with a 12 month time horizon, and issues of credit quality such as the emergence of new competition for a borrower. Any downgrade or upgrade of a loan triggers an e-mail report to the Chief Financial Officer (CFO), Deputy CFO, and to the person who originated the loan for the Bank. The system generates exception reports on loans falling outside of expected parameters as well as quarterly reports to the CFO.

One of the benefits of the system is the richness of insight that it can provide about why a loan is facing a decline in credit quality. An ExIm Bank official reports that the experience of using the system to generate a composite portfolio report has helped to catch problem loans earlier and generally to prompt officials to ask more of the right questions about potential issues.

The critical importance of the Asset Management System is that it maintains all portfolio data in a single place. The system interfaces with other Bank systems such as the document management system (where the legal documents on a loan are maintained) and the Bank's systems that record the payment history of loans and loan guarantees.

Besides providing loan-level information, the Asset Management System records the placement of a borrower or project on credit watch and helps analysts monitor any loan restructuring. The system also provides the basis for aggregate reports. The Asset Monitoring and Restructuring group prepares an annual portfolio review for the Board and ExIm Bank's senior managers which summarizes the status of the loan portfolio. The group uses information contained and generated from the monitoring system to prepare this comprehensive report of portfolio performance. This is in addition to a detailed semiannual portfolio report that the group generates.

**Stage of Implementation:**

The Asset Management Division began working on their system in 2000 and took delivery in March 2002. The Asset Monitoring and Restructuring group is considering establishing a brief report, perhaps one or two pages in length, which summarizes the status of the loan portfolio for ExIm Bank senior managers. This would accompany the longer semiannual portfolio report that the group currently generates. Another question is whether data input could be made easier by performing more of the task at the time the loan is being developed rather than only after Board approval. These issues are currently under consideration.

**Related Private Sector Business Practices:**

Financial guaranty companies and large lenders use such loan-level tracking systems to help monitor the credit quality of their portfolios. This is essential so that they can act promptly to address changing circumstances with respect loans to loans before they become troubled and expensive to resolve.

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## **B. Promising Practice: Division of Insurance and Research (DIR)**

**Agency:** Federal Deposit Insurance Corporation (FDIC)

**Overview:** The FDIC's mission is to promote public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for up to \$100,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.

The FDIC established the division in 1995 to monitor and analyze risks to the FDIC's insurance funds. In early 2003, the FDIC created the National Risk Committee (NRC), a cross-divisional body of senior managers established to identify and evaluate major business risks facing the banking industry and the insurance funds. The NRC provides coordinated policy guidance to the operating units, including the development of appropriate strategies and operating policies. A network of similar committees in the FDIC regions delivers regular regional risk reports to the NRC.

DIR provides analytic support to the NRC. The DIR risk analysis group in Washington works with economists in the FDIC's regional offices to prepare quarterly state profiles on economic and banking conditions and trends. The risk analysis group then aggregates these reports to prepare regular reports on national trends.

The division works with other FDIC units to monitor and analyze economic, financial, regulatory and supervisory trends, and their potential implications for the continued financial health of the banking industry and the deposit insurance funds through the Risk Analysis Center (RAC), which the FDIC established in March 2005. The RAC monitors emerging macro and micro risks on a daily basis and recommends responses to the NRC. Working with other parts of the FDIC, the division develops comprehensive solutions to address risks identified by the RAC and reports results monthly to the NRC.

The division also supports the efforts of the Financial Risk Committee (FRC) which is tasked with establishing the FDIC's contingent loss reserve for banks that might fail. DIR runs models to project institutions that could have capital ratios above and below two percent within one year, and to estimate a two year projection for failed bank assets.

The division prepares two dashboards to assist the NRC in its work. One provides a short, standardized summary of insurance fund exposures and liquidity measures. This NRC dashboard includes information such as the percent of insured deposits covered by the insurance fund, contingent loss reserves and actual losses to the funds, insured deposit growth, and portfolio liquidity.

The second dashboard shows key measures of the strength of the banking industry and economy that the RAC tracks on an ongoing basis. This includes measures of risk trends that change gradually, such as credit risk, employment levels and debt ratings, and other measures that can change more rapidly, such as supervisory ratings, market exposures and interest rate volatility measures. The division helps the RAC to update this dashboard quarterly. The division also includes the Center for Financial Research, which encourages and supports innovative research on topics -- including risk management -- that are important to the FDIC's role as deposit insurer and bank supervisor.

The division prepares two semiannual reports to inform the FDIC Board of Directors at the semiannual insurance rate case meeting:

- The *Semiannual Insurance Rate Case* provides a current assessment of the adequacy of the insurance funds, forecasts of near-term funds' condition, and offers recommendations for insurance premium rates.
- The *Semiannual Risk Case* provides a comprehensive analysis of local, national and international economic conditions that might affect insured banks and thrifts, as well as the insurance funds.

#### **Stage of Implementation:**

FDIC created the division in 1995 to monitor and analyze risk with respect to financial institutions for which the FDIC provides deposit insurance. In July 2003, McKinsey and company released an analysis of the FDIC risk management capabilities, and made recommendations for improvements. FDIC has now implemented the McKinsey recommendations and has created the National Risk Committee, the Risk Analysis Center, the Center for Financial Research, and a Financial Risk Committee.

