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EXPORT-IMPORT BANK

Recent Growth Underscores Need for Improved Risk Management and Reporting

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Chairman Campbell, Ranking Member Clay,
and Members of the Subcommittee:

I am pleased to be here today to discuss our recent work on the U.S. Export-Import Bank (Ex-Im). Ex-Im serves as the official export credit agency of the United States and helps U.S. firms export goods and services by providing a range of financial products, including direct loans, loan guarantees, and insurance. Ex-Im's business volume has grown dramatically in recent years. From 2008 through 2012, Ex-Im's exposure—that is, its total outstanding financial commitments—rose from $58.5 billion to $106.6 billion. Factors associated with this growth include the reduced availability of private-sector financing following the 2007-2009 financial crisis. The rapid increase in business has challenged Ex-Im's ability to plan for and manage its portfolio.

My testimony today draws on two reports we issued in March and May of this year in response to requirements in the Export-Import Bank Reauthorization Act of 2012 (Reauthorization Act).[1] The act required us to assess aspects of Ex-Im's risk management and 2012 Business Plan in the context of the agency's growth. The act also increased the statutory ceiling on the agency's total exposure (exposure limit). I will discuss Ex-Im's efforts to (1) forecast exposure levels, (2) manage financial risks and estimate losses, and (3) manage its workload.

For the March and May 2013 reports, we analyzed Ex-Im's financial data, policies and procedures, and processes. We also reviewed Ex-Im's Business Plan, related analyses, and other reports. We examined the models Ex-Im used to forecast exposure levels and estimate credit losses, including the data and assumptions underlying the models. In addition, we reviewed Congressional Budget Justifications, annual reports, and other reports for information on Ex-Im's administrative budgets and the size of its workforce. We reviewed various sources of guidance on risk management and cost estimation, including federal internal control standards, Office of Management and Budget (OMB)

[1]Pub. L. No. 112-122 § 4 and § 5 (2012). See GAO, *Export-Import Bank: Recent Growth Underscores Need for Continued Improvements in Risk Management*, GAO-13-303 ((Washington, D.C.: Mar. 28, 2013); and *Export-Import Bank: Additional Analysis and Information Could Better Inform Congress on Exposure, Risk, and Resources*, GAO-13-620 (Washington, D.C.: May 30, 2013).

guidance, and federal banking regulator guidance. Finally, we interviewed Ex-Im officials and other entities involved in export financing. Our prior reports each include a detailed description of our scope and methodology. We conducted the performance audits on which this testimony is based in accordance with generally accepted government auditing standards.

Background

Ex-Im is an independent agency operating under the Export-Import Bank Act of 1945, as amended. Its mission is to support the export of U.S. goods and services, thereby supporting U.S. jobs. Ex-Im's charter states that it should not compete with the private sector. Rather, Ex-Im's role is to assume the credit and country risks that the private sector is unable or unwilling to accept, while still maintaining a reasonable assurance of repayment.

