ASSESSING REFORM AT THE EXPORT-IMPORT BANK

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

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ASSESSING REFORM AT THE EXPORT-IMPORT BANK

Thursday, June 13, 2013

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [vice chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Pearce, Fincher, Stutzman, Mulvaney, Pittenger, Cotton; Clay, Moore, Peters, Perlmutter, Foster, Carney, Sewell, Kildee, and Murphy.

Ex officio present: Representative Hensarling.

Also present: Representative Heck.

Mr. HUIZENGA [presiding]. The subcommittee will come to order. And without objection, the Chair is authorized to declare a recess of the committee at any time. Also, without objection, members of the full committee who are not members of this subcommittee may sit on the dais and participate in today's hearing, as well.

At this point, the Chair recognizes himself for 5 minutes for an opening statement. This morning, we are welcoming the Honorable Fred Hochberg, chairman and president of the Export-Import Bank, also known as Ex-Im; the Honorable Osvaldo Gratacos, Inspector General of the Export-Import Bank; and Mathew Scire, Director of Financial Markets and Community Investment for the U.S. Government Accountability Office, the GAO.

Gentlemen, thank you for joining us. You will be dealing with me, the vice chairman, today. Our chairman is recovering back in California right now and, of course, he is in our thoughts and prayers, and we hope that he is doing well. But it is my honor to be able to chair this subcommittee today.

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 stated mission is to support domestic job creation in the United States. The Export-Import Bank is intended to facilitate the export of U.S. goods and services to international markets by providing working capital guarantees, export credit insurance, loan guarantees, and direct loans. Since its creation, Ex-Im's subsidized lending cap of $5 million has grown to a whopping $140 billion cap, as we sit here today. Obviously, inflation has occurred.

With the national debt quickly approaching $17 trillion, many fear that these taxpayer-backed loan guarantees put taxpayer dollars at significant risk and raise the concern that Ex-Im is looming towards yet another bailout that the American people simply cannot afford. My goal here is really making sure that we have accountability, efficiency and effectiveness of government, and that responsibility is had by those who are in charge of all of these various programs.

Last year, the Congress reauthorized Ex-Im, while mandating several reform provisions that shared broad bipartisan support. These reform provisions included requiring Ex-Im to monitor and report not less than quarterly the Bank's overall default rate, as well as default rates by product, market, and industry sector. Additionally, Ex-Im is required to establish a business plan and have a GAO audit of the Bank's risk management policies. Since that time, the GAO and the Inspector General have issued reports that found disregard for this congressional mandate and—to reform some of these policies and to better protect American taxpayers. And we are hoping to explore that today.

According to the Inspector General's report, Ex-Im clearly has not met its obligations to maximize the financing of exports through the private capital markets while minimizing the risk to the American taxpayers. Today, I look forward to hearing from Ex-Im, the Inspector General, and the GAO regarding the progress and the reforms that we are hoping to see.

With that, I will yield back the rest of my time, and I will recognize the distinguished ranking member of the subcommittee, Mr. Clay of Missouri, for 5 minutes, as well.

Mr. CLAY. Thank you, Mr. Chairman. And thank you for holding this hearing entitled, "Assessing Reform at the Export-Import Bank." I want to thank the witnesses for appearing today.

The Export-Import Bank was last reauthorized in 2012, and includes a congressional mandate of reviews and reporting requirements from the Bank, the Treasury Department, and the GAO. This reporting requirement includes risk management, export subsidy, default rates, and purposes of loans. Currently, the Bank has a very low default rate of 0.307 percent, and they actually generate revenue for the taxpayer, more than $800 million last year, plus the additional $400 million Congress rescinded. In Sub-Saharan Africa, the Export-Import Bank has grown the amount of financing it does by nearly 300 percent, going from $576 million in Fiscal Year 2008 to more than $1.5 billion in Fiscal Year 2012.

In the last 4 years, the Export-Import Bank has set record numbers in small business financing. Financing went from $3.2 billion in Fiscal Year 2008 to $6.1 billion in Fiscal Year 2012. In my home State of Missouri, the Export-Import Bank is financing exports ranging from soybeans to aluminum, to crushing and pulverizing equipment from St. Louis. As Members of Congress, we have an obligation to do oversight of the Bank under our jurisdiction. And by all accounts, the Obama Administration has been diligent in its risk management practices, and the Bank has demonstrated an openness to continue improvements.

In fact, for each of the three GAO reports that have been done since the Reauthorization Act, the Export-Import Bank has agreed to each of the recommendations by the GAO. In closing, the Export-Import Bank benefits the Nation by generating more than a billion dollars for the taxpayers, while supporting hundreds of thousands of jobs.

And again, thank you, Mr. Chairman. I look forward to the questions and comments, and I yield back.

Mr. HUIZENGA. The gentleman yields back.

With that, I would like to recognize the chairman of our full Financial Services Committee, the distinguished gentleman from Texas, Jeb Hensarling, for 3 minutes.

Chairman HENSARLING. I thank the chairman. While I don't often find myself in agreement with statements coming out of the Obama Administration, I have found occasion to agree with them on the market-distorting power of the Export-Import Bank. In a 2012 Treasury report to Congress, the Obama Administration argued, "There should be a level playing field for U.S. exporters, allowing them to compete based on the quality and price of their goods and services rather than on the quality of any officially supported financing."

In addition, the President once described the Bank as "little more than a fund for corporate welfare," and I could not agree more. The Bank picks winners and losers in our economy by providing loan guarantees, export credit insurance, working capital guarantees, and direct loans to American exporters and purchasers of U.S. exports. Some of those winners have included the likes of Enron and Solyndra, hardly worthwhile investments, on behalf of the American taxpayer. And a review of the Bank's top 10 recipients include companies like Boeing, General Electric, and Caterpillar. I find it inconceivable that these companies would be in need of the government dole.

Put another way, the Bank ostensibly makes loans backed by taxpayers that the private sector is unwilling to make. And if private creditors are unwilling to engage in these transactions, it begs the question, why should the American taxpayer? Some will argue the Bank is self-sustaining, thus posing little risk to taxpayers. Unfortunately, we need not look past Fannie Mae and Freddie Mac, the National Flood Insurance Program, or the Federal Housing Administration to know that it is perhaps impossible to provide government backing at no risk to hardworking taxpayers.

I believe Ex-Im does pose risks to taxpayers, and it could be doing more to mitigate those risks, many of which have been identified by the Inspector General. I want to thank the Inspector General and his team, in particular for the important work that they have been doing to identify weaknesses in the Bank's management of its portfolio. By inserting political considerations into the market, the Bank's activities do expose taxpayers to risks, while producing a less efficient economy than would otherwise occur in a free market without the Bank's interference. I have long believed that many taxpayers feel that it is indeed time to exit Ex-Im.

With that, Mr. Chairman, I yield back my time.

Mr. HUIZENGA. The chairman yields back.

With that, the Chair recognizes Mr. Peters, my colleague from Michigan, for 2 minutes.

Mr. PETERS. Thank you, Mr. Chairman. And good morning and thank you to our witnesses for being here today, and for your service. I support the Export-Import Bank, and I appreciate all that they do to help Michigan businesses of all sizes boost exports and create jobs. I am proud that the Bank chose the greater Detroit area for one of its new export finance centers, and I think this speaks both to Michigan's current strength in exporting as well as our potential for future growth.

Whether it is a cherry producer in Travers City, a robotics manufacturer in Auburn Hills, a medical equipment company in Portage, or our auto industry in the greater Detroit area, the Export-Import Bank provides critical export finance support that keeps Michigan and the United States competitive in an increasingly competitive global market. Michigan is a State that grows and builds things, and the Export-Import Bank helps get these products to our trading partners as close as across the Detroit River into Canada, and to the other side of the globe and places like Turkey.

By providing much-needed capital, the Ex-Im Bank helps businesses grow their customer base, boost exports abroad, and create jobs here in the United States, all while earning money back for the taxpayers. Today, I hope we can put pragmatism above political point-scoring and, most of all, put job creation and support for small businesses above ideology. While I believe I have made it clear that I support the Bank, I think we can all agree that there is no perfect government program and we can always do better.

I look forward to hearing how the Bank has implemented recommendations from their Inspector General and the Government Accountability Office. And I hope that we can all work in a bipartisan manner and a practical manner to keep defaults down and exports up. I yield back.

Mr. HUIZENGA. The gentleman yields back.

With that, the Chair recognizes the distinguished gentleman from South Carolina, Mr. Mulvaney, for 2 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman. And thank you, gentlemen, for being here. As we move forward today, I recognize the fact that the Bank is up for reauthorization in September of 2014. And I know many people are eager to begin the discussion about the next round of reauthorization. I am coming to this meeting today, Mr. Chairman, with a little bit different perspective. I want to look at what has happened since the last reauthorization. We gave the Bank a 40 percent increase in its lending limits last year. It was a dramatic increase, dramatic, at a time when we were asking other parts of the Federal Government to take 40 percent decreases in what they were able to do.

So I think it is incumbent upon us, before we start talking about the next reauthorization, to see how we have done since the last one. As part of the last reauthorization bill, for example, we required the GAO to conduct a review of the Bank's risk management and make necessary recommendations. I want to talk about that today. We also included a provision that directed the Secretary of the Treasury to initiate and pursue multilateral negotiations in order to substantially reduce, with the ultimate goal of eliminating—that is in the text of the law—all trade-distorting export subsidies, especially those for a wide array of aircraft.

Finally, we also require the Export-Import Bank to start submitting multiyear business plans. I know that some activities have been conducted since the last reauthorization. I know, for example, that the international working group has been put together, and I know they have put a schedule together for the next round of meetings. And I think that is great. I think there are some of us who wish that we had been able to accomplish more than just scheduling the meetings, but we will talk about that today, and the progress that we are making.

But I think that the focus before we start talking about the next reauthorization should be on how we have done on the requirements since the previous reauthorization. I am looking forward to getting into that today.

Thank you.

Mr. HUIZENGA. With that, the gentleman yields back.

I want to extend a welcome to our guests today. We thank you for your time and your ability to come up here and join us for this very important discussion that we are going to have. First, we have the Honorable Fred Hochberg. Mr. Hochberg serves as chairman and president of the Export-Import Bank of the United States. He previously served as the acting Administrator for the Small Business Administration, and previously had served as president and CEO of the Lillian Vernon Corporation, as well.

Next, we have the Honorable Osvaldo Gratacos. He serves as the Inspector General of the Export-Import Bank of the United States. He previously had worked for Motorola as commercial counsel, and had served as legal counsel to the Inspector General for the U.S. Agency for International Development.

And finally, last but certainly not least, we have Mr. Matt Scire, who serves as the Director of Financial Markets and Community Investment at the U.S. Government Accountability Office. He has over 30 years of audit experience, including management of Federal credit programs, and recently completed the audit work focused on risk management at the Export-Import Bank.

