



Center on Federal Financial Institutions

2005 Annual Report

Dear Friends,

I left investment banking to found COFFI a year and a half ago because



Washington has a critical need for *neutral expertise* on the federal government's \$1.4 trillion of lending and \$7 trillion of insurance activity.

These programs affect all taxpayers and tens of millions of homeowners, students, retirees, and small businesses. Yet, vested interests have often been the only source of true expertise available to Congress concerning these complex fi-

“COFFI performs an invaluable service...I wish I'd had their analyses.”

Steven Kandarian
former head of the PBGC

financial institutions, resulting in expensive or ineffective policies.

We made an impact far more quickly than I expected. We assisted in crucial policy debates that sprang up as federal financial institutions faced critical challenges.

• The Pension Benefit Guaranty Corporation is losing more than \$10 billion a year and could need an eventual taxpayer rescue of \$100 billion.

“COFFI provides a wealth of information...without a hint of dogma...and in refreshingly understandable language...”

The New York Times
May 28, 2005

• The National Flood Insurance Program lost \$23 billion on Katrina, despite most homeowners remaining dangerously unprotected from flood losses.

• The Terrorism Risk Insurance Program expires this year, potentially leaving many businesses without coverage against a major attack.

• Federal student loans grow ever more important as tuitions soar.

COFFI plays multiple crucial roles. We shine a spotlight on troubled programs. We educate policymakers and their advisors about how programs work and the effects of various policy options. We produce groundbreaking financial analyses similar to Wall Street's reports on private sector firms, which is virtually unheard of in

“COFFI effectively bridges the gaps between academics, policymakers, program managers, and financial markets.”

John Weicher
former head of the FHA

Washington. We assemble experts for policy forums. Finally, we magnify our impact by using the media as a megaphone to get our messages out.

We have established our credibility, are being listened to, and are making a difference. Congress, the Administration, and the Federal Reserve have called on our expertise and the

“COFFI provides useful, objective and nonpartisan information and financial analyses.”

David Walker
Comptroller General
of the United States

media often look to us for an understanding of the issues. One sign of success is that our website averages over 2,500 visits a month.

Please take a moment to read about our successes in programs ranging from pension reform to flood insurance. We can do much more with your continued assistance, whether through financial support or volunteer assistance. As a 501 (c)(3) non-profit organization we rely on your support. Finally, thanks very much to our Board of Directors, a distinguished group of policy experts who have unselfishly given COFFI great support from the beginning.

Doug Elliott

COFFI's Mission

The staggering amounts of money invested in federal lending and insurance activities make it critical that the most benefit be obtained at the lowest cost.

However, members of Congress and the Administration often do not have the expertise to make these decisions without outside help. Unfortunately, it is usually only vested interests who volunteer to fill the gap in financial expertise. It is rare to find neutral parties with both the interest and the expertise to advise on the specialized complexities of financial institutions.

As a result, federal financial institutions are often structurally unsound. For example, the Pension Benefit Guaranty Corporation is losing over \$10 billion a year and the National Flood Insurance Program just lost \$23 billion, on a premium base of \$2 billion a year. Even when programs are financially stable, it is easy to waste billions of taxpayer dollars or to direct them into the pockets of groups with strong lobbying arms.

The Center on Federal Financial Institutions (COFFI) was launched in March, 2004, to provide that neutral expertise to the policymakers responsible for running the largest financial institution in the world: the federal government.

Our goal is to increase the effectiveness and efficiency of the government's lending and insurance operations by ensuring that decision-makers understand the effects of policy options available to them. Objective analyses and educational efforts make a difference for the simple reason that both parties want federal financial programs to get the most "bang from the buck." Selfish interests and bureaucratic inertia have a harder time when policymakers understand the issues.

COFFI does this by providing policymakers with the tools needed to make effective decisions. COFFI publishes primers and reports on complex financial issues, creates detailed financial models to project future results under various policy options, hosts policy forums to encourage discussion of important topics, and brings the most advanced thinking from academia and Wall Street to Washington.