#### **Related Private Sector Business Practices:**

Private insurers, lenders, and rating agencies monitor and analyze trends and other developments in regional economies, and the likely impact on credit risk. They use regional and other economic analyses to forecast the impact of such changes on the institution's portfolio and on potential losses, and then adjust their reserves accordingly.

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The 2003 McKinsey report, *Strengthening Financial Risk Management at the FDIC*, can be found at <http://www.fdic.gov/deposit/insurance/strengthening/>

The two semiannual reports that the Division prepares to inform the FDIC Board of Directors, the Semiannual Insurance Rate Case and the Semiannual Risk Case, can be found at <http://www.fdic.gov/deposit/insurance/risk/index.html>

The quarterly state profiles on economic and banking conditions and trends are available at <http://www.fdic.gov/bank/analytical/stateprofile/index.html>.

## V. Managing Operational Risk

Another area of significant agency progress has been in managing critical processes in the credit cycle. Some of the promising practices presented in this section rely on available commercial products and services; others build on agency-developed systems and processes, although these too are generally based on consideration of practices in the private sector.

One of the practices, the loan origination software of the USDA's Water and Environmental Programs, helps to standardize loan origination information between the many program field offices and USDA managers and analysts in state offices and Washington, DC. USDA's information technology specialists built and implemented the software in a process of consulting users and letting their needs drive the specifications. The system is being enhanced in segments according to ongoing consultations with the users.

Another USDA practice, the application of commercial-off-the-shelf origination software to loans in the Rural Business Cooperative Services, facilitates easy transmittal of data to a central database and strengthens the quality of loan underwriting. The system gives the USDA specialist access to information about the financial characteristics and ratios of peer groups of businesses in the same economic sector as the loan applicant. As the specialist reviews the loan application, the system raises questions if aspects of the applicant's financial statements appear out of line.

The VA has developed performance-based contracting to employ a leading private loan servicer that also performs servicing for a large number of conventional loans. FSA similarly uses performance-based contracting to employ high-performance private collection agencies to collect on defaulted student loans. In both cases the agencies have informed themselves extensively about comparable private sector practices so that they obtain state-of-the-art services.

The HUD Real Estate Assessment Center (REAC), by contrast, helps to manage risk through an agency-developed approach. The REAC obtains critical information about the condition of each borrower and multifamily property, scores them with an advanced scoring model, and raises flags when anomalies appear. The result has been to improve significantly HUD's knowledge of emerging risks.

A common theme across each of these practices is the way in which information is brought to bear when making credit or contracting decisions. Different approaches are used by each agency, based on their needs and resources. They reflect the application of technologies, processes, and services that have greatly improved since the promising practices workshop in 1996.

## **A. Promising Practice: Applying COTS Software to Loan Underwriting and Monitoring**

**Agency:** U.S. Department of Agriculture – Rural Development

**Overview:** Rural Business Cooperative Services adopted Moody's commercial-off-the-shelf (COTS) risk analysis software to permit USDA loan specialists to review loan applications before issuing a guarantee. The software collects industry data by line of business (now called the North American Industry Classification System or NAICS) and permits USDA loan reviewers to compare loan applicants to industry standards, including financial ratios of peers in the same line of business. Peers may be selected according to asset size, sales size, or the entire universe of similar firms. The applicant is matched on a broad range of factors such as revenue or sales or cost or capital projections.

The software allows the USDA loan reviewer to test the sensitivity of particular assumptions made in the application. For example, a loan reviewer can change the projected estimates for sales or expenses or changes in Consumer Price Index to see the impact on the economic prospects of the applicant. The software also flags unusual information from the loan application. It prompts analysis by raising questions about the implications of the data. For example, a question might be raised about the justification for projected sales that are above the norm for the peer group of similar companies.

USDA also uses the software to check on the quality of lender servicing of a guaranteed loan, even for loans that are not yet delinquent. Lenders must submit borrower financial statements annually. USDA officials review the financial statements and compare them to peer group financial ratios taken from the Moody's database. If a flag goes up, USDA uses the information to help decide on an appropriate course of action.

Loan specialists located in 47 state offices all have the same software package on their computers. This enhances uniformity of decisions across states. The system also allows the loan reviewers to create data files and send them, along with the peer information, by e-mail. USDA officials report that delinquency rates of guaranteed loans declined after the agency began using the software.

### **Stage of Implementation:**

USDA purchased the system in 2001 and implemented it, including installation and training of staff, in late 2002.

### **Related Private Sector Business Practices:**

Moody's provides the same program, called Moody's KMV Financial Analyst, to commercial banks, including both community banks and larger banks. Moody's reports that all major banks are included in its customer base. While USDA currently uses a version that is available by CD-ROMs

which are loaded on individual computers, commercial customers are migrating to a web-based version of the software which offers the means to bring all loan-related information into a single database.