Thank you, gentlemen, for being here. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, your written statements will be made a part of the record.

On the table, there is a light in front of you that will start out as green. It will turn yellow when you have 1 minute left to sum up. And when it turns red, we ask that you please suspend. Once each of you has finished presenting, members of the committee will have 5 minutes in which they may ask any or all of you questions.

Chairman Hochberg, you are now recognized for your 5 minutes. Thank you.

STATEMENT OF THE HONORABLE FRED P. HOCHBERG, PRESIDENT AND CHAIRMAN, EXPORT-IMPORT BANK OF THE UNITED STATES

Mr. HOCHBERG. Thank you. Thank you, Chairman Huizenga, Ranking Member Clay, and members of the subcommittee. I am pleased to provide an update about the Export-Import Bank one year after our reauthorization became law. Our mission supports U.S. jobs through exports, and I am proud of the work of the 400 employees of Ex-Im Bank to support just that. They do so at no cost to the taxpayer, and have actually generated more than $1.6 billion for the taxpayers over the last 5 years.

Since I joined the Bank as chairman and president in 2009, we have seen significant growth. As acknowledged by the GAO, a portion of this growth is due in large part to the liquidity crisis caused by the worst global economic crisis since the Great Depression. On top of that, our exports now exceed $2.2 trillion. The Bank is continually called upon to step in when commercial lenders are unwilling or unable to do so. In Fiscal Year 2008, the Bank authorized $14.4 billion in authorizations, supporting 144,800 jobs. By Fiscal Year 2012, that grew to 255,000 jobs, with nearly $36 billion in authorization. That is approximately 1,000 jobs for every working day of the year.

With significant growth comes the responsibility to manage risk appropriately, which is why I am proud of the Bank's low default rate of one-third of one percent. Ex-Im Bank has been developing a more comprehensive risk management framework, as acknowledged by the recent GAO study. This framework starts with effective underwriting to ensure reasonable assurance of repayment, a standard set by our charter decades ago. More than 80 percent of our portfolio is backed by either collateral or the sovereign guarantee of a foreign government.

Our comprehensive risk management program continues long after a transaction is approved, with proactive monitoring in order to ensure timely payments and to minimize defaults. In those rare cases of actual defaults, the Bank aggressively seeks recoveries and delivers results. Roughly speaking, we recover 50 cents on the dollar, a rate far higher than the recovery rate of most commercial banks. Thanks to our diligent underwriting and monitoring of transactions, we reduced the amount of claims paid from $200 million in 2008 down to $37 million in Fiscal Year 2012.

Comprehensive risk management and continuous improvement are what we strive towards. Our low default rate reflects that. The Bank has made many improvements over the past 2 years, including improving our underwriting, creating a special assets unit to address emerging credit issues, improving our monitoring, and enhancing reserves with qualitative factors, including concentration risk. And we are not stopping there. Specifically, several months ago I asked for the creation of an enterprise risk committee. And today, I am pleased to announce to the Inspector General and to Congress that a new Chief Risk Officer position will be created to head that committee.

The Bank continues to be transparent and open to suggestions from all quarters in improving our operations. During the past 24 months, the Bank's risk framework and financials have been reviewed by our independent auditors, Deloitte & Touche, the Bank's audit committee, our audit committee's outside firm, KPMG, our Inspector General, and the Government Accountability Office. Let me close with two priorities important to both Congress and, frankly, to all of us at the Bank. Our support for small business is at record highs.

In Fiscal Year 2008, the Bank financed $3.2 billion in direct small business exports. By Fiscal Year 2012, we had financed a total of $7.5 billion in small business exports, of which $6.1 billion was direct. We have done more financing of small business in the past 4 years than the previous 8 years combined. And financing for minority-and women-owned businesses is up 17 percent this year. In fact, we have financed more minority- and women-owned businesses in the past 4 years than the Bank did in the previous 16 years combined.

In Sub-Saharan Africa, our financing has nearly tripled over the past 4 years, to a record high of $1.5 billion. In closing, the thousands of businesses that utilize Ex-Im Bank financing, of which 88 percent are small businesses, appreciate that Congress reached a bipartisan agreement to reauthorize the Bank last year. And let me add, as a former small business owner, I know that businesses, large and small, need certainty and continuity.

I look forward to working with the committee to provide that certainty as we approach our reauthorization next year.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Hochberg can be found on page 48 of the appendix.]

Mr. HUIZENGA. Thank you.

We will now go to Mr. Gratacos for 5 minutes.

STATEMENT OF THE HONORABLE OSVALDO LUIS GRATACOS, INSPECTOR GENERAL, EXPORT-IMPORT BANK OF THE UNITED STATES

Mr. GRATACOS. Thank you. Good morning. Thank you, Chairman Huizenga, Ranking Member Clay, and members of the subcommittee. Thank you for the opportunity to testify in front of you today about Ex-Im Bank, my office, and the challenges Ex-Im Bank is facing. Before I continue, I would like to thank the Almighty for the opportunity of being here, my family, and members of the OIG staff.

In my remarks, I will provide a brief history of the Office of the Inspector General and some of our accomplishments. And then, I will discuss some of the challenges and operational weaknesses that Ex-Im Bank is facing in performing its mission, given its significant growth since 2008. Some of you may know Ex-Im Bank OIG, my office, was created by law in 2002. But the IG, my predecessor, did not officially take office until August 2007. Since reaching its current staffing levels, the OIG has achieved noticeable success. Specifically, since 2008 the IG has issued 39 audit and special reports, containing over 165 findings, recommendations just for improving Ex-Im Bank programs and operations.

Since 2010, our investigative efforts have resulted in a number of law enforcement actions, including 67 indictments, 32 convictions, over 398 management referrals for enhanced diligence actions, and over $200 million in court-imposed restitution and payments. Ex-Im Bank, as official credit agency of the United States, is experiencing unprecedented growth, achieving 3 straight years of record authorization levels. In 2012, Ex-Im Bank authorized over $35 billion in export transactions, a new record high. This is in addition to the previous record high of $32 billion the year before.

Further, Ex-Im's portfolio has increased by 82 percent since 2008: $58.4 billion versus $106.6 billion by the end of 2012. At this level, approximately $35 billion, mainly in long-term and finance transactions, had not been disbursed yet. Further, in the current charter, Ex-Im Bank has authority to approve up to $140 billion in export transactions. Naturally, this rapid growth in Ex-Im total portfolio exposure caught our oversight attention, as to Ex-Im's ability to manage this significant portfolio growth from the risk management at the monitoring and operational perspective.

Specifically, Ex-Im Bank annual reports between 2009 and 2012 show that Ex-Im portfolio loss reserves have declined from 8 percent to 4.3 percent, while the overall exposure growth grew 82 percent since 2008. Further, long-term direct loan program authorizations have increased significantly between 2008 and 2012. In 2008, Ex-Im Bank authorized $356 million in direct loans versus $11.7 billion in 2012. Reports from my office, as well as GAO, and OMB Circular 129, highlight these concerns and provide best practice in risk management areas.

Specifically, both reports in the OMB circular recommend, among other things, that Ex-Im develop a more comprehensive risk management framework, including establishing a Chief Risk Officer function that is independent from the business function. And I am glad to hear that Chairman Hochberg unveiled the creation of the risk officer position just now and, hopefully, it is an independent function from the business function of the Bank. Also, the reports required, or recommended, that Ex-Im establish risk-appetizing thresholds in order to better manage its portfolio and risk.

And also that Ex-Im conduct portfolio stress testing. In addition to the risk management aspect, Ex-Im needs to improve the efficiency of IT systems in order to better and more efficiently manage its increased workload. Current systems are obsolete, fragmented, susceptible to human error, and inefficient, as highlighted by our IT system audit. I am glad to see that Ex-Im Bank has taken steps towards addressing some of the concerns under its new Total Enterprise Modernization (TEM) initiative. We hope to closely work with Ex-Im Bank in implementing this initiative.

Finally, we think that the Bank is to continue its effort to meet the small business goals, as expressed by the chairman. Ex-Im Bank's charter sets a 20 percent small business participation goal, in all the authorizations per year. And the last 2 years, Ex-Im Bank has increased the amount of money going to small business transactions, but has not met the 20 percent threshold.

Mr. Chairman, Ranking Member Clay, and distinguished members of the subcommittee, thank you once again for the opportunity to be in front of you today, and I will be more than pleased to respond to any questions you may have. Thank you.

[The prepared statement of Mr. Gratacos can be found on page 40 of the appendix.]

Mr. HUIZENGA. Thank you for your testimony. We appreciate that.

And finally, from the Government Accountability Office, we have Mr. Mathew Scire, who will be recognized for 5 minutes.

STATEMENT OF MATHEW J. SCIRE, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SCIRE. Mr. Chairman, Ranking Member Clay, and members of the subcommittee, thank you for the opportunity to be here today to discuss our recent work. We conducted this work in response to the Export-Import Bank Reauthorization Act of 2012. My statement today focuses on certain aspects of risk management and reporting.

Ex-Im's business volume has grown dramatically in recent years, with total outstanding financial commitments exceeding $100 billion in 2012, an 82 percent increase from its 2008 level. This rapid growth would present challenges to any organization, and Ex-Im is no exception. One of the first challenges is to understand what to expect in terms of future activity. We found the methods used by Ex-Im to forecast its total exposure for 2013 and 2014 had certain weaknesses. In estimating new authorizations in its business plan, for example, Ex-Im followed the same practices that in prior years resulted in underestimates.

Also, in estimating repayment speeds, Ex-Im used outdated assumptions. For example, it assumed that the portfolio of new business that would comprise short-term financing, and therefore repay or cancel in one year, would be greater than recent years might suggest. It also assumed that existing long-term obligations would repay, on average, in 10 years. We found that changing these assumptions based on recent experience could result in a forecasted exposure level that exceeds the exposure limit in 2014. Despite this sensitivity, Ex-Im did not reassess its assumptions to reflect changing conditions or conduct sensitivity analysis to assess and report on the range of potential outcomes. We think that Ex-Im should do so.

Another challenge facing the Bank is understanding the risk of loss. This is particularly challenging for Ex-Im because of the need to anticipate losses far into the future, and because of weaknesses in its data. Most of Ex-Im's recent growth occurred through its long-term loan guarantee and direct loan products. Annual production in these programs grew threefold between 2008 and 2012, and represented three-quarters of annual authorizations in 2012. To improve its loss modeling, the Bank added certain qualitative factors.

These include minimum loss rates, global economic risk, and portfolio concentration risks, whether by region, industry or obligor. These should help Ex-Im better capture risk that may be different than historical experience might suggest. But we found that its technique for assessing global economic risk could be improved by considering longer-term default forecasts. We therefore recommended that Ex-Im consider whether it is using the best available data for adjusting loss estimates for longer-term transactions to account for global economic risk.

