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United States House of Representatives
Committee on Financial Services
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M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: June 10, 2013

Subject: June 13, 2013, Monetary Policy and Trade Subcommittee Hearing on "Assessing the Reform at the Export-Import Bank".

The Subcommittee on Monetary Policy and Trade will hold a hearing on "Assessing Reform at the Export-Import Bank" at 10:00 a.m. on Thursday, June 13, 2013, in room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- The Honorable Fred Hochberg, Chairman of the Board and President, Export-Import Bank
- The Honorable Osvaldo Gratacos, Inspector General, Export-Import Bank
- Mr. Matt Scire, Director, Financial Markets and Community Investment, Government Accountability Office

The Export-Import Bank of the United States (the "Bank") was last reauthorized in 2012 (P.L. 112-122). Included in the 2012 reauthorization were a number of Congressionally-mandated reviews and reporting requirements from the Bank, the Treasury Department, and the Government Accountability Office (GAO). These reports and reviews have been supplemented over the previous year by several reports from the Office of the Inspector General of the Export-Import Bank (OIG), public comment letters from stakeholders, and members of the public. This hearing is an assessment of the status of reform at the Bank since its previous reauthorization.

Overview of the Export-Import Bank

The Export-Import Bank of the United States was established by executive order in 1934 and became an independent agency in 1945. The Bank's mission is to contribute to maintaining or increasing employment in the United States. The Bank facilitates the export of U.S. goods and services to international markets by providing working capital guarantees, export credit insurance, loan guarantees, and direct loans.

The working capital guarantee backs commercial lenders who agree to make working capital loans by guaranteeing 90% of the working capital loan, decreasing the risk for the commercial lender. Export credit insurance allows a company to mitigate commercial risks and certain political risks through an insurance policy. The Loan Guarantee allows companies to secure financing for their international buyers through a guarantee to the lender for financing up to 10 years to the buyers, and to finance 30% of a company's local costs. Direct loans give companies the ability to obtain fixed rate financing for international buyers for up to 12 years (18 for renewable energy products).

Major Reform Requirements from the 2012 Reauthorization

The Export-Import Bank charter's authorization expires on September 30, 2014. In response to perceived weaknesses in the Bank's governance and risk management, Congress included several reform measures as part of the reauthorization. Some of these reform measures are discussed in the following paragraphs.

Business Plan

The Obama Administration requested a 40% increase in the exposure limit of the Bank in 2012, taking the total exposure limit from $100 billion to $140 billion. Many Members of Congress expressed reservations about the tremendous growth in the Bank's portfolio and the ability of the Bank to manage its growing portfolio. As a result, the reauthorization included a section that requires the Bank to submit a multi-year business plan that identifies, among other items, potential for increased financial risk from its operations. In its business plan, the Bank must provide estimates for its appropriate exposure limit for fiscal years 2012, 2013, and 2014; justify the estimates; and estimate the anticipated growth by each industry sector, Bank product, and key market in fiscal years 2012, 2013, and 2014. Under the Act, the Bank was required to submit its business plan first to Congress and the GAO, and GAO was required to review the Bank's business plan and submit a report to Congress by May 31, 2013. On May 30, GAO published that report.[1] Its contents may be explored at this hearing.

Review of the Bank's Risk Management

As mentioned above, many Members of Congress expressed concern about the Bank's ability to prudently manage a rapidly-expanding portfolio. As a result, the Act requires the GAO to conduct a review of the Bank's risk management and make any necessary recommendations. Section 13 of the Act then requires the Bank to provide a report detailing the implementation or rejection of the GAO's recommendations.[2] This report's contents, as well as the contents of a report on risk conducted by the Office of the Inspector General of the Export-Import Bank (OIG), may also be explored at this hearing.[3]

Negotiations on Export Subsidies

Most economists agree that the market functions best when there is a level playing field for exporters, allowing them to compete based on the quality and price of their goods

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[1] Government Accountability Office, *Additional Analysis and Information Could Better Inform Congress on Exposure, Risk, and Resources*, (May 30, 2013), available at http://www.gao.gov/products/GAO-13-620

[2] Government Accountability Office, *Recent Growth Underscores Need for Continued Improvements in Risk Management*, (Mar. 28, 2013). Available at: http://www.gao.gov/products/GAO-13-303

[3] Office of the Inspector General, Export-Import Bank of the United States, *Report on Portfolio Risk and Loss Reserve Allocation Policies*, (Sept. 28, 2012). Available at http://www.exim.gov/oig/upload/Final-20Report-20Complete-20Portfolio-20Risk-20120928-1.pdf

and services, rather than on the quality of any officially-supported financing or other government subsidies. Alarmed by the tremendous growth in the use of officially-supported financing following the 2007 economic crisis, especially in aircraft, Congress included a provision in the Bank's reauthorization that directs the Secretary of the Treasury to initiate and pursue multilateral negotiations in order to substantially reduce—with the ultimate goal of eliminating—all trade-distorting export subsidies, especially those for a wide array of aircraft. This section was included to help protect certain U.S. manufacturers and American taxpayers from a global race to the bottom in export credit financing.