The Federal Government as Insurer

The federal government takes on over \$7 trillion of insured risk to:

- Encourage retirement security
- Insure deposits
- Protect homes from floods
- Insure farmers against bad weather and poor prices
- Protect against extreme events such as terrorist attacks and nuclear disasters

The Federal Government as Lender

The federal government provides \$1.4 trillion of credit to help millions of Americans:

- Buy homes
- Attend college
- Build businesses
- Run farms and rural enterprises
- Finance other activities

Judging COFFI's Effectiveness

COFFI is able to make a major difference, despite being very small, because our approach leverages the immense size of the federal government.

Modest investments in analysis and education can help to save billions of dollars in wasted money, which can be redirected to the needy or returned to taxpayers. When trillions of dollars are at stake, even very small percentage changes add up to huge sums.

How do we know our strategy is working?

We listen to and observe our target audiences, with a focus on five principal criteria:

Are COFFI's analyses timely, relevant, unique, and of high quality?

We are absolutely on target with our reports. Our Wall Street flavored approach is nearly unique in Washington. We favor quick, understandable, numbers-based reports that allow readers to react quickly when there is breaking news. We back this up with thorough financial analysis of the background issues, which we explain in comprehensible primers and reports. The cover of this Annual Report has quotes from enthusiastic users of our material; we could have filled multiple pages with similar praise.

Is the work being seen and heard?

The back cover contains a partial listing of our media coverage, which has served as a powerful megaphone for COFFI. Journalists like us for our neutral expertise just as much as policymakers do—they know that we will present a clear, unbiased explanation of complex facts.

COFFI President Doug Elliott is also a frequent speaker at events in Washington and elsewhere. Our

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email discussion group focused on the PBGC, the only one of its kind, has over 100 members, many of them top names in the field. Our policy forums are well-attended and well-covered. The most recent, on flood insurance, was carried live on C-SPAN for two hours.

Are we reaching decision-makers?

Yes, we are. COFFI President Doug Elliott has testified before Congress on issues ranging from pension reform to flood insurance. The Comptroller General of the

U.S. asked Mr. Elliott to moderate a session at an invitation-only pension policy conclave. Mr. Elliott often addresses members of Congress and their staffs in large groups and even more frequently on an individual basis. Secretary of Labor Chao invited him to be on the dais with her as one of three special guests when she announced the Administration's pension reform proposal at the National Press Club.

Are the ultimate policy decisions any different?

A number of observers credit our ground-breaking financial analyses of the PBGC as an impetus for the pension reform proposals being considered by Congress now. Many politicians would have preferred to ignore this growing problem.

Is our impact growing?

Our momentum is palpably increasing. In one week in mid-October, Mr. Elliott testified before the Senate Banking Committee on flood insurance and then delivered a 45-minute speech on federal credit and insurance activities at a Federal Reserve conference devoted to the topic. Increasingly, policymakers and key journalists turn to COFFI for information and analyses of a variety of complex issues.

COFFI's Areas of Focus and Recent Accomplishments

Pension Reform

The Pension Benefit Guaranty Corporation

Currently, 44 million employees and retirees rely on the Pension Benefit Guaranty Corporation (PBGC) to help protect \$1.8 trillion of promised pension payments. The PBGC was created in 1974 to insure people against the loss of pension benefits due to corporate bankruptcies.

Unfortunately, it faced a \$23 billion deficit last year, a number that will grow by at least \$10 billion this year. The recent bankruptcy filings of the nation's largest airlines and the beginnings of major trouble in the auto sector could raise this deficit to nearly \$100 billion within a few years.

In the absence of pension reform we could end up paying for the second-largest taxpayer bailout of a financial institution in history, exceeded only by the rescue of the Savings and Loan industry.