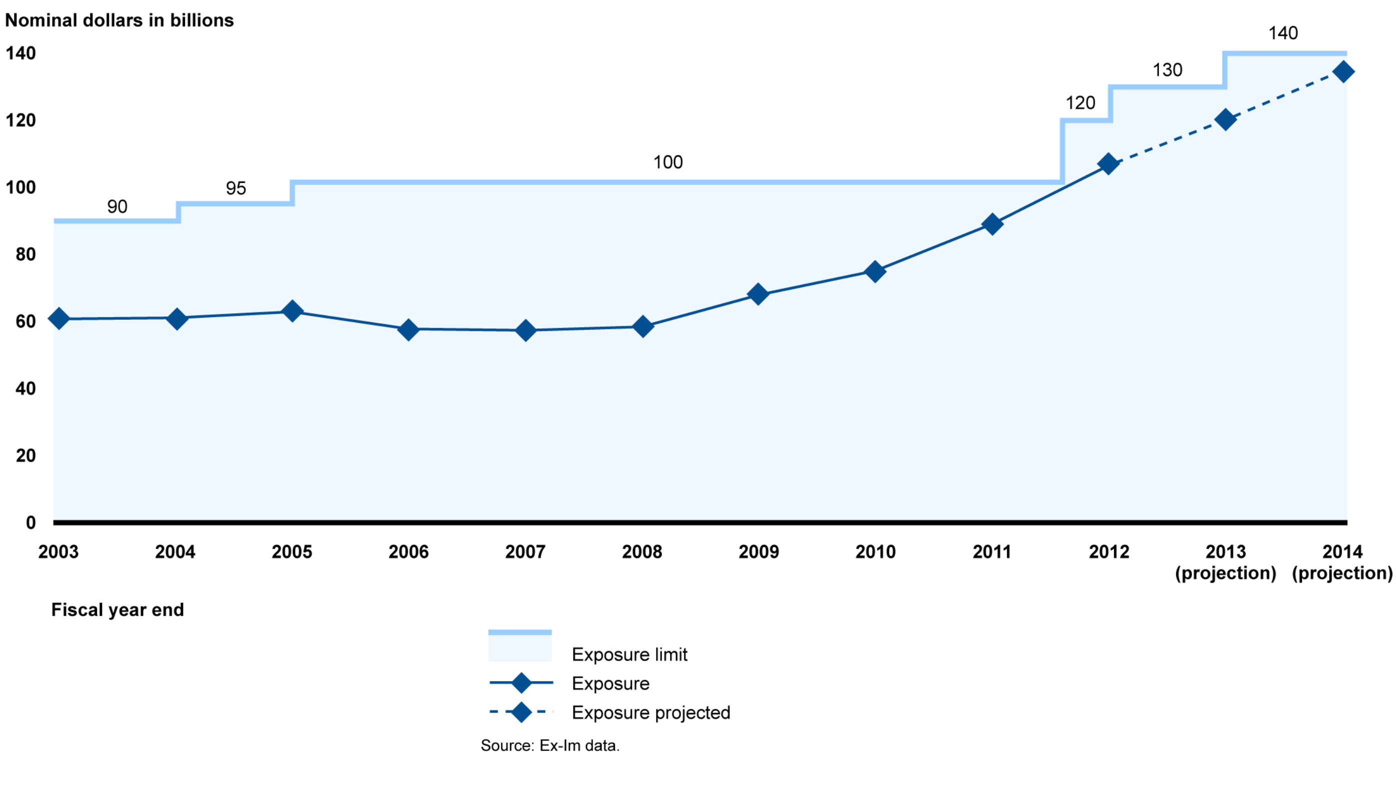
Ex-Im faces multiple risks when it extends export credit financing. These risks include (1) credit risk (the risk that an obligor may not have sufficient funds to service its debt or be willing to service its debt), (2) political risk (the risk that expropriation of the obligor's property, war, or inconvertibility of the obligor's currency into U.S. dollars may result in nonrepayment), (3) concentration risk (the risk that events could negatively affect not only one entity or location but also many entities or locations simultaneously), (4) market risk (the risk of loss from declining prices or volatility of prices in the financial markets, which could arise from changing macroeconomic conditions), and (5) operational risk (the risk that loss may result from inadequate or failed internal processes, people, and systems, or from external events).

While Ex-Im's business is generally driven by demand for its services from exporters, Congress also mandated that Ex-Im support specific objectives. Since the 1980s, Congress has required that Ex-Im make available a certain percentage of its total export financing each year for small business (in 2002, the small business financing requirement increased from 10 to 20 percent). Congress has further instructed that Ex-Im promote the expansion of its financial commitments in sub-Saharan Africa. Finally, in its 2012 appropriations, Congress directed that "not less than 10 percent of the aggregate loan, guarantee, and insurance authority available to [Ex-Im]…should be used for renewable energy technologies or end-use energy efficiency technologies," to which we refer in this statement as the renewable energy mandate.