Taxpayer Protection Provisions

In order to mitigate the possibility of the Bank requiring a taxpayer bailout in the future, section 6 of the Act requires the Bank to calculate the default rate of the various entities receiving financing and report the overall default rate and the default rate by product, market, and industry sector. Should the default rate equal or exceed 2%, the Bank must implement a corrective plan and provide monthly updates to Congress. If the Bank does not remedy the situation within six months, a third party shall audit the Bank.

Given the heightened potential for market distortions arising from larger transactions, section 9 of Act requires that the Bank disclose and solicit public comment on any transaction over $100 million, that such public comments be provided to the Board of the Bank, and that affected parties receive, upon their request, a summary of the facts and conclusions reached by the Bank.

One of the lessons from the Solyndra bankruptcy is that the government's claims should not be subordinated to those of other entities when a loan goes bad or the recipient of government assistance goes bankrupt. Section 8 of the Act prohibits the Bank from entering into financing contracts in which the Bank would be subordinate to all other creditors. The non-subordination requirement is intended to reduce the risk, and also to enhance the recoveries, for the Bank.

Categorizing the Purposes of Loans

The Act requires, for the first time, the Bank to categorize the reason for making each loan and long-term guarantee, classifying them as necessary either (1) to assume risk the private sector would not undertake, (2) overcome limits in private finance, or (3) meet competition from foreign export credit agencies. This will provide the public with critical information with which to hold the Bank accountable.

Inspector General Report on Portfolio Risk and Loss Reserve Allocation Policies

In addition to the GAO's mandated work on risk management, the OIG issued a report on September 28, 2012, entitled "Report on Portfolio Risk and Loss Reserve

Allocation Policies."[4] The Inspector General made five primary findings: (1) Ex-Im Bank lacks a systematic approach to identify, measure, price, and reserve for portfolio risk; (2) Ex-Im Bank lacks formal policies and procedures for its loss reserve forecasting model which clearly define roles and responsibilities, and provide for independent validation of the model's integrity; (3) Ex-Im Bank does not conduct portfolio stress testing in a systematic manner to assess potential exposures under challenging economic conditions; (4) Ex-Im Bank does not self-impose portfolio concentration sub-limits or thresholds either by industry, geography, or asset class as internal guidance to inform management on risk and determine exposure fees in new transactions; and (5) Ex-Im Bank's current risk management framework and governance structure are not commensurate with the size, scope, and strategic ambition of the institution.

These findings formed the basis for seven OIG recommendations to improve the Bank's loss reserve allocation and portfolio risk management policies and to bring the Bank in line with best practices. Bank management concurred with four of the seven recommendations and rejected the following three recommendations:

(1) Recommendation: Ex-Im Bank should implement soft portfolio concentration sub-limits based on industry, geography, or asset class as internal guidance to manage risk tolerance levels and return parameters. Once exposure fees are in place, these guidelines can inform the Bank about future pricing, risk management decisions, and business development when analyzing new transactions.

    Ex-Im response: Management responded that such limits on the risk portfolio would be inconsistent with the Bank's mandate. The Bank argues that its long-time policy has been to meet demand as long as it receives the reasonable assurance of repayment, and that placing limits on portfolio concentration impedes the Bank's ability to meet the demand. Thus, argues the Bank, the limits would result in it picking "winners and losers."

(2) Recommendation: Ex-Im Bank should create the position of Chief Risk Officer (CRO) to oversee the design and implementation of an agency-wide risk management function. The CRO should have sufficient independence in the organizational structure from the business units whose activities and exposures it reviews. Working with Ex-Im Bank's senior management and the Board of Directors, the CRO would be responsible for drafting, presenting, and then implementing approved key risk policies, including a portfolio risk mitigation policy, a financial model governance policy, as well as broader financial governance policies.

    Ex-Im response: Management responded that they do not believe a CRO is necessary. Currently, the Bank separates the duties between policy-setting and

[4] Office of the Inspector General, Export-Import Bank of the United States, *Report on Portfolio Risk and Loss Reserve Allocation Policies*, (Sept. 28, 2012). Available at http://www.exim.gov/oig/upload/Final-20Report-20Complete-20Portfolio-20Risk-20120928-1.pdf

credit risk monitoring once a credit has been approved. Setting the broad credit policies falls to the Credit Risk Management Division, whereas the Office of the Chief Financial Officer has the responsibility for monitoring credit risk after a credit has been approved.

(3) Recommendation: Ex-Im Bank's Board of Directors should amend its by-laws to include the oversight of an agency-wide risk management function covering the full range of credit, operational, and other risks.

Ex-Im response: Management responded that the President of the Bank has broad operational authority, including oversight of all of Ex-Im Bank's risk management functions. In addition, the Bank has an Audit Committee which may undertake certain risk management projects regarding the Bank's financial reporting process and independent accountants.