Since its inception, COFFI has devoted much of its effort to the issue of pensions and the viability of the Pension Benefit Guaranty Corporation. COFFI published a series of primers and policy papers designed to explain the issues facing the PBGC and provide a comprehensive list of potential solutions for its financial problems. All of these materials are readily available on www.coffi.org and are written in a straight-forward manner designed to appeal to audiences both with and without technical expertise.

COFFI's forecast that the PBGC will run out of funds by 2021 served as a major catalyst for pension reform legislation. We were able to make

this projection because we have the only publicly-available annual cash flow model of the PBGC. *The New York Times* heralded our model in September 2004 with a major story starting on the cover of the Business section. Most of the major media then picked up on the issue.

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COFFI's policy forums and electronic discussion group on PBGC-related topics have spurred debates on next steps.

COFFI's November 2004 PBGC Policy Forum was the first symposium in ten years focused on PBGC's financial viability.

It featured a highly-respected

panel of experts including the Executive Director of the Pension Benefit Guaranty Corporation, the Comptroller General of the United States, the Director of the Congressional Budget Office and the President of the American Benefits Council. COFFI's ability to attract high-level experts to its policy forums stems in large part from its neutral stance on the issues and its commitment to providing policymakers and the public with the information needed to develop a coherent position on pension policies.

As a result of our efforts on pension reform, **COFFI President Doug Elliott was one of three special guests on the dais with the Labor Secretary** when she announced the Administration's pension reform proposal in January 2005.

In March 2005, he was invited to provide testimony before Congress on pensions and has been asked to return many times to speak with members of Congress and their staffs, outside of formal hearings. In addition, he has been a frequent speaker on pension reform at various media and think tank events, including at a pension reform forum in June 2005 sponsored by *The New Republic*, another later that summer sponsored by *The National Journal*, and at a Harvard University Law School conference on pensions.

Flood Insurance Program

The federal government's National Flood Insurance Program (NFIP) is by far the largest provider of insurance against floods, since regular homeowners' policies do not cover this risk.

Unfortunately, only about a third of families in flood prone areas purchase the insurance, despite requirements that mandate coverage in many cases.

The federal flood insurer is essentially broke. Katrina will bring an estimated \$23 billion of claims, well above the \$14 billion cumulative losses from the first 36 years of the program's life. This is an unsustainable burden for a program that started with under \$1 billion in cash and collects only \$2 billion a year in premiums. The cash gap will be borrowed from the U.S. Treasury, but decisions must be made regarding future insurance premiums and a probable taxpayer rescue.

Worse, well under half of endangered homeowners were covered by flood insurance. Even in New Orleans, where people lived with a deep awareness of the water surrounding them, only about half of homeowners had flood insurance. The numbers for the rest of the affected area were much lower.

Many families will be ruined financially, even with the federal disaster aid that will provide minimal resources to restart shattered lives. These grants are not a real

substitute—a flood victim receives an average of only 33 cents in disaster aid for every dollar they would receive from flood insurance.

There is a strong consensus that many more homes must be covered by flood insurance, but there is not yet a good understanding of how to reach that worthy goal. Can it be done with voluntary measures or must the coverage be mandated, as it already is in certain circumstances?

COFFI's ability to provide timely analysis and to fill in the important analytical gaps on federal insurance issues was demonstrated in its response after Hurricane Katrina. COFFI's publications on the National Flood Insurance Program, including a report that presents a number of key issues about potential changes to the program, are in high demand as the program undergoes increased scrutiny.

Our Policy Forum on Federal Flood Insurance held in late September 2005 was carried live for the full two hours on C-SPAN and featured panelists including the Head of the National Flood Insurance Program, the Comptroller General of the United States and the former director of The Brookings Institution's Economic Studies Division, among other participants. A transcript of the forum, as well as a summary of the main discussion points, will be available shortly at www.coffi.org.