More fundamentally, we found that Ex-Im had not maintained historical data on defaults that might be used in evaluating the performance and loss potential of the current portfolio. That is, Ex-Im had not maintained records that permit comparing the performance of a transaction with that of a like transaction at a similar age. Such vintage analysis is critical for quantitative models that estimate the likelihood and timing of defaults. We therefore recommended that Ex-Im retain point-in-time historical data on credit performance.

Ultimately, loss estimates can never be certain. For this reason, it is useful to conduct stress tests to better understand and inform the Congress of the potential outcomes of alternate scenarios. Ex-Im intends to conduct such stress tests, and we recommend that it report to the Congress their content and results.

Another challenge facing Ex-Im is the sufficiency of its resources. We note that the rapid growth in business volume, coupled with the more modest growth in FTEs, creates potential operational risks for Ex-Im. And Ex-Im recognizes this risk, but has not formally determined the level of business it can prudently manage either agencywide or within specific functional areas with a given level of resources.

We recommend that Ex-Im develop workload benchmarks, monitor workload against those benchmarks, and develop control activities for mitigating risk when workloads approach or exceed those benchmarks.

The recommendations we make in these most recent studies provide important guidepost for Ex-Im as it works through the increased risk represented by its rapid growth. And Ex-Im has agreed to implement these recommendations. We are glad to help the Congress in providing critical oversight of this program.

This concludes my opening remarks. Thank you again for the opportunity to speak today. I would be glad to answer any questions that you may have.

[The prepared statement of Mr. Scire can be found on page 56 of the appendix.]

Mr. HUIZENGA. Thank you, we appreciate that.

Now, the Chair recognizes himself for 5 minutes, as we go into the questioning. And, Mr. Scire, I am curious if we could maybe unpack this a little bit. You were talking about outdated assumptions as the risk analysis, no historical data being retained for comparison of those default rates. Would it be normal to do that, or to act that way?

Mr. SCIRE. No, not at all. We have done—GAO does quite a bit of work looking at management of other Federal credit programs. You would certainly expect an agency to retain that kind of historical data. Now, I understand there has been some movement on this at the agency, and they are finding ways to retrieve some of these data. But nonetheless, as a routine matter of management of Federal—any credit program, you should be maintaining data that tells you something about how your credits perform.

Mr. HUIZENGA. And Mr. Hochberg, I am assuming when you were at Lillian Vernon that would be vital information to have, to be able to look back and find out what was happening. What is your position? And I know that some of this may precede you, as well, but you are the person with the title, just like I get blamed for Congress even though I have only been here for two terms. I understand sometimes those burdens of what you come into.

So why not this historical data, and these outdated assumptions for your risk analysis?

Mr. HOCHBERG. First, I just want to start by thanking both our Inspector General and the Government Accountability Office. They have both helped, frankly. And I think the three of us have the same goal in mind, and that is to find ways that we can continually improve the Bank, enhance our comprehensive risk management. And I work very closely, particularly with Osvaldo. We meet once a month to review those kinds of things. In fact, just as an example, we are renovating our offices, and his office will be on the 12th floor, right down the hall from mine.

So my point is, we work very closely because we are trying to continually find ways that we can do continuous improvement.

Mr. HUIZENGA. But that has been one of the criticisms, correct, that there hasn't been as rapid an implementation of some of the recommendations?

Mr. HOCHBERG. What we are doing is putting in more and more of these on a regular basis. And we are looking at historical data, we are looking at—when we make an estimate of a risk of a loan, we do it by guidelines that are approved by OMB. They also—our results each year, Congressman, are reviewed by our outside auditors, Deloitte & Touche; the audit committee, which is made up of three independent directors but also has their own independent, KPMG; the Inspector General; and GAO is looking at all those.

So, I think that there is a program. And as you mentioned, I was in business for 20 years. I am continually trying to find better ways to forecast better ways to evaluate the risk and to make sure that we don't cause undue risk in the—

Mr. HUIZENGA. Okay, but you are saying that you have a 0.307 percent rate of default. Now, a number of us believe that the default rate reported, and maybe the forecasting I think is what Mr. Scire is getting at, might cause some problems. But many supporters point to that default rate. However, the Inspector General's report noted that the Bank uses a very limited definition of default and "does not include the failure to comply with other conditions in the loan agreement."

Your disagreement of how to show the Bank's loan portfolio performance in the best light possible isn't necessarily limited to the Inspector General, though. The chairman's testimony, I believe, ignores the White House Office of Management and Budget's own default projections listed in the President's budget. So how do you reconcile those two things?

Mr. HOCHBERG. We look at defaults, Congressman. If we were to lend you $100, and after paying back $50, you default, we would have a $50 loss. We would then have to pay that to the Bank because we loaned you money. We are a guarantee. We will then go and try and pursue that claim. And as I mentioned, we then—

Mr. HUIZENGA. But is it a different formula than what everybody else is using?

Mr. HOCHBERG. We are using a formula that, to the best of my knowledge, is consistent with what everybody else is using. And we are looking at what are the actual paid out claims that occur in any particular year.

Mr. HUIZENGA. Let me ask the other two gentlemen, is the formula that the Ex-Im Bank is using the formula that you believe: one, should be the formula; or two, the same one that you are using? Mr. Scire?

Mr. SCIRE. There are a couple of issues here. First off, so far as what they are doing in terms of modeling, I think what the chairman is saying is that they are complying with the requirements that are out there for modeling and that is the case. But what we are really talking about here is best practices in modeling. And so far as the numbers that are used for measuring default, what we would urge is caution in use of that statistic.

Mr. HUIZENGA. Okay.

Mr. SCIRE. And it can be easily misinterpreted, especially when you have rapid growth.

Mr. HUIZENGA. Right. And I need to adhere to this myself as Chair. My time has expired.

So with that, I recognize Ranking Member Clay for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. Let me—Chairman Hochberg, I understand that Ex-Im uses a number of risk management techniques throughout the different stages of a transaction, which include underwriting, monitoring, and restructuring in claims, and recovery. With regard to the underwriting function, what kind of collateral standards does Ex-Im impose, and how often, and what kind of assets might be used to secure a given transaction?

Mr. HOCHBERG. Thank you, Ranking Member Clay, for your help on this. After we underwrite a transaction, our work does not end there. We monitor a transaction on a regular basis. We have a separate and distinct from the business units in the chief financial officer's office that looks at the asset and monitors on a regular basis. We monitor transactions as small as $1 million. And at the end of each fiscal year, we do a mark-to-market. We look at each and every transaction, and determine if the credit has been proved or degraded and, as a result, adjust our reserves accordingly.

So that is done on a regular basis each and every year to make sure that our portfolio is properly risk-rated. And it is approved by our outside auditors, Deloitte & Touche. So, that is the process we use to set the proper reserves to make sure we have adequate reserves against any potential loss.

Mr. CLAY. And if Ex-Im identifies the deterioration in credit quality in any of these transactions, what kind of steps does the Bank take to help prevent the default?

Mr. HOCHBERG. One, we will therefore monitor it more closely. We look at both global tends—if there is a political disruption in part of the world, we will pay more careful attention to transactions that are housed in that country. We will look at industry trends, and we do—we have, as I said, a distinct monitoring group. That team is frequently traveling around the world visiting different credits or different countries to make sure that we adequately understand what the degree of risk is so we can adjust our reserves accordingly.

Mr. CLAY. Thank you for that response.

And Mr. Gratacos, what are some of the key areas where Ex-Im has made progress in implementing the recommendations you outline in your 2012 report?

Mr. GRATACOS. You are alluding to the risk management report recommendations?

Mr. CLAY. Yes.

Mr. GRATACOS. There were a number of recommendations that we issued. The main one in the beginning was the use of qualitative factors. That was something that, when we started looking at it, was not done by the Bank at the time. By the time we worked on the final report, the Bank was taking steps towards enacting some of the qualitative factors described by GAO, next to me. We still think that there is a way of—to learn how to implement those better, down the road. We have to independently assess and verify those factors.

We are in the follow-up process in that. We also suggested that independent validation be done by either the consultant or ourselves. The Bank had KPMG, or the audit committee used KPMG to look at the factors. We still think that a more independent process should take place. For those steps have taken place. Now, I hear about the creation of the Chief Risk Officer. Obviously, that will be a step in the right direction, from our perspective.

So we think those two steps are useful. I know the stress-testing portion—they have been moved to implement it on the aircraft side. And we have seen some of the discussions in board meetings, where the aircraft team discusses the stress-testing scenario for the aircraft side. We haven't independently validated those yet. That will be our follow-up in the next semi-annual process.

Mr. CLAY. Tell me, what steps has the IG taken to go after fraud in Ex-Im programs? Are there further actions the IG can or plans to take to deter bad actors that attempt to defraud Ex-Im?

Mr. GRATACOS. Thanks for the question. That has been the area where we have been very active since we started in 2008. The fraud side—when we came in, there was one program particular in the Ex-Im portfolio that has been susceptible to fraud. It was a medium term firm. And we came in and have been very successful in the prosecution, and also deterrence of fraud. You can see how the claims in the medium term program have actually gone down 80 percent since that time.

So, we have worked very closely with the Bank. We try to send information to the front end. And that is why we mentioned the intelligence changes for enhanced diligence. Every time we see something in our investigation, we try to send it to the front end. We also develop red flags for the loan officers to keep an eye on aspects that might raise concern, and to please send it to us so we can investigate.

Mr. CLAY. Thank you for your response. My time is up, Mr. Chairman.

Mr. HUIZENGA. The gentleman's time has expired.

With that, I recognize Congressman Mulvaney for 5 minutes.

Mr. MULVANEY. Great. I want to go over a couple of lines from the various reports: from the IG's report; and from the GAO report. And I want to know where we stand on fixing these things. Starting with the GAO's report, on page three, I am going to read the text because I don't want to get any of this stuff wrong. By the way, I was surprised at the candor in some of these, and I appreciate the candor in both of the reports.

It strikes me that if I had read these types of reports about private banks, the banks would probably be shut down by the regulators. So I will be curious to know what is going on in response to these inquiries: "Although Ex-Im forecast models sensitive 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."

Are you working to fix that, Mr. Hochberg?

Mr. HOCHBERG. I'm sorry, I didn't hear what you said.

Mr. MULVANEY. Are you working to fix that?.

Mr. HOCHBERG. Excuse me. We look at the probability of default for an entire transaction. We look over the entire life of the transaction to make sure that we have an adequate risk reserve policy. And the risk—the reserves that are put on our books are actually paid for by our customers. So our customers pay a fee. The fee that they pay us is based on our assessment of what is the risk in that country, what is the risk in that particular credit or industry, what is the risk in that specific transaction.

Mr. MULVANEY. So you are saying you disagree with the GAO when they said that your assumptions about product mix and repayments were not consistent with historical trends?