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Further information about the software, Moody's KMV Financial Analyst, is available at [http://www.moodyskmv.com/products/dc\\_financialAnalyst.html](http://www.moodyskmv.com/products/dc_financialAnalyst.html)

## **B. Promising Practice: Community Programs Application Processing (CPAP) Loan Origination Software**

**Agency:** U.S. Department of Agriculture – Water and Environmental Programs

**Overview:** The CPAP loan origination software provides a standardized template for origination of rural water direct loans and grants. Rural Development field staff enter information from the standard “Application for Federal Assistance.” From this information the system generates underwriting data and information such as the USDA maximum loan amount and total USDA grant assistance that the project would need. The system also allows the underwriter to enter comparable cost data from similar water projects that were funded with USDA assistance. Once loans and grants are ready to approve, the software validates and transmits the data for obligation.

The standardized information is transferred to a data warehouse which is accessible by staff in field and state offices and in Washington, DC. The template has significantly reduced processing time for rural water loans and grants and permits officials at the state and Federal levels to analyze the portfolios for which they are responsible.

The CPAP servicing module permits field staff to enter servicing-related information such as annual and audit reports and required servicing actions such as checking on insurance or the borrower’s reserve for debt service.

### **Stage of Implementation:**

CPAP began as a personal-computer based program to develop and print forms needed to process Water and Environmental Programs (WEP) loans and grants. Rural Development formed a CPAP Advisory Group that includes users and technical staff. In January 2002 CPAP was upgraded to allow for central storage of data, nightly transfer of data to the WEP data warehouse and automatic updates. A legacy system that tracked processing and servicing actions was folded into CPAP in January 2003, thereby eliminating duplicate data entry and associated errors. In April 2003 an interface was created between CPAP and the Rural Utilities Servicing System to allow field staff to obligate loans in that servicing system.

Further enhancements have taken place and other upgrades and enhancements are planned. Two particularly useful software features are the ability to check out projects while online and work on those projects while offline i.e. at a borrower’s facility. The borrower’s data is automatically updated in the system when the computer is placed back online. The software also automatically checks for and installs updates when connected to the Internet. Approximately 1000 regular users utilize the system to enter, review, or add to data with respect to 20,580

borrowers with respect to over 35,000 projects consisting of over 60,000 loans and grants.

**Related Private Sector Business Practices:**

Private lenders utilize standardized electronic loan application and processing systems that link directly to central portfolio databases.

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Rural Development Utilities Programs, Water and Environmental Programs, *CPAP 4: Users' Guide for Loan and Grant Processing*, March 2005

Rural Development Utilities Programs, Water and Environmental Programs, *CPAP Web Servicing Software Manual*

## C. Promising Practice: State-of-the-Art Servicing of VA Vendee Loans

**Agency:** Loan Guaranty Service, Veterans Benefits Administration,  
Department of Veterans Affairs

**Overview:** The VA Loan Guaranty Service is using performance-based contracting to hire a major private sector servicer, Countrywide Financial, to service 16,000 VA-owned loans in its portfolio of direct loans, Vendee loans, repurchased loans, and refunded loans. The servicer is paid out of proceeds of loan collections, and thus has an incentive to keep them current (i.e. the servicer does not earn a service fee on delinquent loans). In addition, bidders on the contract were required to respond to a statement of VA's objectives by proposing a range of performance incentives and disincentives to be built into their compensation, based on their individual servicing best practices.

The performance-based servicing contract helped the VA Loan Guaranty Service to cope with significant congressional pressures to downsize by outsourcing the activities of perhaps 150 people, and to inexpensively access leading edge technology available to the private sector. For example, VA had a manual process of checking the status of taxes paid on each loan in each of the thousands of counties around the nation. The new contract has a very simple objective, that there shall be no delinquent taxes. The servicer uses its technology to constantly and automatically check and pay taxes as needed in each of the taxing jurisdictions around the nation; VA did not need to dictate how the servicer should do so.

The contractor also provides VA officials with much more comprehensive and timely portfolio information than had previously been available. The servicer provides complete portfolio information daily as well as special reports as needed. Within two days of the disaster, the servicer was able to provide VA a report on loans affected by Katrina. Those reports have been followed by updates at two week intervals.

### **Stage of Implementation:**

About seven years ago the VA Loan Guaranty Service retained a contractor to survey private sector practices, review VA's own loan servicing processes, and develop a performance-based request for proposals. That contractor helped VA staff to become thoroughly familiar with leading mortgage industry practices, learn and appreciate the value of performance-based and outcome-based contracting, and to build these into the contract framework. One of VA's biggest challenges was to show procurement staff that a contract that was denoted nominally in terms of a firm fixed-price (in terms of each loan serviced) actually operated as a performance-based contract.

In 2000 VA awarded a servicing contract to Countrywide for a five-year term. The contract has just been recompeted for another five-year term.

**Related Private Business Practices:**

Countrywide is the nation's largest servicer of home mortgage loans. It maintains state-of-the-art loan servicing systems and services over \$ 1 trillion in loans for the private sector. It services loans for VA according to industry standards, modified somewhat to address special needs of a government client, such as the need to conform to government accounting and financial reporting standards. VA is Countrywide's first government client for loan servicing.