COFFI President Doug Elliott testified in October 2005 before the Senate Banking Committee, which was beginning a thorough review of the flood insurance program. His official remarks focused on the need to increase participation in the program and to cure the NFIP's structural financial problems. He also emphasized the importance of clear and useful budget numbers.

Flood Insurance Program

The federal government's National Flood Insurance Program (NFIP) is by far the largest provider of insurance against floods, since regular homeowners' policies do not cover this risk.

Federal flood insurance covers 4.6 million families and small businesses with more than \$743 billion in insured assets.

Unfortunately, only about a third of families in flood-prone areas purchase the insurance, despite requirements that mandate coverage in many cases.

COFFI's Areas of Focus and Recent Accomplishments

Terrorism Insurance Program

The terrorist attacks of September 11, and the \$40 billion in insured losses that resulted from this event, quickly and radically changed the risk landscape for insurers. In the aftermath of that tragedy, the Terrorism Risk Insurance Act of 2002 (TRIA) was enacted as a partnership between the federal government and the private sector to ensure that terrorism insurance would be available for businesses to purchase.

Terrorism Risk Insurance

The Terrorism Risk Insurance Act of 2002 (TRIA) expires at the end of this year. TRIA offers a federal backstop of up to \$100 billion per year for claims from certain terrorist attacks. Neutral expertise is needed at this crossroads to determine if TRIA should be renewed and, if so, whether there is room for improvement.

COFFI published a series of analyses on the future of TRIA, most of them written by COFFI Fellow Debra Roberts. COFFI's papers address basic concepts related to the Terrorism Risk Insurance Act and outline key questions to be addressed as part of the renewal process for the program.

In May 2005, COFFI's TRIA Policy Forum brought together panelists with a range of viewpoints, including representatives of the insurers; the real estate industry, a consumer advocate; an economist; and the head of the Congressional Budget Office.

Student Loan Programs

Higher education drives opportunity, social mobility and economic progress. Sadly, unequal access hampers many students. This problem is amplified by dramatic increases in college tuition. For example, during the 1990's, median family income grew by 13% while college costs increased 30%.

Federal student loans are a key to overcoming access problems. This year, the Education Department will sponsor more than \$67 billion in loans, about 70% of all student aid, to help millions of students and families pay for postsecondary education. These funds are critical to helping make higher education affordable.

Student Loans

The Higher Education Act is due to expire at the end of 2005 and there is heavy debate on how student loans should be altered when the Act is reauthorized. A key underlying issue is the relative cost of providing loans directly through the Department of Education, as compared to guaranteeing loans made by the private sector. Some claim that direct government provision avoids excessive costs and profits for private sector lenders, while advocates of guaranteed loans dispute these figures and maintain that government inefficiency more than offsets any private costs.

COFFI recently published an analysis of the relative costs of the direct and guaranteed stu-

Student Loan Programs

This year, the Education Department will sponsor about \$67 billion of loans to students and their parents for education at colleges, trade schools, and graduate schools.

Loans are provided through two channels. The William D. Ford Direct Loan program provides loans directly from the federal government. The Federal Family Education Loan (FFEL) program provides loans through private lenders, who receive federal guarantees of principal and interest as incentives to offer student loans.

Roughly three-quarters of federally sponsored student loans are offered through the FFEL program.

dent loan programs, using a groundbreaking financial model, in an effort to help policymakers and the public better understand the complexities of the student loan issue. This was coupled with a companion piece that explains precisely how the federal government determines the budget cost of these programs.

Doug Elliott will present the results of these analyses at a panel discussion in November sponsored by the American Enterprise Institute and The Institute for College Access and Success.

Future Program Areas

COFFI is well-positioned to provide high quality research and analysis related to other federal financial institutions. Our long-term goal is to comprehensively cover all major federal lending and insurance activity. However, our limited resources mean that we must progress by dividing our effort between major areas of focus, such as the four described above, and other areas that we cover less thoroughly. We will choose new focus areas in the same flexible way that we chose the existing ones. We consider:

- Importance
- Timeliness
- Potential for capturing the attention of policymakers, media, and the interested public.