Mr. HOCHBERG. No, we look at historical trends. That is one factor in what we look at. We obviously look at historical trends, but we don't limit ourselves to looking backwards. We also look forward in terms of—

Mr. MULVANEY. Then help me, Mr. Scire, because it is your report.

Mr. SCIRE. I think there is some confusion here. The report that you are asking questions about—the question is really about estimation for a forecast of exposure as opposed to estimates of credit and loss.

Mr. MULVANEY. I will go to the next one and see if we can find one we can get on the same page on: "Stemming from our analysis in the business plan, in our May 23, 2013 report, we found that Ex-Im had not routinely reported the performance of its sub-portfolios relating to the small business, Sub-Saharan Africa, and renewable energy mandates. While Ex-Im provides quarterly default rate reports to Congress, Ex-Im has not included in the default rates for transactions supporting these three congressional mandates in its report."

Are you working to fix that, Mr. Hochberg?

Mr. HOCHBERG. The default report, to my knowledge, is in compliance with what Congress has asked for. At the same time, we are continually trying to improve it and trying to find better ways of monitoring our business. We have a comprehensive risk program. We are looking to find better ways to do so, and I am always looking for suggestions on how to do so. That is why I said we work very closely with our Inspector General and we have taken every single recommendation that the Government Accountability Office has made and are working to implement each and every one of those.

Mr. MULVANEY. There are a couple of others, but I only have a minute-and-a-half, so I will skip to the last one, which was the most striking to me. This in the Inspector General's report. It is rather lengthy, but give me a second. It is on page six: "One of the patterns our offices observed in conducting our investigations is the lack of due diligence and asset monitoring efforts conducted by lenders, specifically the ones who have a history of defaulted transactions. Even though there is an expectation that such efforts are taken, Ex-Im Bank does not require participating lenders to conduct due diligence or asset monitoring on their transactions.

"In fact, there is no real accountability or penalty for not performing such operations. The OIG has anecdotal evidence of loan officers in lending institutions expressing their position that the lender would not devote resources on due diligence efforts when there is a government guarantee and such efforts are not required by Ex-Im Bank. Although the OIG is not in a position to state this as a behavior demonstrated by all lenders, we can certainly state that this moral hazard issue has been prevalent in fraud cases involving multiple transactions."

I guess the question is, are we working to fix that, as well, but really, what strikes me, gentlemen, is this—that these are the sorts of red flags we will look back at 4 years from now, when there is a huge taxpayer bill to be picked up. I am not saying that is—we know that is going on. I am not trying to cast any aspersions on the Ex-Im Bank. But it strikes me we could go back and find these exact same statements about Fannie Mae and Freddie Mac 4 and 5 years before we ended up paying for their bailout.

These red flags bother me a great deal, and I hope that we are working very diligently so that we do begin the discussions on next year's reauthorization so you can come in, Mr. Hochberg, and say, "Look, we looked at that section of the IG report and here is what we did. We looked at that section of the GAO report and here is what we did." Because right now, like I said, if my private bankers back home got this kind of report, their examiners would shut them down. And I am not suggesting that we do that, but I am suggesting that the next time we come in and start talking about reauthorization again, we are going to have to look very closely at whether or not these improvements are being made.

Thank you, gentlemen.

Mr. HUIZENGA. The gentleman's time has expired.

With that, we go to the gentlelady from Wisconsin, Ms. Moore, for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman. And I want to thank the panel for the time and the work that they do. I would like to start out by sort of following up on the questioning that Mr. Mulvaney had with regard to the moral hazard and Freddie and Fannie and so forth. Isn't it true, Mr. Hochberg, that the mission of the Ex-Im Bank is to lend to those businesses that the private sector would not lend to so that you don't compete with the private sector? So doesn't that provide an element of risk just because of that particular mandate?

Mr. HOCHBERG. Thank you, Congresswoman. Our mandate is to fill gaps that the private sector cannot or is unwilling or unable to, or unwilling to do so at a cost that would make the transaction go forward. So one could say that frequently it is because—I will give you an example. A bank may have a certain lending limit to Sub-Saharan Africa or may have a limit of how much exposure they will have in a certain industry.

So what we do is, we help fill in the gap. When they have reached their ceiling, we are able to extend credit to make sure that U.S. companies can compete overseas, create jobs in this country, and not—

Ms. MOORE. Okay. Okay, thank you. Because they are going to cut me off, so thank you so much for that. One of the things—the Ex-Im Bank has a very important mission. A staggering statistic to me is that 95 percent of all consumers in the world live outside of the United States. So if we didn't have an Ex-Im Bank or an ability to export our technology and our products we would—what would that cost us, sir, in terms of commerce, do you think?

Mr. HOCHBERG. Last year, using the Bureau of Labor Statistics, we supported 255,000 jobs, or better than 1,000 jobs every working day of the year. A large number of those jobs, perhaps all—certainly all of them would be in jeopardy because those companies are exporting those products, sustaining jobs here. And those jobs are here versus being supplied by foreign governments.

Ms. MOORE. Okay, thank you. Sir from the GAO, I really appreciate the comprehensive report that you did on the Export-Import Bank and the suggestions that you have given for risk management in the report, and I hope they follow through with them. Some questions—one of the things that concerned me was sort of a suggestion that the congressional mandate with respect to serving Sub-Saharan Africa and small businesses is a risk. And I guess I would like you to sort of opine on what that risk is, as compared to the assets that are there with respect to serving small businesses.

And Sub-Saharan Africa has three huge assets. One is demographics, two demographics, and three demographics. There are an awful lot of consumers in Sub-Saharan Africa. So I am wondering what the break-even point is for being so risk-averse that we don't have a program to try to reach those markets, in your view?

Mr. SCIRE. We have not assessed what the risk is of lending under the Sub-Saharan African mandate. I could—as you know, the Ex-Im is nowhere near reaching the levels that you might expect. So I would expect, then, that Ex-Im should want to have sufficient data to know how that portfolio performs so that then you can have some facts to back up an analysis to back up—

Ms. MOORE. Thank you. That was good. And now, Mr. Hochberg, I will let you take the last minute on this. Because there was some suggestion, even in the questioning here among our colleagues, about that risk of Sub-Saharan African activity.

Mr. HOCHBERG. Actually, to follow up on that question and Congressman Mulvaney, in the June default report we will actually show defaults by the three mandates you are referring to so that the Members of Congress can see the precise defaults of each of those programs. But no, we do not see any greater defaults at the moment, at a macro level, with any of those programs. Sub-Saharan Africa is growing rapidly, as you commented. I will actually be joining President Obama there at the end of the month.

We are seeing a lot of growth in infrastructure, in small business. It is actually been a very fruitful areas for small business exports, as well. And our vice chair, who—

Ms. MOORE. And also minority and women participation, would you think?

Mr. HOCHBERG. Minority women is very high, and I said—our vice chair of the board, Wanda Felton, one of her prime responsibilities is to oversee that portfolio and make it grow.

Ms. MOORE. Thank you so much. I yield back my time.

Mr. HUIZENGA. The gentlelady yields back.

With that, we go to one of the new members of the committee, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Huizenga. Thank you, gentlemen, for being with us today. I would like to ask each of you a question, if we have time. Mr. Gratacos, your office regularly engages with private shareholders—stakeholders to obtain input on the Bank's operations. In your opinion, is the Bank effectively limiting itself to markets and customers not being served by private lenders? And if not, what steps could the Bank take to better mitigate the risk that is crowding out any private capital markets?

Mr. GRATACOS. We haven't made an assessment as to whether or not the Bank is displacing the private sector. We have not received complaints from commercial banks or any other bank stating that they have been displaced, either. So from our perspective, one of the things that we have asked of the Bank in the past has been whether or not there is any sort of requirement, proof that a transaction has been denied or funding has been denied by a private sector institution before they come to Ex-Im Bank as the lender of last resort.

And there has been a conversation that we have raised on a number of occasions where the Bank in the project finance long-term type of deals, there is a number of back and forth for up to a year before any transaction really makes it to the board. So there are a lot of communications. On the short-term and medium-term side, we asked this question as part of our review of the medium-term program. And the answer was mixed.

And so, in terms of whether or not the Bank requires any proof of denial of credit, it is a mixed bag, in that sense.

Mr. PITTENGER. So do you—if it is a mixed bag, are there areas you can see that could be better improved or mitigated so that there wouldn't be that possibility in the future?

Mr. GRATACOS. It is hard to tell. It is hard to tell in that sense. But for—at least from the oversight of the audit that we do on specific programs, that is one of the questions we ask. I believe, in certain areas, the application actually asks the question. But we haven't monitored across the Bank.

Mr. PITTENGER. Mr. Scire, what is your assessment of the Ex-Im Bank's loan loss model?

Mr. SCIRE. We think that there are certain weaknesses in the model. And what we look to there is for example, what I mentioned before in terms of data and the absence of this historical data that might be used to inform assessments of risk of transactions. Now, there have been some improvements that have been made in the model in terms of adding qualitative factors which will help Ex-Im try to assess risk that is not necessarily represented by historical experience. And that is a move in the right direction.

But even there, there is one particular qualitative factor where we think they could do more in that they are currently using 1-year forecasts of defaults. And we think they could move to looking at forecasts for outyears, and they plan to do that. So I would point to the weaknesses in—in terms of the data, something that is fairly important. Overall, these models are estimates, so you can never be certain. And so we also think it is very important to do stress testing.

And I understand the Bank is moving in that direction. But you cannot be certain. We heard the chairman say that there are adequate reserves against any potential loss, and that is not correct. There are adequate reserves to guard against the losses that you are expecting. So that is where this kind of stress testing will help you better understand these potential outcomes.

Mr. PITTENGER. Thank you. Mr. Hochberg, you might want to respond. But in addition, I would just like to know, are there any policy prescriptions that you would support? But if you would like to respond to any other comments, as well, that would be fine.

Mr. HOCHBERG. Thank you for your questions. Let me try and respond quickly to all of them. You asked about crowding out the private sector, on our application we actually—there is a question "reason for requesting Ex-Im Bank support." The applicant has to verify on their application why they are asking for support, what the need is. And that is then followed up in the actual due diligence and the underwriting process. So, we are very careful. We are not interested whatsoever in crowding out banks, and that is—

Mr. PITTENGER. You have 20 seconds.

Mr. HOCHBERG. Pardon me?

Mr. PITTENGER. You have 20 seconds.

Mr. HOCHBERG. In terms of stress testing, as the GAO said, we are undertaking stress testing. We will be reporting that in the fall, and then on a regular basis. And in terms of weaknesses, the reason we are sitting here, the reason we have an IG and a GAO is so we can improve those weaknesses. We are always striving to find better ways of doing what we do. I was in business for 20 years. You don't sit on your laurels; you find better ways to do it, better ways to underwrite and better ways to mitigate against loss.