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The most recent solicitation was a Request for Quotations (RFQ) – VA Portfolio Loan Servicing Contract; 101-049AF-06-Q-0002 JEH, conducted through the General Services Administration's (GSA) Financial and Business Solutions Schedule, October 20, 2005.

## **D. Promising Practice: Real Estate Assessment Center (REAC)**

**Agency:** FHA Multifamily program and HUD Public Housing program

**Overview:** The Real Estate Assessment Center collects (1) physical inspection data, (2) annual financial statements, and (3) surveys of resident satisfaction of FHA insured, privately-owned, multifamily properties. REAC analyzes the data, develops performance scores, and provides the assessment results to HUD program staff.

REAC contracts for physical inspections of all FHA insured multifamily properties. The mortgage lender pays for regularly scheduled inspections of FHA properties while special inspections may be paid for by FHA or the property owner. HUD-trained inspectors use data collection devices, hand-held computers, to record observations of deficiencies in more than 500 condition points in conducting the inspection. The inspection results are transmitted electronically to REAC. REAC scores and reports results to owners and HUD staff via the Internet. The owners are required to complete needed repairs of any exigent health and safety conditions identified and certify to their completion.

To assess the financial condition of the properties, REAC collects annual financial statements on all FHA insured properties. These assessments determine the financial soundness of HUD multifamily properties and verify compliance with HUD financial regulations. CPAs electronically submit audited financial statements to REAC in a required format based on GAAP. REAC scores and reports the results via the Internet to owners and HUD staff. Property owners may be referred to the Departmental Enforcement Center for issues of non-compliance with contract or HUD requirements.

Where HUD is the lender by virtue of loan assignment, FHA's oversight is supported by REAC's conduct of physical inspections and collection of project financial data at FHA's expense.

REAC performs similar data collection and assessment functions with respect to public housing agencies, generally assessing at the agency level rather than the project level as with FHA projects.

### **Stage of Implementation:**

In 1998, HUD finalized its uniform physical inspection standards. In 2000, HUD published a final rule strengthening its enforcement powers to deal with substandard conditions.

### **Related Private Business Practices:**

Conventional multifamily lenders monitor physical and financial conditions of multifamily properties whose loans they service. The level of lender oversight is generally a function of the lender's fiduciary responsibility or

liability. Conventional mortgage lender oversight is generally limited to ensuring that in case of default, the lender or its investor will be made whole. The difference between conventional mortgages and FHA insured mortgages is that FHA mortgages have a high loan-to-value ratio of 85% or more while a conventional mortgage might be no more than 60% or 70%. In conventional loans, with lower loan to value ratios, the recovery at foreclosure almost always covers any potential loss.

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“About REAC,” available at <http://www.hud.gov/offices/react/aboutreact.cfm>

“REAC at a Glance,” available at <http://www.hud.gov/offices/react/atglance.cfm>

Other materials, including relevant regulations and guidebooks, are accessible from these two web pages.

## **E. Promising Practice: Debt Collection Program**

**Agency:** Office of Federal Student Aid

**Overview:** The FSA Collections Group oversees a portfolio of 2.4 million defaulted student loans amounting in 2004 to \$ 18 billion of outstanding principal balance. Fifty five percent of these are defaulted guaranteed student loans that have been put back to the agency and another 41 percent are defaulted direct student loans. FSA relies heavily on private collection agencies (PCAs) to collect on defaulted student loans.

FSA wants to do business only with the best collectors in the business. For FY 2005, FSA selected 17 private collection agencies, including five small businesses, to receive task orders. Collection contractors are paid a percentage of the accounts that they recover. FSA must receive payments on a collected account before the contractor is paid out of the proceeds. The solicitation provides a schedule of commissions and fees for different types of collection activity. FSA has set these based on close study of the collection industry as to appropriate remuneration.

FSA has created performance-based competition among its contractors. High-performing PCAs are rewarded with bonuses and increased allocations of loans to collect. Rather than measuring contractors against a pre-established standard, FSA measures their performance against the top performer on each element of a balanced scorecard. Contractors compete against each other with the top performance setting the standard against which all others are measured. This dynamic performance standard thus reflects an achievable level of performance and automatically adjusts for economic and environmental variables that can affect performance. FSA also reserves the right to recall accounts from low performing contractors.

### **Stage of Implementation:**

The FSA Collections Group began to apply performance-based contracting in 1979 and has been continually refining its approach. The agency uses a legacy system to monitor the FSA collections portfolio. This system has limitations in terms of functionality as well as the number of years of data that it can store. FSA plans to replace this system with a new integrated data system, and awarded a contract for the new system in early FY 2004. FSA reduced the cost to collect the default portion of the student loan portfolio serviced by PCAs from more than \$0.21 per dollar collected in FY 1998 to \$0.16 per dollar collected in FY 2004, while increasing overall collections six-fold during that same period.

### **Related Private Business Practices:**

FSA sets its fees based on close study of the private collection industry as to appropriate remuneration. The agency closely monitors practices of the collections industry and seeks feedback whether its performance

measures create the best incentives. The FSA Collections Group follows industry standards in making collections the subject of continuous process improvement.