Ex-Im's Process for Forecasting Exposure Has Weaknesses

Ex-Im's Business Plan concluded that the exposure limits in the Reauthorization Act were appropriate, but our May 2013 report found weaknesses in the methodology Ex-Im used to justify that conclusion. The Reauthorization Act increased the Ex-Im exposure limit to $120 billion in 2012, with provisions for additional increases to $130 billion in 2013 and $140 billion in 2014. As shown in figure 1, Ex-Im forecast that its year-end exposure would be $120.2 billion in 2013 and $134.9 billion in 2014, below the congressionally determined limits. However, the buffer between the exposure limit and Ex-Im's exposure forecast for 2013 and 2014 is small in comparison with recent historical experience.

Figure 1: Ex-Im Exposure and Exposure Limit, Fiscal Years 2003-2014



Source: Ex-Im data.

Although Ex-Im's forecast model is sensitive to key assumptions, we found that Ex-Im did not reassess these assumptions to reflect changing conditions or conduct sensitivity analyses to assess and report the range of potential outcomes. For example, certain Ex-Im assumptions about product mix and repayments were not consistent with historical trends. We used historical data in lieu of these assumptions and found that, if these conditions were to occur in the future, Ex-Im's forecast of exposure could be higher than the limit set by Congress for 2014. Our cost guidance calls for agencies' assumptions and forecasts to be supported by historical data and experience, and a sensitivity analysis, which can assess the effect of changes in assumptions. Because Ex-Im has not taken these steps, the reliability of its forecasts is diminished. This is of particular concern because Ex-Im projects that its outstanding financing in the future will be closer to its exposure limit than it has been historically. Consequently, any forecast errors could result in the bank having to take actions, such as delaying financing for creditworthy projects, to avoid exceeding its limit. Thus, in our May report, we recommended that Ex-Im (1) compare previous forecasts and key assumptions to actual results and adjust its forecast models to incorporate previous experience and (2) assess the sensitivity of the exposure forecast model to key assumptions and estimates and identify and report the range of forecasts based on this analysis. Ex-Im agreed with our recommendations and stated that it would incorporate these steps into preparation of updated and revised forecasts to be provided to Congress by September 30, 2013.

Ex-Im Could Take Additional Steps to Improve Risk Management and Loss Estimates

Our March report found that Ex-Im has been developing a more comprehensive risk-management framework, but could take additional steps to improve this process. For example, Ex-Im has started addressing recommendations by its Inspector General (IG) about portfolio stress testing, thresholds for managing portfolio concentrations, and risk governance. Our review indicated that the IG's recommendations represent promising techniques that merit continued attention. In addition, we concluded that reporting stress testing scenarios and their results would aid congressional oversight and be consistent with internal control standards for effective external communication. Thus, in our March 2013 report, we recommended that Ex-Im report this information to Congress. Ex-Im agreed with our recommendation and intends to report its stress test scenarios and results in quarterly reports to Congress.

However, Ex-Im could further improve its risk management, including its risk modeling. Ex-Im calculates credit subsidy costs and loss reserves and allowances with a loss estimation model that uses historical data and takes credit, political, and other risks into account.[2] Consistent with industry practices, Ex-Im added factors to the model in 2012 to adjust for circumstances that may cause estimated credit losses to differ from historical experience. For example, Ex-Im uses a 1-year forecast of certain bond defaults to predict possible changes in loss estimates from changed economic conditions. But a short-term forecast may not be appropriate for adjusting estimated defaults for longer-term products. Guidance from the Federal Accounting Standards Advisory Board for federal credit agencies states that agencies should develop cash flow projections for their transactions based upon the best available data. In our March report, we concluded that Ex-Im might not be making the appropriate adjustment to estimate future losses, which could lead to underestimation of credit subsidy costs and loss reserves and allowances. Thus, we recommended that Ex-Im assess whether it is using the best available data for adjusting the loss estimates for longer-term transactions. Ex-Im agreed with our recommendation and said it would conduct this assessment as part of its 2013 reevaluation of its loss estimation model.