Mr. PITTENGER. Thank you.

I yield back.

Mr. HUIZENGA. The gentleman's time has expired.

I now recognize the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Mr. Chairman. Chairman Hochberg, let me see if I understand at least a couple of the things that you do in that Bank, or that the Bank does. So part of the role is to guarantee loans that are made by other banks to, at least in Colorado, in my district, 11 small businesses. So you are a guarantor, right? And then you are also a direct lender in certain instances. Is that correct?

Okay. And I look at your testimony, and on page two, "The Bank continues its prudent risk management, and is proud of the improvements made during the past few years. In Fiscal Year 2012, the Bank paid $37 million in gross claims on a portfolio of $106 billion." So Mr. Scire, let me see if I understand the math. Because I listened to Mr. Mulvaney's questions, and I was—based on his questions, I was very concerned. But if I do the math, if it is $37 million over $106 billion, that is 37 out of 106,000, is it not? Was that a yes, sir?

Mr. SCIRE. Yes.

Mr. PERLMUTTER. Okay. So if losses doubled, it would be 74 out of 106,000, right?

Mr. SCIRE. Yes.

Mr. PERLMUTTER. So for me—coming from Colorado, where we are in the middle of the country—we love to export because that gives our small businesses business and puts Coloradans to work. I see this Export-Import Bank assisting either through direct loans to my small businesses in my district, or by guaranteeing certain loans. So I have had the pleasure, I guess, of serving on this committee now for the last 7 years and went through the travails of Fannie Mae and Freddie Mac, where they basically bought mortgages that were based upon very little documentation.

In your study of the Export-Import Bank's loan processing, do they take—do they have loan applications? Do they demand a business plan? Were there any problems you saw in the loan process or the guarantee process?

Mr. SCIRE. No. I think that they have controls in place in terms of underwriting and documentation and so forth. But where I might take issue is the characterization of that percentage as the best measure of the performance. And especially during a period where you have rapid growth. You may, today, book certain claims, and your portfolio may be very, very large. But much of that portfolio has not aged to the point where you might expect a claim to occur. And—

Mr. PERLMUTTER. Okay, but let me—so let's talk about that for a second. Because I agree with you. I don't know if you know my background. I did a lot of Chapter 11 and Bankruptcy work for a long time, and I dealt—I represented banks which were dealing with stressed or distressed assets. So as I understand it, the Export-Import Bank has been in existence for about 79 years? Is that right?

Mr. SCIRE. I believe so, yes.

Mr. PERLMUTTER. So in those 79 years, to your knowledge, have we had any experiences like we had recently with Fannie Mae and Freddie Mac?

Mr. SCIRE. I am not sure that there is a direct comparison, but—

Mr. PERLMUTTER. And that is my point. That is exactly my point. The comparison that Mr. Mulvaney is trying to draw I think is way out in left field. Because—and he will have a chance to take me to task on this—for 4 years, the last 4 years from 2004 to 2008, they were in the business of purchasing mortgages which had very little, if any, underwriting backing them up. That was a real problem.

Now that we have underwriting again, Fannie Mae and Freddie Mac are making a lot of money. And as I understand it, over the course of the last few years, not only have exports grown and jobs been created, but the Export-Import Bank has been making money for the United States of America. Is that right?

Mr. SCIRE. I think that estimate has to be used with great caution.

Mr. PERLMUTTER. Okay.

Mr. SCIRE. Those numbers are based upon estimates of credit subsidy that are done initially, and then updated every year. And again, much of this portfolio is brand-new.

Mr. PERLMUTTER. All right. So let's go back to the 79 years. Over the 79 years, how many losses and what kinds of losses has this Bank had over the last 79 years?

Mr. SCIRE. I think, as you point out, this is a different time. The—

Mr. PERLMUTTER. I understand it is a different time. My question is, what has happened in the last 79 years? Past is prologue.

Mr. SCIRE. I am not sure that is exactly relevant. But I think it is important to keep in mind that these, all of these are estimates. And I can guarantee you the estimate is wrong. It is going to be something different, and that is why I think it is so important to present a range of potential outcomes so you can understand the risk that is presented.

Mr. PERLMUTTER. All right. Thank you very much.

Mr. HUIZENGA. The gentleman's time has expired.

With that, we go to the distinguished gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you. Thank you, Mr. Chairman. And thank you, gentlemen, for being here. Mr. Scire, it is my understanding that there are single obligors that have more outstanding than the loan reserves, the loan loss reserves. Is that correct. Do either of you—Mr. Gratacos, either one of you understand—know the answer to that?

Mr. SCIRE. No, I don't.

Mr. PEARCE. So how much does Pemax—how much does Pemax owe? Mr. Hochberg?

Mr. HOCHBERG. I am not sure I understand the question.

Mr. PEARCE. I am asking how much loan value do you have to Pemax?

Mr. HOCHBERG. Oh, to Pemex. I'm sorry, excuse me. I didn't understand.

Mr. PEARCE. Sorry, it is west Texan. We speak that—

Mr. HOCHBERG. I apologize. Pemex, which is the oil company of Mexico, is our largest creditor. It is in the range—it is in the $5 billion range.

Mr. PEARCE. Five billion?

Mr. HOCHBERG. Five billion dollar range.

Mr. PEARCE. And how much of your loan loss reserves?

Mr. HOCHBERG. The loan loss reserve, I could not tell you precisely what it is for each loan. But we risk rate—

Mr. PEARCE. No, total. Total for your Bank.

Mr. HOCHBERG. We have $1.4 billion in cash to back up loans outstanding.

Mr. PEARCE. You have more outstanding in this one—to one company than you have in cash as a reserve. That is—just trying to get a little bit more clarity on the last line of questions. Now, Mr. Hochberg, you had mentioned that the Sub-Saharan Africa growth, you are seeing tremendous growth in the Sub-Saharan. Now, I have just, in the past 3 years, visited probably 10 to 15 Sub-Saharan countries. Can you tell me the countries where the income is escalating? The growth that you are seeing?

Mr. HOCHBERG. Well—

Mr. PEARCE. Just name two of them, if you would.

Mr. HOCHBERG. Where income—where GDP is growing?

Mr. PEARCE. Yes, you told me that—you said earlier, in response to a question, that you are seeing tremendous growth in the Sub-Saharan. I would like you to now get specific.

Mr. HOCHBERG. Ethiopia has been a very strong market for Ex-Im Bank. That is one. South Africa has been a strong market for Ex-Im Bank. Those are two right there.

Mr. PEARCE. Okay.

Mr. HOCHBERG. I would—there is always Mozambique, most recently.

Mr. PEARCE. Okay. Now, you—in one of the papers it says that your mission is to support U.S. exports. Is that a correct statement?

Mr. HOCHBERG. We support U.S. exports in the interest of supporting U.S. jobs.

Mr. PEARCE. And so why would Pemex have $5 billion in loans?

Mr. HOCHBERG. What Pemex is doing is, we are making sure that when they buy goods and services, they buy from U.S. companies. So they are buying from companies, a lot of them in the Texas, Louisiana, Oklahoma area. They have a choice. They can buy those goods and services from other foreign countries or from U.S. small businesses, and—

Mr. PEARCE. So then how about Abignor? That is a Spanish company?

Mr. HOCHBERG. Abengoa?

Mr. PEARCE. Yes. And I think maybe in January, they got $87 million. They got quite a few million. And keep in mind that in quarter one of this year they posted, in euros, about another—about a 20 percent growth into a billion-dollar range, profits. And so the taxpayer is standing as a safety net for these companies that make a lot of money, and we—so Abengoa is—they are a big user of U.S. domestic products. Is that right?

Mr. HOCHBERG. The only products that we would finance is when a company outside the United States wishes to purchase goods made, produced or serviced—

Mr. PEARCE. So you are telling me that is a true statement about Abengoa?

Mr. HOCHBERG. I am not fully familiar with the exact details of what loans are outstanding to Abengoa itself. I can certainly get back—

Mr. PEARCE. Could you find that out?

Mr. HOCHBERG. I would be happy—

Mr. PEARCE. It would be interesting. But, see, what I see is that Abengoa just went into southern California a couple years ago, and they were building a solar facility like I suspect that you are financing for this improving climate in the Sub-Saharan. And for the people in southern California, who make a lot of money every year, the hardest hurdle to get over was the cost of the electrical power, because the cost of solar power is so much better.

Now, in the Sub-Saharan countries that I traveled through, the average wage per day is $1 a day. And so, you are financing these really exotic things that are very problematic to get placed into our highest, wealthiest place in America, and you are sending them over somewhere else. And I suspect that it is going to be a program exactly like I have seen other places. We were in Burma on one of these trips. They had a 12-lane highway—one car going on a 12-lane highway in Burma.

So I suspect that some of the times that the jobs that are being created are ending up with no designation and nobody to drive on and nobody to use that expensive power.

I yield back, Mr. Chairman.

Mr. HOCHBERG. Mr. Chairman, can I answer that question?

Mr. HUIZENGA. The gentleman's time has expired. We will let—if Mr. Foster, from Illinois, who is going to control the next 5 minutes can choose to do that, or he may choose to respond in writing. So with that, you have 5 minutes, Mr. Foster.

Mr. FOSTER. I will proceed with my questions, and yield time if it works. In a perfect world, the Export-Import Bank would not need to exist. But I am afraid that the dreams of a pure and undistorted world economy are not met by the realities due to the asymmetry from subsidized credit by our foreign creditors. And in my point of view, the next best thing to a transparent and undistorted world economy is an economy in which the market-distorting credit subsidies of our competitors are at least partly offset by equal and opposite distortions on our side.

So my attitude is very much one of, we will put down our weapons when they put down theirs. And right now, you are the best weapon that we have. Quite frankly, you have to look far and wide to find any weapons system in the United States that actually turns a profit for the U.S. taxpayer. Now, one of my concerns is that when you discharge your weapon in a crowded world economy, innocent bystanders in the U.S. economy are not damaged.

And, Chairman Hochberg, one specific example that I would like you to discuss is the unintended consequences specifically of loans and guarantees to foreign airlines to purchase U.S. airplanes. These arguably help U.S. exporters of airplanes, but potentially disadvantage U.S. airlines which do not have access to the same subsidized credit. And so my question is, in addition to specific comments on that situation, how do you generally handle this type of tradeoff, to understand whether a given transaction actually nets out positive for the U.S. economy?

Mr. HOCHBERG. Thank you, Congressman Foster, for giving me a chance to talk a little bit about that. When foreign airlines make a purchase of an aircraft, they generally have a choice between the Boeing company or Airbus. And soon, in the next several years—in this decade—we are going to see aircraft being produced by China, Japan, and Russia, and larger aircraft out of Canada. This is a very competitive market. So, when a foreign airline has a choice to make, they are going to—they are generally, today, choosing between Airbus and Boeing.