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Information about the contracting process for collections, including solicitations and statements of work can be found at:  
<http://www.pca.ed.gov/index.html>

## **VI. Linking Management to Budgeting and Investment**

One of the drivers of improved credit practices has been the Credit Reform Act of 1992. As agencies implement that act and receive feedback in the form of reestimates from earlier years, they have been able to refine both their modeling and the quality of information they use to generate subsidy estimates. Some program constituents have become sensitive to the implications of credit budgeting and the need to keep program costs within budgeted estimates. Major lender groups, for example, may concern themselves with default rates and the impact that these may have on the credit subsidy estimates of particular programs.

It would be entirely appropriate, then, that Federal credit agencies be allowed to benefit in their budget calculations from improved portfolio management, once the impact of the improvements on critical variables such as default or recovery rates can be demonstrated. In addition, most domestic Federal agencies also face clear budget constraints. Linking the benefits and costs of investments can help agencies to prioritize commitments of resources for new information-based processes, systems, and services.

The three promising practices in this section represent ways that agencies have strengthened the linkage between management and budgeting or management and investment, as the case may be.

The Social Security Administration's (SSA's) management information system is intended to provide accurate and timely data needed by agency staff at all levels to make decisions on managing workloads, programs and resources. The agency has rolled out the system in close consultation with users and under the direction of an agencywide committee. SSA has benefited from a sequential approach: the clear success of a specific application helped build the needed in-house constituency for expansion to support other areas as well. The system allows the agency to reallocate staff and resources to meet changing workloads and agency responsibilities.

The investment process of the Office of Student Federal Aid is a different kind of promising practice. It relies on an approach of assisting program managers in building the business case for proposed investments and a multi-level transparent process for evaluating the benefits and costs. At the end of the process the agency reconciles the availability of budget resources with the highest priority investments to ensure that available resources are allocated to the best investments.

Debt Management Services (DMS), a part of Treasury's Financial Management Service (FMS), has implemented an activity-based costing system that is fully integrated with the office's workload. This permits the office to charge its users appropriately and also to demonstrate the cost-effectiveness of the processes and resources that it applies to collect on defaulted loans for each of the agencies that use its services.

The practices discussed in this section represent the development of a much-needed feedback loop between management and budgets so that agencies will be able to quantify the impact of their practices and obtain appropriate credit subsidy estimates, or funding, as the case may be, for their activities.

## **A. Promising Practice: Management Information System**

**Agency:** Social Security Administration

**Overview:** The SSA Unified Measurement System (SUMS) and the newer SUMS-Management Cost and Accounting System (SUMS-MCAS) have replaced earlier legacy systems and brought uniformity and accuracy to collecting and managing data needed for management information. The mission of SUMS/MCAS is to improve the quality, consistency and access to information used by managers and analysts throughout SSA to manage work and account for resources.

SSA managers may use the data for tactical purposes, e.g., to manage processes at the 1300 SSA field offices, and for strategic purposes, e.g., to forecast workload and budgets and plan for emerging trends. The most recent success of the system was the way that it provided the necessary infrastructure to support the workload management and strategic management information needs of the new Medicare Prescription Drug Program. Using this approach enabled SSA to provide tactical and strategic management information in a very short timeframe.

SSA is rolling out the systems with integration as a primary goal, based on a six-year plan. The SUMS-MCAS Steering Committee, consisting of senior SSA officials from all involved parts of the agency, manages the six-year timeline and makes decisions about timing and direction. The Steering Committee makes recommendations to SSA's Information Technology Advisory Board, which has a two-year time horizon for allocating resources and setting milestones. All project activities are reviewed and approved at the Deputy Commissioner level.

### **Stage of Implementation:**

SSA is rolling out the management information system in stages. In 1996-7 SSA it implemented a data warehouse strategy to support the Office of Disability by providing historical data on disability decisions. The success of this system persuaded senior SSA management to allocate additional funding and priority to the expansion of the management information system to provide other forms of support. In 2003 SSA adopted the SUMS/MCAS six-year plan and the governance structure needed to assure the plan's implementation. The system currently is evolving to merge operational information about the SSA programs with administrative and cost information, for example, with respect to the time it takes SSA, and particular offices, to complete specific tasks and processes.

### **Related Private Sector Business Practices:**

SSA has evolved the Management Information System in close coordination with the private sector as it relates to data warehousing technologies. It regularly incorporates new technological developments into implementation of the six-year management information system plan.

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Daryl Wise, “Leveraging Business Intelligence and Data Warehousing for Government Performance Management,” February 22, 2006

## **B. Promising Practice: Applying Activity Based Costing to Debt Collection Alternatives**

**Agency:** Debt Management Services, U.S. Treasury Department

**Overview:** DMS is responsible for collecting billions of dollars of delinquent debts owed to the Federal government. Agencies refer Federal non-tax debts more than 180 days delinquent to DMS for collection. The agency applies a variety of collection tools to these debts, including Treasury demand letters, telephone calls to debtors, referral of debts to the Treasury Offset Program, administrative wage garnishment, reports to credit bureaus, referral to private collection agencies (PCAs) under contract to DMS, and referral to the Department of Justice for litigation.