We have tentatively identified housing programs and the

Small Business Administration as candidate areas, but we will remain flexible.

We will also expand our series of shorter briefing papers on federal financial institutions. These already cover: the Department of Agriculture, the Department of Housing and Urban Development, the Small Business Administration and the Department of Veterans Affairs.

These shorter summaries, generally 5-7 pages, provide a good condensed explanation of the key facts and figures about these programs. This allows us to serve Congressional staffers, their equivalents in the Administration, and the media, when they need basic background on a program. They also give us an institutional headstart when one of these areas suddenly requires attention, as the flood insurance program did after Katrina.

WWW.COFFI.ORG

Our goal is for www.coffi.org to be the first place people go for information about federal lending and insurance. This is especially important for Congressional staff members and journalists, who often need a comprehensive, neutral overview of a topic very quickly.

We are well on our way to meeting this goal. We already average over 2,500 visits to our website each month. *The New York Times* praised the site, saying, among other things, “www.coffi.org provides a wealth of information ... in refreshingly understandable language.”

This wealth of information includes: all our reports and analyses; information on COFFI events; and a detailed database on federal financial institutions. The database contains a spreadsheet with financial statistics on nearly 200 individual federal financial institutions.

Founder and President

The Center on Federal Financial Institutions was founded by Douglas Elliott who was an investment banker for nearly two decades, principally with J.P. Morgan, as well as with Sanford Bernstein, Sandler O’Neill & Partners and ABN AMRO. For much of his career, he worked with insurers, banks and pension funds. He advised on mergers and acquisitions and overall strategy, and also worked in credit analysis, equities analysis, and capital-raising.

During his career on Wall Street, he advised clients that included Prudential, Allstate, Xerox, Dow Chemical, Zurich Insurance, ITT, St. Paul, Farmers Group, and Ralston Purina. He is an expert on both private and public financial institutions and was the first to author a detailed, independent annual cash flow model of the Pension Benefit Guaranty Corporation.

Mr. Elliott has a life-long interest in public policy. He graduated from Harvard College with an A.B. in Sociology, magna cum laude, and with a Master’s in Computer Science from Duke University.

COFFI

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Media Coverage

COFFI has gained a reputation for providing timely and balanced analyses on a variety of issues being debated in Washington.

COFFI's President Doug Elliott has appeared on ABC's *World News Tonight*, *The Newshour with Jim Lehrer*, PBS's *Nightly Business Report*, *The Wall Street Journal Editorial Report*, CNN, Bloomberg TV, CNBC's *Squawk Box*, and ITV London.

He has also been quoted in the following newspapers and magazines.

Newspapers

| | |
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| New York Times | Houston Chronicle |
| Wall Street Journal | International Herald Tribune |
| Washington Post | New York Post |
| Financial Times | Newsday |
| Los Angeles Times | Kansas City Star |
| Die Zeit | Pittsburgh Post Gazette |
| Le Monde | St. Louis Post Dispatch |
| USA Today | Milwaukee Journal Sentinel |
| Chicago Tribune | Detroit News/Free Press |
| Philadelphia Inquirer | San Diego Union Tribune |
| Boston Herald | Niagara Falls Reporter |
| Denver Post | Brandenton Herald |

Magazines

| | |
|----------------------------|----------------------------------|
| The Economist | National Journal |
| Business Week | Risk Magazine |
| U.S. News and World Report | Business Insurance |
| Congressional Quarterly | U.S. Credit |
| The New Republic | BNA Pension and Benefit Reporter |

Support the Center's Work

We need your support to move forward in our work. Those with expertise in financial institutions can help our research and educational efforts by suggesting ideas, writing pieces, participating in forums, and publicizing our activities. Tax-deductible donations may be sent directly to:

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