And the Airbus company, which was originally owned by four governments and is now less—more and more in private sector hands, but still owned largely by a number of European governments—has the export credit agencies of those countries backing that purchase. So I mentioned Ethiopian Airlines. When they are making a purchase, they look at the Airbus company and the financing that they get provided by either the country of Britain, France or Germany. And they are looking at the Boeing company and the financing that we would provide to Ethiopia to buy Boeing aircraft.

We level the playing field. We have put a floor so that no one entity can have lower financing costs than the other. What we are trying to do is avoid a race to the bottom. Try to avoid rogue financing, one-off financing. But simply say that is the basic financing. It is the same. Let the customer decide do they want a Boeing aircraft or an Airbus aircraft. And that is true whether it is Caterpillar or—large companies and small companies. We put a floor so we stop foreign countries from providing such low interest rates and such advantageous terms to disadvantaged U.S. companies and lose jobs in this country.

The second part of your question is, every single transaction we do at Ex-Im Bank we look at to make sure the benefits to our economy outweigh any harm. It is called economic impact. We sent a report to Congress, to this committee, in November. We implemented new procedures in April. We make an assessment, an estimate, what are the benefits, what is the potential harm? And make sure the benefits outweigh any potential harm. And that is what we do to make sure that what we are doing is helping the U.S. economy.

Mr. FOSTER. Do you often reject transactions because it nets our negative?

Mr. HOCHBERG. Generally speaking, that would certainly be a criteria for rejecting an application. We tend to work with the applicant. So we indicate that if that is going to be an outcome we will see if they can find some offsets or find ways that will not be the case so they don't have a flat-out rejection on that basis. But that certainly is a criteria that is reviewed, and it is reviewed for large transactions by our board, who is here today, who actually takes a very careful and independent look at every single transaction we do above a certain threshold.

Mr. FOSTER. And I guess in my remaining time, if you could just comment quickly on your exposure to sovereign defaults, which are a non-trivial issue these days. How do you have any experience with them? How do you intend to handle them? Where are you on the list of—

Mr. HOCHBERG. I would say a decade ago the vast majority of loans at Ex-Im Bank were to sovereign nations. Today, it is—it continues to decline. And the vast majority of our loans are actually backed by our private sector. In some cases, we obviously—if it is a—certain economies are weak we will require a sovereign guarantee to back a loan to give us greater security.

Mr. FOSTER. Okay. I guess I am out of time here, and I yield back.

Mr. HUIZENGA. And the gentleman's time has expired.

With that, we go to the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman. And thank you to the gentlemen for being here and for the information that you brought forward to us today. I want to start by going to the testimony of Mr. Hochberg, just really for my information. I am still trying to understand entirely how Ex-Im Bank does work. Not only—not just with companies here in the United States. But you mentioned in your testimony, and it is the purpose of Ex-Im Bank, that Ex-Im Bank also provides support, when necessary, to level the playing field when financing is provided by foreign governments to their companies who compete for export sales with U.S. exporters.

Could you expound on that a little bit more, and kind of maybe give us some examples of where, or how, you level the playing field?

Mr. HOCHBERG. I would be happy to. Actually, in your home State of Indiana, EMD, Electro-Motive Diesel, which is now a division of Caterpillar, is frequently competing to sell locomotives overseas. In particular, they—we are working with them on a potential transaction in Pakistan. The alternate bid is from China, which was providing exceedingly generous terms of their financing. We were able to learn of that financing and were able to match it.

In the interest of saying that—let the Pakistan rail authority decide between EMD or U.S.-made locomotives or Chinese locomotives, based on the quality, service, value and price, but not because they got cut-rate or one-off financing that could not be matched by the United States. So we were able to, in that case, level the playing field and let the rail authority decide which is the best locomotive suited to their needs.

Mr. STUTZMAN. Thank you. How aggressive is Ex-Im Bank in—do you operate like a traditional lender would, and with loan officers that are out pursuing business? Do you typically find companies that come to you are looking for help? How does that relationship start?

Mr. HOCHBERG. Frankly, both ways. Sometimes, the exporter comes to us because they are facing brutal foreign competition, and says, "We need to make sure we have a financing package to back our export." Sometime the importing entity—it could be a rail company or an airline or a small business—knows of us, and therefore will go to their exporter and say let's—can we get Ex-Im back in so we can complete this transaction. I cannot find the financing locally through conventional terms. So it is sometime the exporter, sometime it is the actual buyer overseas.

Mr. STUTZMAN. So will you ever partner with a traditional lender on a project, or not?

Mr. HOCHBERG. Oh, the vast majority of our loans are guaranteed—a partner with a conventional lender, where we will guarantee a loan. Frequently, if it is a large project, then maybe a portion of that is simply commercial. There would be a portion that might be guaranteed by the Ex-Im Bank. And frequently, we are co-financing with other export credit agencies from other countries around the world.

Mr. STUTZMAN. How do you—when you have an application in front of you, what sort of stress test measures do you all take? How do you start to—as you consider these sorts of opportunities, the taxpayer is backing—not funding, but backing. Is that correct? Do I understand that correctly? That it is the full faith and credit of the U.S. Government that backs the loans? What kind of stress test levels or measurements do you take to be sure that taxpayers aren't exposed to default?

Mr. HOCHBERG. As part of the underwriting process, we will look at a particular credit and make assessments of what if the outcomes vary from what is expected. What if the price of oil goes up? What if there is an interruption in service? It could be any of those different factors in a transaction. What if the supply chain is interrupted? So we will run a number of scenarios and stress tests to say if there is going to be sufficient cash generated in the project to meet the debt obligations so we have a reasonable assurance of repayment.

That has been the standard that Ex-Im Bank has been using for decades to ensure that there is a reasonable assurance of repayment before we would consider a loan. And those loans of over $10 million are evaluated by our independent board members. They are all here. There are two Republicans and two Democrats on that board who are independently assessing that to make sure that those standards are met.

Mr. STUTZMAN. Okay.

Thank you, Mr. Chairman. I yield back.

Mr. HUIZENGA. The gentleman yields back.

With that, we go to the gentleman from Delaware, Mr. Carney, for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman. It is a very interesting hearing. Thank you to the panelists for coming in today and for your expertise. Obviously, these are very important questions that the Members have posed today about the viability and usefulness of the Ex-Im Bank.

I would like to return for a moment first, though, to the comparisons with Fannie and Freddie, because I didn't find them helpful myself. And I would just like for you each to comment on whether or not there are any real comparisons there that we should keep in mind as we evaluate what the Ex-Im Bank does and the vulnerabilities there.

Mr. Hochberg, why don't we start with you?

Mr. HOCHBERG. Thank you for that question. I want to also thank Congressman Perlmutter for that question. They are entirely different entities. We operate in 160 countries; Fannie and Freddie operate in one country. We have no shareholders that we are accountable to in terms of paying dividends or increasing earnings. We don't pay any Wall Street-type bonuses. We don't have any concentration in one industry.

When I look at our portfolio—and, frankly, the 59 other export credit agencies around the world—we are largely lending to developing economies which have had better financial performance in the last several years. So it is convenient, but I don't think it is an accurate comparison to say that we are similar to Fannie and Freddie. Also, our portfolio is far smaller and is collateralized, that is independently assessed each and every year when we review our portfolio.

Mr. CARNEY. So in terms of the quality of the underwriting, is there any comparison? Would the IG or the GAO like to comment on that?

Mr. GRATACOS. In terms of the underwriting, we are talking about, obviously, different asset classes. The bigger exposure the Bank has is on the aircraft side, where you have collateral that historically has performed fairly well. We are more focused on how the portfolio is growing. It took the Bank 70-plus years to get $50 billion; it took them 4 years to get to $106 billion.

Mr. CARNEY. What is happening now and into the future?

Mr. GRATACOS. That is the concern.

Mr. CARNEY. Right.

Mr. GRATACOS. You are getting into more direct lending, credit finance.

Mr. CARNEY. In terms of how those loans are going to perform in the future?

Mr. GRATACOS. How those are going to perform in the future?

Mr. CARNEY. Right.

Mr. GRATACOS. It is hard to tell.

Mr. CARNEY. Mr. Scire?

Mr. SCIRE. The products are nowhere near the same. So given that, if there is any similarity here it is this idea of understanding what is a sufficient level of reserves, or capital, to withstand unexpected circumstances.

Mr. CARNEY. So is it your view that the reserves aren't adequate?

Mr. SCIRE. The reserves right now are set to provide sufficient coverage for expected losses. And so if some event were to happen which would affect some part of that portfolio that you may not expect or that history may not inform you about, you don't have reserves to cover that. That is why we talk about having, or presenting, doing stress testing and presenting a range of possibilities in terms of expected losses.

Mr. CARNEY. Okay, fair enough. So not much comparison there. Thank you for that. I do have a question about how you determine—you mentioned, Mr. Hochberg, that Ex-Im Bank fills in the gaps. How do you determine that it is a gap? It sounds to me, as you were talking about it with Mr. Stutzman, that it is more about leveling the playing field. But how do you determine that you are filling the gaps as opposed to making loans that the private banks could make?

Mr. HOCHBERG. Sometimes it is leveling the playing field, and sometimes we are called upon to fill a gap. We recently made—

Mr. CARNEY. Do you have a sense as to what that distribution is? How much it is leveling the playing field and how much it is filling a gap?

Mr. HOCHBERG. We ask that question on our application. That information is now provided in our annual report. There is a code whether an application was—whether a loan was made to fill a gap or to meet the competition or to level the playing field in that regard. So we do look at that on a regular basis and report that publicly in our annual report and to Congress. So there is—I don't have the precise breakdown in my memory, but I can certainly get that.

Mr. CARNEY. We could get that.

Mr. HOCHBERG. Yes, of course we can get that. But sometimes, it is filling a gap. I will give you an example. We made a loan to Kazakhstan Rail to purchase locomotives that are made in Pennsylvania. When we go to the market, we work with the actual borrower. And they will often send us one bank that will make the loan, and we can verify it. And they will only make the loan with our guarantee. That gives me a pretty good indication. If they have five or six banks that are willing to make the loan, perhaps one of them would do it without our guarantee. And that is part of the conversation we have.

We are continually trying to talk clients out of using us. We would like to be used as little as possible. We have a precious amount—

Mr. CARNEY. Thank you. My time has expired. Thanks very much.

Mr. HUIZENGA. The gentleman's time has expired.

With that, we go to Mr. Cotton for 5 minutes.

Mr. COTTON. Thank you, Mr. Chairman. Before I get to my questions, I would just like to correct something for the record that the gentleman from Colorado said earlier. He accused my colleague from South Carolina of coming out of left field. If I know anything about Mr. Mulvaney, he only comes out of right field in this Congress.

Mr. HUIZENGA. Point taken.