DMS receives 100% reimbursement for services provided to agencies that refer their debts to DMS for collection. DMS uses activity-based costing to allocate costs among activities for purposes of charging annual fees to each customer agency. For example, the Financial Management Service (FMS) utilizes an Integrated Document Management System that includes extensive imaging capability, to assist agencies in converting their files to an electronic format. Depending on whether they submit their records electronically or on paper, agencies may pay for this service, which can be essential for effective collection.

DMS's annual budget requests clearly indicate the full cost of achieving all performance goals. Through its activity based costing system, DMS assesses the year-over-year marginal costs of its major performance indicators, the percent of collection dollars and collection transactions processed electronically, and tax vs. non-tax collection activities. This data and other information are used in budget deliberations to project future strategic goals, performance measures, and targets.

### **Stage of Implementation:**

FMS instituted its activity-based costing system three years ago. The agency uses a web-based time reporting system that allows employees to assign their time to individual projects. The system is auditable and permits Debt Collection Services to determine where its revenues come from and where its costs go. In FY 2004 Congress authorized a permanent indefinite appropriation for costs associated with the Collections Program, indicating that it meets high government standards for control and administration of program funds.

### **Related Private Sector Business Practices:**

Activity-based costing is an important part of the analysis that private firms undertake to assure that their activities are profitable rather than a loss for the firm. This information also provides unit cost measures that are useful in modeling changes in demand or in resource levels.

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## C. Promising Practice: Investment Planning Process

**Agency:** Office of Federal Student Aid, Department of Education

**Overview:** FSA uses a three-step process to consider investments of discretionary funds in information technology and other process improvements. The first step is for the manager to prepare a business case, with help from FSA staff or consultants. In the second step, the business case goes to the FSA Decision Support Group, a group of mid-level FSA officials which meets once every week or two to review proposals and decide either to forward them, to recommend modifications, or to send them back for more work.

The purpose of this review is to get proposals ready for the third step, the FSA Investment Planning Council (IPC), which consists of top FSA management plus FSA budget officials and visitors from the FSA staff. It generally meets weekly. The IPC asks proponents tough questions about their proposals. The participation of top agency management means that a proposal, once it is approved, fits well within the context of priorities across the enterprise. The IPC decides whether to approve proposals, the scope of approved projects, and the timing, consistent with the budget cycle and available funds. Through the IPC, FSA manages IT initiatives from an enterprise perspective; encourages partnerships; eliminates duplicative and stovepipe projects; and balances benefits against the costs and risks of IT initiatives.

Once an initiative is approved by the IPC, the members monitor its progress, using project scorecards (discussed above), and take appropriate follow-up action.

### **Stage of Implementation:**

FSA established the Investment Planning Council in FY 2003 to ensure a rigorous review process for all FSA IT initiatives. The IPC was developed to ensure that FSA is in compliance with the Clinger-Cohen Act and that IT initiatives are in alignment with FSA's Performance Plan and the department's Strategic Plan.

### **Related Private Sector Business Practices:**

Many private firms utilize a similar process to prepare proposals and present them to the company's board of directors for a decision concerning investment.

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## VII. Lessons From the Promising Practices

The fourteen promising practices presented in this report offer a number of useful lessons:

### *Effective Portfolio Management is a Necessity for all Federal Financial Agencies.*

As these promising practices show, effective portfolio management is now within reach of virtually all Federal financial agencies, regardless of the size of their programs. The Asset Management System of the ExIm Bank promotes effective enterprise-wide management of a portfolio of only a few hundred large loans. By contrast, SBA's Office of Lender Oversight and Ginnie Mae's GPADS assist managers of multibillion dollar portfolios of much smaller loans.

Effective portfolio management tends to grow upon itself. Access to loan-level data has enabled the SBA's Office of Lender Oversight to screen lenders and detect patterns and concentrations of risk that merit special attention. The Risk Management Unit of the Office of Federal Student Aid is helping individual units to detect and manage risk, not only for themselves, but also for the enterprise as a whole.

The size of portfolio management units and the nature of the available software and technology platforms vary across agencies of government, including those surveyed for this report. An effective portfolio analysis staff can start small. What is important in risk monitoring is that an agency link its loan-level information through relevant levels, e.g., to capture lender-level risks, with higher-level analysis that provides top management with periodic and special reports on the state of the portfolio as a whole, along with indications of emerging risks. What is then important is that the agency link its portfolio-monitoring function with a process for effectively managing risks that are detected.

### *Commitment at the Top can be the Key to Successful Action.*

Many of the promising practices came about because of commitment and support from the top of an agency. Several of the practices carried out by the Office of Federal Student Aid – the risk management organization, the executive dashboard, and the investment process – reflect the support that the office's Chief Operating Officer provides for such businesslike approaches. The SBA's Office of Lender Oversight began because of the vision and drive of the head of SBA's Office of Capital Access. The successful outsourcing of servicing through a performance-based VA contract came about thanks to support from the Director and Deputy Director of the VA's Loan Guaranty Service. Other promising practices similarly reflect commitment from the top.