Ex-Im also could improve its analysis of the financial performance of its portfolio. As of December 2012, Ex-Im reported an overall default rate of less than 1 percent. Ex-Im's default rate declined steadily from about 1.6 percent as of September 30, 2006, to just under 0.3 percent as of September 30, 2012, before edging up slightly by the end of the calendar year. However, this downward trend should be viewed with caution because Ex-Im's portfolio contains a large volume of recent transactions that have not reached their peak default periods. Moreover, Ex-Im has not maintained data needed to compare the performance of newer books of business with more seasoned books at comparable points in time, a type of analysis recommended by federal banking regulators.[3] In addition, the lack of point-in-time data showing when defaults occur may reduce the precision of Ex-Im's loss estimation model. Therefore, we recommended in our March report that Ex-Im retain point-in-time performance data to compare the performance of newer and older business and enhance loss

[2]Ex-Im uses the model to build the agency's credit subsidy estimates in the President's budget as well as for calculating loss reserves and allowances reported in its annual financial statements.

[3]While Ex-Im is not bound by federal banking regulator guidance, it faces similar challenges to regulated private financial institutions in managing risks.

modeling. Ex-Im agreed with our recommendation and said it has begun to retain such data.

Finally, stemming from our analysis of Ex-Im's Business Plan in our May 2013 report, we found that Ex-Im had not routinely reported the performance of its subportfolios relating to the small business, sub-Saharan Africa, and renewable energy mandates.[4] While Ex-Im provides quarterly default rate reports to Congress, Ex-Im has not included the default rates for transactions supporting these three congressional mandates in its reports. Also, Ex-Im's annual report documents the weighted-average risk rating of its overall portfolio, but has not provided further breakdowns of the risk rating for these subportfolios.[5] OMB guidance indicates that agencies should use comprehensive reports on the status of the credit financing portfolios to evaluate effectiveness and collect data for program performance measures such as default rates. Furthermore, federal banking regulator guidance suggests that banks should provide financial performance information by portfolio and specific product type to allow management to properly evaluate lending activities. We concluded that Ex-Im could analyze additional information about its subportfolios related to the three mandates. Consequently, we recommended in our May report that Ex-Im routinely report the financial performance of subportfolios supporting congressional mandates. Ex-Im concurred with our recommendation and stated that it would include such information in its next quarterly default rate report to Congress on June 30, 2013.

[4]The performance of the subportfolios differs from the overall Ex-Im portfolio. For instance, the higher risk ratings of the subportfolios suggest these transactions generally are more risky than Ex-Im's overall portfolio.

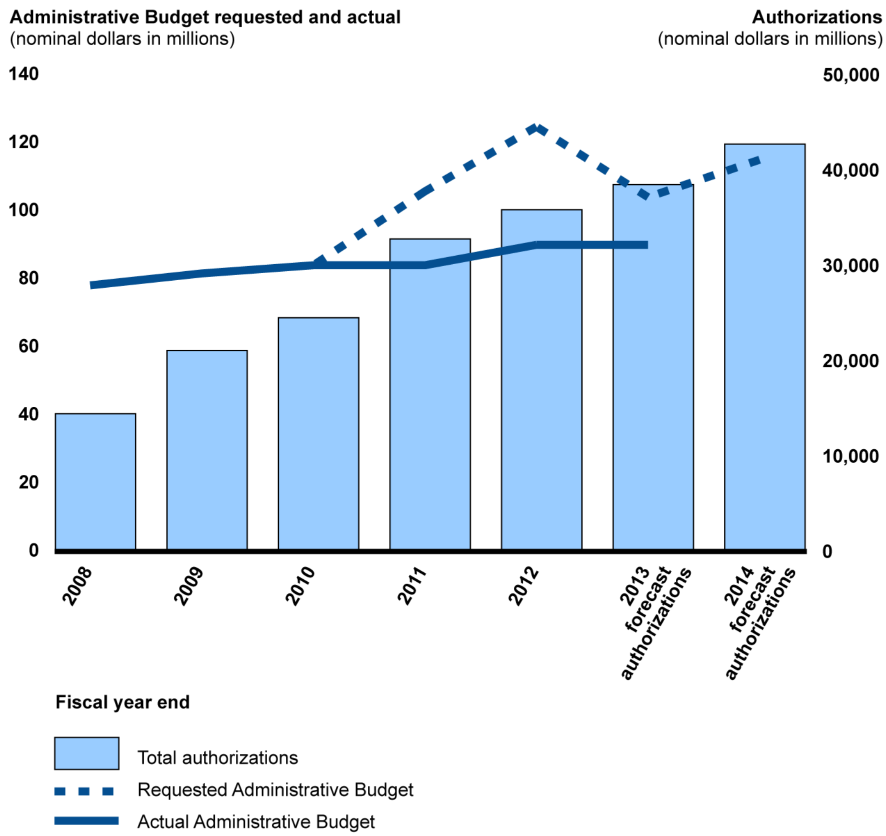
[5]Ex-Im reviews each credit transaction and assigns a numerical risk rating based on assessments of credit, political, and market risks.