Mr. COTTON. Mr. Inspector General, you, in your report on portfolio risk, argue that the Bank lacks a comprehensive risk management framework. You have several recommendations: one, establish a Chief Risk Officer or risk management office, with independent reporting requirements; two, have qualified, experienced staff; three, have periodic stress testing of the portfolio; and four, actively monitor industry geographic exposure levels in lending. I would like to focus in on a couple of these. Can you elaborate on why you think the Bank needs to create a Chief Risk Officer?

Mr. GRATACOS. For two reasons. The first is best practices. We learned this from the last several years. We have a number of institutions and organizations expressing this as one of the important elements of risk management. We have the—

Mr. HUIZENGA. Mr. Gratacos, can you pull the microphone closer to you?

Mr. GRATACOS. Yes. We have the international association of certified portfolio managers, we have guidance from the Federal Reserve, we have OMB Circular 129, all these different organizations and guidance are an important element of risk management. We think that an independent Chief Risk Officer from—independent from business function is important, given where we are going in terms of the portfolio.

Mr. COTTON. Okay. Mr. Chairman, so far you have not implemented this recommendation to create a Chief Risk Officer. Could you explain, and perhaps respond to the Inspector General?

Mr. HOCHBERG. I will be happy to. First, I mentioned in my opening oral testimony that we are moving in that direction. I am looking to fill that position this year. We work very closely with the Inspector General's office. As I mentioned, Osvaldo and I meet on a regular basis to review his concerns, and his findings before they come out in a full report. Because I think both of us are dedicated to continuous improvement at the Bank.

He made a recommendation, his office made a recommendation, about a Chief Risk Officer. We took that to heart. I have been meeting with my colleagues around the world in terms of how they operate their export credit agencies. We have talked to other credit agencies in Washington. That is why, a few months ago, I asked for an enterprise risk committee that would be look across the entire Bank. Not just credit risk or portfolio risk, but look at IT risk, human capital. Look at the full range of risk, and then have, as running that, someone who has the function of a Chief Risk Officer who is outside of the actual transaction underwriting side of the Bank.

Mr. COTTON. So we can expect to see the creation and appointment of a Chief Risk Officer in—

Mr. HOCHBERG. We are going to be identifying the Chief Risk Officer so that is clear, and that person will then be reporting to me. And the enterprise risk committee and the Chief Risk Officer will be meeting with our independent audit committee twice a year.

Mr. COTTON. In 2013?

Mr. HOCHBERG. My goal is to get it completed this fiscal year. It may be this calendar year, but my goal is to get it between fiscal and calendar year.

Mr. COTTON. Mr. Inspector General, back to you. Is this satisfactory, in light of what you have recommended in your reports?

Mr. GRATACOS. We will see. It is not the title; it is a function. So we will have to see how it is established and what are the authorities that the position will have. And then, we will take a look.

Mr. HOCHBERG. I think, actually, if I can add, the Inspector General is exactly right. This is not about just everybody feeling good, we checked the box and we put somebody on the job. It is about an enterprise risk committee, which is made up of—is it going to be co-chaired or co-secretary? Have two career people in the Bank who are going to be looking across the entire Bank at all possible areas of risk where the outcome is different than expected. That is what risk is: where the outcome is different than expected, better or worse.

Mr. COTTON. I take your point that a title is not necessarily what you need. You need functions, whether those functions are performed by one person without a title and staff, or performed by a board or a committee of those people. I think, Mr. Inspector General, you referenced Circular alpha-129 in your response earlier. Is that correct?

Mr. GRATACOS. Correct.

Mr. COTTON. Now, that document says that representation in a kind of credit management program should include, but not be limited to, an agency CFO and the Chief Risk Officer. Do you think it is satisfactory, and either could answer, to not have a Chief Risk Officer in light of President Obama's OMB circular alpha-129?

Mr. GRATACOS. That is to me? Yes, if you look at the other aspects of A-129, which is section B, it talks about credit program management. And it specifically states that it should develop oversight and risk assessment officially independent from the program functions. That is kind of like the trickle down from your conversation. So if it is set up in a way that is independent, so they can look at the portfolio rates and they can communicate without influence back to the front end and the business folks, then I think we will move in that direction.

Mr. COTTON. Mr. Chairman, do you agree?

Mr. HOCHBERG. It is independent today. The credit policy and CFO is totally independent from underwriting.

Mr. COTTON. Thank you both for your answers and time.

Mr. HUIZENGA. The Chair was being generous with that challenge of time. But with that, we will go to my other colleague from Michigan who serves on this subcommittee, Mr. Kildee, for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. I would like to just take a couple of minutes and follow up with Mr. Scire on—is that the correct pronunciation, by the way?

Mr. SCIRE. Yes.

Mr. KILDEE. Thank you. On Mr. Perlmutter's question, and on the point of left field to right field, I hope that this is something that we can keep in mind as we have tonight's congressional baseball game. I assume that we can instruct our hitters to hit into left field because you won't have anybody standing there. Is that right? [laughter]

Mr. HUIZENGA. Now, the chairman has to step in. We always cover our left flank, but we will tend to hit it into the right field.

Mr. HOCHBERG. Usually Senator Paul plays left field.

Mr. KILDEE. Thank you. So I think you did acknowledge that of the existing performance that the default rate was relatively modest compared to other benchmarks. I won't try to do the math that Mr. Perlmutter did. But that you did indicate—and this is where I want to have you make some further comment—that because of the life of the existing portfolio, or the lack of maturity in the existing portfolio, that there was built-in risk that has yet to be realized. Could you explain to me what you mean by that?

In other words, is it something about the structure of the loans, the characteristic of the guarantee that is being provided relative to other risk. Or is it something about the characteristics of the loan recipients or those being guaranteed themselves? In other words, the sectors that are being invested in, or the companies that we are engaged with, or the underwriting process itself, or something about the political or economic environment. I guess what I am trying to get at is, what is it about the current portfolio and the characteristics of those that are yet to be mature that you can point to that clearly distinguishes them as—in the aggregate because that is how the risk is measured, from the 79-year history of the Ex-Im Bank.

It would be helpful to get a sense of why you have a greater concern about that sector or that section of the loan portfolio or the guarantee portfolio. And I would actually ask Mr. Hochberg, immediately following to respond, if you could, as well.

Mr. SCIRE. I hope you will find my answers coming from center field, but the point that I am trying to make there is that there is uncertainty. And the history will tell you, if everything plays out in the future exactly as it did in the past, and all your data from historical experience is applied, then you will get that outcome. But you can never be certain that is the case. And so that is why you would want to do some sort of stress testing to see, well, what if history doesn't follow through.

And so even though you have had this history without much default, we don't know what possibly could happen in the future. And we happen to be at a point in time where we have a really big, young portfolio.

Mr. KILDEE. So is it then the size of the portfolio that is the primary concern? Because that—I guess at any point in time during the 79-year history there were loans that were new that had performed.

Mr. SCIRE. Right.

Mr. KILDEE. And those that have been completed. So guess I understand theoretically the point, but what I am trying to get at is, just because, as I see it, there is a clear need that is being filled. This is one of these cases where it is almost as if we are sort of penalizing, or some are criticizing the Bank for being too successful at doing what we have charged them to do. Is it the fact that there is something unique about the current practices or the current loans or the environment, political or otherwise, that these loans are being made in that distinguished them from past loans?

That we can say yes, that we should assume that there is a greater risk. Something other than just having a higher level of activity and a higher—or a larger portfolio?

Mr. SCIRE. Let's take an example. You could have some sort of global event that could affect these credits. Something that we haven't seen before.

Mr. KILDEE. Like World War II or something like that?

Mr. SCIRE. I won't—I can't describe what it might be. But the point is that you can never be certain about these. And so that is why we argue for presenting a range of estimates here so that you can understand the potential outcomes. And it is a little bit more important, in a way, when you are talking about Federal credit programs because the estimates that you are providing in terms of credit subsidy and cost for these programs is based upon a baseline.

And so it would be worthwhile to take a look to see what a divergence from that baseline might mean in terms of potential losses.

Mr. KILDEE. And I know I am out of time, so if Mr. Hochberg can answer that at some other point in time during the other questioning, or provide an answer to me in writing, I would appreciate it. Thank you.

Mr. HUIZENGA. The chairman is at liberty to write you an answer on that. So, thank you.

With that, we will go to the gentleman from Florida, Mr. Murphy, for 5 minutes.

Mr. MURPHY. Thank you, Mr. Chairman, and Mr. Ranking Member, and thank you to all the witnesses for taking the time to be here with us today. Chairman Hochberg, I understand part of the criteria for you all is to help support small businesses and companies in the renewable energy sector. Looking forward a little bit, what are some of the plans to boost some of these small businesses and renewables so they have more opportunities?

Mr. HOCHBERG. Thank you for giving me a chance to talk a little bit about our small business portfolio. We have had a lot of focus on risk, but our job is to create jobs in the U.S. economy and support them. And small businesses are a key component to that, and making sure that they compete globally.

We are developing one product—to give you an example, we have a product called Express Insurance. This is for small businesses that need credit insurance. So when they sell to a customer in Singapore, Costa Rica, or so forth, we insure that transaction.

They make an application. It is a one-page application. We respond in 5 days. And we have, so far, in the last—we have now written over 600 policies. The Kennedy School of Government actually thought so highly of this we got an innovation in government award in terms of meeting the needs of small business and doing a very fast turnaround time.

Mr. MURPHY. So this is an—you are insuring each transaction?

Mr. HOCHBERG. We are insuring—when a small business—an example of that actually was on television recently, called Jennie's Pickles. When they sell their pickles to China, we can guarantee that transaction. So if their customer there doesn't pay, they don't have to go hire a lawyer to collect. We will make good on the transaction, and then we will go and collect on their behalf.

Mr. MURPHY. And what about for renewable energy companies?

Mr. HOCHBERG. Renewable energy, our portfolio—our underwriting annually is up tenfold since 2008. It is more in solar; solar and wind are the two predominate ones. We have done a lot of wind in Latin America, and we were the dominant financier of solar power into India in 2011. That market has cooled a little bit, but that is a focus of the Bank. It is a congressional mandate.

We have a team of people who work with the renewable energy companies in this country. So when they go to market, they understand that—and they are trying to compete against China, in particular. But other foreign nations, if they need our backing to help finance that transaction, we are there for them.

Mr. MURPHY. Switching gears a little bit, can you talk about how you monitor some of the transactions over a million dollars from the steps you take?

Mr. HOCHBERG. Yes, of course. We monitor all transactions on a regular basis with an asset monitoring division. And transactions from a million dollars and up are evaluated. We review financials, sometime we make site visits. And at the end of each fiscal year, we do a mark-to-market. We look at each—we look at the transactions and make an evaluation whether the credit has improved or eroded, and therefore adjust what is called "the budget cost level," or adjust our reserves accordingly.