It is possible for promising practices to emerge without a champion at the top, but that is much more difficult. A champion at the top can encourage the flow of resources that may be needed to get a new practice off the ground. A powerful champion also can help to protect the new practice from sniping by others in the agency who otherwise might try to defend their turf against the emergence of the new idea. As in the case of the SSA's SUMS-MCAS Steering Committee, broad support from the top also can assure that powerful entities within the agency actually come to the table to join in an enterprise-wide effort.

### *An Enterprise-wide Perspective is Best.*

One of the important changes between the promising practices workshop of 1996 and today is that the practices ten years ago tended to be isolated within single units (so-called “stovepipes”) of an agency. By contrast, many of the practices in this report involve an enterprise-wide perspective. These include the risk management organization, the executive dashboard, and the investment process of the Office of Student Financial Aid, the Division of Insurance and Research of the FDIC, the Asset Management System of the ExIm Bank, and the SSA’s SUMS-MCAS management information system.

The loan underwriting and loan origination software systems of USDA’s Rural Development programs help to establish greater uniformity and precision in loan origination across the department’s far-flung network of field offices. Other practices that otherwise might be isolated within a particular stovepipe, such as the SBA’s Office of Lender Oversight, are becoming increasingly integrated with enterprise-wide operations thanks to support from higher levels of the agency.

Officials of the Enterprise Risk Management Organization of the Office of Federal Student Aid nicely articulate the logic in favor of an enterprise-wide perspective for risk management. If managers don’t take a broad view, individual units within the agency could simply deflect risk to other parts of the enterprise, rather than joining together to manage and reduce it. Indeed, if a committee works well, such as the Management Committee of the Office of Federal Student Aid, the interaction among units with differing interests (say, those who are trying to increase the volume of credit provided to constituent groups versus those who want to be sure that the agency does not take on too much financial risk) can prove extremely fruitful. The struggle to reconcile different interests, if properly managed, can lead to better solutions in the end. Again, the tone at the top matters.

### *Good Practices Don’t Always Cost a Lot.*

A number of these practices were not expensive. The risk management organization, the executive dashboard, and the investment process of the Office of Student Financial Aid, are not big-ticket items. The Asset Management System of the ExIm Bank fitted itself within many larger systems and helped to pull critical loan-level portfolio information together that otherwise could not be found in one place.

Another interesting example is the SSA’s SUMS-MCAS system. The SSA’s Information and Integrity Systems Division established the concept of the management information system and then applied it to a specific part of the agency that badly needed it. Once the business case was demonstrated, others in the agency became a constituency for expanding the system, in modules, to the entire enterprise.

Indeed, some practices save money. The VA’s outsourcing of servicing of the Vendee Loan program allowed the agency to cope with pressure to downsize significantly.

Other practices, that do require outlays, also may provide benefits that can be much greater than their costs. The Moody’s financial analysis software allows USDA’s Rural Development business programs to assess credit quality of loan applicants much more effectively than ever before.

### ***Don't Hold Off Until Problems Hit.***

The United States has been fortunate to have had many very prosperous years, starting in the mid-1990s. There have been few bank failures and many sectors of the economy, notably the housing market, have experienced a boom period. Credit losses from failed borrowers have been low for many programs for a number of years.

As a senior Federal official warned at the Promising Practices Conference on February 22, 2006, these good times, when agencies are not under financial pressure, are when agencies should build the information and risk management infrastructure that they need. The United States has benefited from a long period of low interest rates and generally low loan delinquency and default rates, compared to the late 1980's and early 1990's.

Agencies have the opportunity now to put portfolio management practices into place that can help to deal with an economic downturn that will materialize at some point in the future. The FDIC's Division of Insurance and Research, Ginnie Mae's expanded GPADS portfolio monitoring system, and SBA's Office of Lender Oversight are examples of portfolio management infrastructure that is likely to help those agencies weather more difficult times, when they come.

### ***Agencies Have Much to Learn – From the Private Sector and From One Another.***

Agencies devised many of these promising practices after undertaking a careful survey of practices in the private sector. The Risk Management organization of the Office of Federal Student Aid is working to adapt the COSO principles that have taken hold among leading private companies, to the government context. The Rural Development Program of USDA, the VA Loan Guaranty Service, and the Social Security Administration all consulted private sector sources before deciding how to restructure their own processes and adopt leading private practices. The Debt Collection Program of the Office of Federal Student Aid consults regularly with firms in the private collection world and adapts its performance-based contracts according to what it learns.

Many of these promising practices also offer an opportunity for agencies to learn from one another. Also, agencies may want to consider providing direct support for one another. For example, FDIC's Division of Insurance and Research regularly collects high quality information about state economic conditions and the health of financial institutions. Why not find a way to share this information with Federal credit agencies on a reimbursable basis?

This report is intended to help officials of Federal agencies learn about practices of interest by contacting the people and sources referenced here. This should be an ongoing process. The author of this report has learned much from the people interviewed for this report. Thank you very much for sharing your insights. It would be greatly appreciated if readers would pass along information about any other promising practices, not featured here, that might be showcased in a subsequent conference or report.