Additional Information and Analysis Could Help Ex-Im Manage Its Workload

In our recent reports, we found that Ex-Im faces potential operational risks because administrative budgets and staff levels have not kept pace with the growth in its portfolio. Ex-Im has reported in its Business Plan that its resource levels cannot sustain the bank's current level of activity or meet expected demand in coming years. From 2008 through 2012, Ex-Im's annual authorizations grew nearly 150 percent.[6] Over the same period, Ex-Im's administrative budget increased 15 percent, from $78 million in 2008 to approximately $90 million in 2012 (see fig. 2). Additionally, Ex-Im's staff level, as measured by full-time equivalents, increased less than 11 percent, from 352 in 2008 to 390 in 2012. In 2008, the ratio of authorizations to Ex-Im staff was about $40 million per employee, while in 2012 the ratio was about $91 million per employee.

[6] An authorization is an export financing transaction for which Ex-Im has granted credit approval.

Figure 2: Ex-Im Administrative Budget Requests and Authorizations, Fiscal Years 2008-2014



Source: GAO analysis of Ex-Im data and budget requests.

While Ex-Im has determined that it needs more staff, it has not formally determined the level of business it can properly manage. Federal internal control standards state that agencies should develop a risk-management approach based on how much risk can be prudently accepted.[7] Without benchmarks to determine when workload levels have created too much risk, Ex-Im's ability to manage its increased business volume may be limited. Monitoring workloads against such benchmarks would help Ex-Im

[7]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999) and *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001).

determine when additional steps—such as tightening underwriting standards or increasing requirements for lender participation—may be needed to mitigate Ex-Im's increased risk.

Ex-Im also expected that administrative resource constraints might prevent it from meeting its congressionally mandated target for small business export financing. The mandated target is fixed to a percentage of the dollar value of Ex-Im's total authorizations. Although Ex-Im has dedicated resources to support congressional mandates, as Ex-Im authorizations have grown, the growth in the value of the mandated target has outpaced Ex-Im's increasing support. Ex-Im projects that the target value will continue to outpace its increasing support for the mandate through 2014. According to Ex-Im officials, processing small business transactions and bringing in new small business customers is resource intensive. Small business authorizations accounted for less than 20 percent of the dollar amount of Ex-Im's total authorizations in 2011 and 2012, but measured in number of transactions, constituted 87 percent of all authorizations. Originating, underwriting, and servicing for small business deals requires more effort than other transactions because small businesses tend to have less exporting experience than larger businesses. OMB guidance directs agency leaders to set ambitious, yet realistic goals that reflect careful analysis of associated challenges and the agency's capacity and priorities. Communicating information about challenges and capacity that may significantly affect achievement of agency goals to external stakeholders, such as Congress, is also consistent with federal internal control standards.

As a result of the challenges Ex-Im faces in managing its workload, in our March and May 2013 reports we recommended that Ex-Im develop benchmarks to monitor and manage workload levels and provide Congress with additional information on the resources associated with meeting mandated targets. Ex-Im concurred with both of these recommendations.

Chairman Campbell, Ranking Member Clay, and Members of the Subcommittee, this concludes my statement. I would be pleased to respond to any questions you may have.

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