## VIII. Next Steps

Each of the agencies reviewed has shown an ability to adopt technologies to address important aspects of portfolio risk. Enough progress has been made for the outlines of needed next steps to become evident. Thus, Federal agencies have developed a range of particular technologies and portfolio management approaches to deal with salient problems. The next step would be to try to develop enterprise-wide systems that coordinate the individual systems that agencies have adopted. A number of Federal financial agencies, and notably the Office of Federal Student Aid among credit agencies, are embarking on this step in a serious way.

The major area where the lack of enterprise-wide systems is apparent is the gap that often exists between portfolio management systems and budgeting systems. An agency will utilize a lender monitoring system, for example, without being able to translate changes in loan delinquency or default rates directly into the budget scoring models needed to generate accurate credit subsidy estimates. Or an agency will utilize an excellent technology-based loan origination or underwriting system in a context that continues to rely largely on paper rather than electronic records and that cannot translate changes in credit quality into reliable estimates of changes in credit subsidy.

The next major step in information management should be to integrate data systems to the point that program managers and budget officers both have access to the same information. In addition, agencies would be well served by striving for greater transparency, so that portfolio data (except for proprietary information) will be accessible both inside and outside of the agency. Providing access to more extensive portfolio information would permit external groups such as the Congressional Budget Office (CBO), interested academics, or private sector constituencies, to review the data and again provide useful feedback that can help enhance agency operations.

A number of agencies currently allow lenders to have access to information about their own performance, compared with a peer group. This can prompt useful feedback and improved information quality in the system. This practice too is worth emulating.

Another area suggesting next steps concerns the quality of the technology platforms and systems that support portfolio management activities. It is difficult, especially in good economic times, for Federal financial agencies to find the resources needed to make improvements in technology systems. Indeed, even a number of the promising practices reviewed for this report are based on legacy systems or systems that otherwise are not state-of-the-art. Only with more advanced systems will some agencies be able to make the needed linkage between portfolio management information and the budget process, for example.

The new portfolio management component of the President's Management Agenda (PMA) is likely to be helpful in this regard. As agencies work to "get to green" and meet the objectives of the new initiative, a number of them will be able to make good cases that the expenditure of budget resources is justified in areas that improve the management of financial risk. Agencies can be expected to implement increasing improvements as they carry out the new PMA Initiative on portfolio management. The promising practices presented in this report are intended to provide useful guidance about opportunities for such progress.

# Appendix A

## Agencies Participating in the Promising Practices Conference

February 22, 2006

### Executive Branch and Independent Agencies

- Debt Management Services of the Treasury Department
- Department of Energy
- Export-Import Bank of the United States
- Federal Deposit Insurance Corporation
- Federal Housing Administration
- Ginnie Mae
- Loan Guaranty Service of the Department of Veterans Affairs
- Neighborhood Reinvestment Corporation
- Office of Federal Student Aid
- Office of Management and Budget
- Rural Development programs of the Department of Agriculture
- Rural Housing Service
- Small Business Administration
- Social Security Administration

### Legislative Branch Offices

- Congressional Budget Office
- Congressional Research Service
- Government Accountability Office

# Appendix B

## About the Author

Thomas H. Stanton is a Fellow of the Center for the Study of American Government at the Johns Hopkins University. He teaches graduate seminars on (1) the law of public institutions (2) government and the American economy, (3) government and the credit markets, and (4) administering homeland security. In 2006 he received the award for Excellence in Teaching. Mr. Stanton is a member of the board of directors of the National Academy of Public Administration (NAPA), and is past Chair of the NAPA Standing Panel on Executive Organization and Management. He is a former member of the federal Senior Executive Service.

As a Washington, DC attorney, Mr. Stanton's practice relates to the capacity of public institutions to deliver services effectively, with specialties relating to organizational design, federal credit and benefit programs, government enterprises, and regulatory oversight. He provides legal and policy counsel relating to the design and operation of Federal programs to federal, state, local, and international organizations, and to many Federal agencies and offices. Mr. Stanton has been an invited witness before many congressional committees and subcommittees.

Mr. Stanton's writings on public administration have appeared in publications including *Public Administration Review*, *The Administrative Law Journal*, *American Banker*, and *The Wall Street Journal*. He edited, with Benjamin Ginsberg, *Making Government Manageable: Executive Organization and Management in the 21<sup>st</sup> Century*, Johns Hopkins University Press, 2004. He also edited a forthcoming book, *Effective Government: Blueprints for Responding to the Challenge of September 11*, M.E. Sharpe Publishers, in press, 2006.

Mr. Stanton's publications on government and the financial markets include two books on government-sponsored enterprises (GSEs). The concerns expressed in *A State of Risk* (HarperCollins, 1991) helped lead to enactment of several pieces of legislation and the creation of a new Federal financial regulator in 1992. He has provided analyses on financial programs to a range of Federal offices and agencies including the Government Accountability Office, Congressional Budget Office, Office of Management and Budget, Farm Credit Administration, Department of Education, Department of Housing and Urban Development, Small Business Administration, and the Financial Management Service of the Treasury Department.

Mr. Stanton's B.A. degree is from the University of California at Davis, M.A. from Yale University, and J.D. from the Harvard Law School. He is fluent in German and has conducted research in several different countries. The National Association of Counties awarded him its Distinguished Service Award for his advocacy on behalf of the intergovernmental partnership.