If the credit has declined, we will add reserves to make sure that we are sufficiently reserved. And if it is improved, we will release reserves. And that we do in accordance with our accounting office and is signed off on by Deloitte & Touche.

Mr. MURPHY. Okay. Mr. Gratacos and Mr. Scire, can you comment on these transactions over a million dollars, and if you are satisfied with their monitoring of them?

Mr. GRATACOS. We have issued a few reports on specific programs and aspects of the monitoring insurance transactions. Like we did an audit last year on the short-term insurance program, and we found some issues that we elevated to the Bank, and the Bank has been working on. And implemented the bulk of the recommendations. Now, our concern is moving forward with direct loans. Even though they are underwritten as a guarantee in the portfolio, some of them are custom—types.

There are lot of local customs involved. And so our question now is what mechanism the Bank has in place to make sure that they can verify invoices coming in from the field and massive construction product finance. That is the aspect of monitoring that we are paying attention to, given the growth and given the outstanding disbursements there are in the pipelines, are going to be disbursed in the future, which ties in with the risk management in the maturity default rate that the IG is talking about. So in that sense, that has been—that is our focus.

Mr. MURPHY. Let me just cut you off. Mr. Scire, what are your thoughts?

Mr. SCIRE. We looked at their monitoring process, and it seemed to follow what you might expect in a credit program. And so I think I defer more to the detailed analysis that the IG has done.

Mr. MURPHY. All right, thank you. I yield back my time.

Mr. HUIZENGA. The gentleman yields back.

With that, we have a guest to the subcommittee that we are going to also recognize for 5 minutes, Mr. Heck from Washington.

Mr. HECK. Thank you very much, Mr. Chairman.

Mr. Hochberg, first, congratulations on your near unanimous vote of confidence from the recommending committee in the Senate a couple of weeks ago. That bodes well for you, the Ex-Im, and America. Congratulations, thus far.

You indicated in your written testimony that Ex-Im had not been the recipient of any taxpayer support for its operations in the last year. In fact, Mr. Hochberg, over the course of your 4-year tenure, have you received any taxpayer support to subsidize your operations or, in fact, to use popular lexicon, to "bail out" failed loans?

Mr. HOCHBERG. We have not. We are self-sustaining, and that is a requirement of WTO in order to be—we have no subsidized export support.

Mr. HECK. No taxpayer support, coming off the worst global recession in 80 years.

Mr. HOCHBERG. That is correct. No taxpayer support.

Mr. HECK. Would it be decently fair, Mr. Hochberg, to, following the money trail, suggest that it is, in fact, foreign customers, through the fee structure and loan repayment, who are subsidizing the Export-Import Bank, whose purpose it is to create American jobs?

Mr. HOCHBERG. Yes, foreign customers are actually paying, through fees and interest—is what we use to run the Bank, to run the administrative costs and to fund our loan loss reserves. And the $1.6 billion that we turned over to Treasury in essentially excess revenue.

Mr. HECK. We send them our gratitude. Thank you. Several decades ago, I had the privilege to serve in the Washington State Legislature. I found myself in a bit of a tiff with the leader of organized labor in our State. And during the argument, when I suggested to him that what he was advocating was not in the best interest of organized labor—and he looked me right in the eye, this was several decades ago, and he said, "Young man, it is not your job to define our self-interest. That is my job." And I think he was right.

I ultimately had the decision on the policy, but it was his job. Mr. Hochberg, it has been suggested here that the existence of the Export-Import Bank disrupts the market, that it is crowding out private financing, that it is in some fashion injurious to the private sector. So I ask you, sir, to enlighten us. For those whose job it is to define the best interest of the private sector—such as the United States Chamber of Commerce and the American Bankers Association—what is their view of the relative merits of the existence of the Export-Import Bank?

Mr. HOCHBERG. We enjoy strong support from the Chamber of Commerce, the National Association of Manufacturers, and many labor unions, as well as the Council for Employment through Exports. The private sector that people talk about, you have to understand the private sector is really the government of China, the government of Japan, the government of Korea. That is who U.S. companies are competing against continually to make sales and keep jobs in our country.

So it is not just another small banker in the adjacent town that would make the loan. What we are dealing with is—continually is, we have foreign governments, state-directed capitalism, that is very much focused on defending the national interest of other nations against job creation in our country.

Mr. HECK. Great segue. And in my time remaining, I would like to follow up on that very point. Namely, I don't think there has been enough said here today about what it is that other countries are doing in the way of credit guarantees or credit assurances for their businesses to compete in the global economy. Is there any way that you can capsulize, distill the relative participation by other civilized and industrialized countries? And especially those who are emerging, and with whom we are directly competing, in effect, for the creation of jobs in America?

Mr. HOCHBERG. We issue a competitiveness report that will be coming to Congress at the end of this month. We do that annually. It assesses the export credit, Export-Import Bank versus other export credit agencies around the world. In sum, we have one of the smallest footprints and most limited engagement with exports in our economy than almost any other developed economy in the world. Far less than that large, gargantuan neighbor to the north, Canada, which has a much larger export credit agency than we do.

And more importantly, just to quickly add, the real problem is countries that are outside of the OECD, outside of the framework, because they are free to do any kind of loan for any reason at any amount at any term. Countries such as—China is not a member, Brazil is not a member, Russia is not a member, although they are looking to be, and India. So, those four BRICs are totally outside of the system and, therefore, not controlled whatsoever.

Mr. HECK. Thank you, Mr. Hochberg. And thank you, Mr. Chairman, very much for allowing me to participate.

Mr. HUIZENGA. You are very welcome.

With that, we have gone through our first round. If you gentleman are open to it, we have some interest in doing a second round. Obviously a bit more diminished, but if that is okay, we would like to proceed with that. And I will start off by recognizing myself for 5 minutes.

I should note that we had tried to get the Treasury Department to join us here, as well, today during the last reauthorization. One of the directives was to have the Treasury start negotiations to end—or to certainly reduce and then, ultimately, end these types of programs that are happening. Apparently, Treasury would not come, or was not willing to come and testify today. It is disappointing to me that would happen.

But Mr. Hochberg, I do have something that I—a couple of things I want to pursue with you a little bit. One is the independent Chief Risk Officer that you are talking about. I want to make sure that there is an independence there. Having someone, as was alluded by Mr. Gratacos and others, having an operation like this, you are not running a pizza parlor or a taco stand or—this is hundreds of billions of dollars that we are dealing with.

And there is a tremendous number of issues here that we have to make sure that whoever is appointed—and I think you said you were "looking to fill this year," 6 months after the directive from this—I believe, as my military friend referred to it, alpha-129 directive, that came from the White House. It is my assumption, and I want reassurances that this person and department will be independent, will be properly staffed, and that they will have access, independent access, to the board.

You had made some sort of remark regarding the Inspector General that should have gone over some of these materials, some of these recommendations first. And it seems to me that they shouldn't be doing that. The idea of Mr. Gratacos is to have him be independent, and to make sure that those recommendations come out; not before they are cleared with you or anybody else, but that they are being cleared. Maybe I misheard you.

But it seems to me that when we are dealing with meaty issues like this, we have to make sure that Mr. Gratacos or Mr. Scire or anybody else has the independence that they need. And I am assuming, OMB, you would agree with that. Wanting to make sure that there is—I don't want to put words in your mouth. I am just assuming you want to make sure that you are not being influenced or having to run anything through anybody.

Mr. SCIRE. Absolutely.

Mr. HUIZENGA. Okay. In my remaining time, we have kind of gone over this. It is not a title; it is a function. I think that is going to be very important. So I am satisfied, unless Mr. Hochberg, you have anything quickly you would like to add to that, or any insight you can give as to what your timing and what the structure of this office is going to look like.

Mr. HOCHBERG. I think if I understand our Inspector General correctly—and he will correct me if I am wrong—is the risk management needs to be independent of the underwriting. And that is exactly the way it is today, is a credit policy committee that determines what is the risk level if you are doing a transaction in one country or another. They determine the risk profile from a policy point of view. The underwriters then use that to make underwriting assessments and decisions. And then they are independently monitored by a chief financial officer.

So there is independence out of—from both—on the front end in terms of policy, and on the back end in terms of the CFO.

Mr. HUIZENGA. Okay.

Mr. HOCHBERG. The criticism that was made by our Inspector General is, they preferred that one person be in charge of that. And so the change is that there is going to be—those two strains will be reporting to a central office that will therefore make sure that there is tight coordination between it. Before—up to now—

Mr. HUIZENGA. All right, I have 1 minute remaining, and I want to hit one other issue. And we can talk more about that. I am curious, how big of a risk is Emirates Air? Are they able to get credit on the open market?

Mr. HOCHBERG. They get some credit on the open market.

Mr. HUIZENGA. Or maybe pay cash?

Mr. HOCHBERG. They don't pay cash. I haven't seen an—the last time an airline paid cash was in China, and they have stopped paying cash, as well.

Mr. HUIZENGA. Okay. It just strikes me, if we are bankrolling groups like Emirates Air, who are buying Airbus as well as Boeing, aren't we starting to help finance competition against U.S. airlines?

Mr. HOCHBERG. The choice Emirates has is to buy an Airbus plane or a Boeing plane. And, sir, I am happier when they buy a Boeing plane, and in the cases where we need to provide offsetting financing, which is the same financing that Airbus is offering so that we keep the jobs in the State of Washington, in the State of South Carolina, and in 48 other States. That is important.

Mr. HUIZENGA. We know that companies like Emirates—Emirates has announced that it wants to be a global-dominant leader in that. And if your directive is to make sure that we are protecting U.S. jobs, we ought to make sure that in this balance, and what was pursued by some of my colleagues over on the other side, as well, is that we weigh that out on both not just the manufacturing side, but how it is going to affect the others. My time is up. I have to be fair to all. So I am sure we will continue this conversation.

With that, Mr. Clay for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. And following in that same vein of inquiry as Mr. Huizenga, Chairman Hochberg, there has been a lot of press about aircraft financing and assertions by some domestic carriers that Ex-Im support puts them at a competitive disadvantage. However, from what I gather, the Organization for Economic Cooperation and Development recently raised the rates on official export credit for commercial aircraft transactions.

Can you explain the OECD process, and is there an un-level playing field for U.S. carriers, in your opinion?

Mr. HOCHBERG. I would be happy to. And frankly, this relates to Chairman Huizenga's question, as well. We evaluate on every transaction, including aircraft, what are the benefits to the U.S. economy versus if there are any offsets or harm to the U.S. economy. As a result of our last reauthorization, we hired an independent outside firm to evaluate if there was an oversupply in the aircraft sector. And the conclusion was there is not.

We use the same criteria for aircraft seats or services that we do for any other industrial product, which is that—what the capacity levels of that are. So we make that evaluation on a single transaction basis. Chairman Huizenga, you have talked about a concern about Emirates. There is a recent press article by Richard Anderson of Delta Airlines, who has been a critic of the Bank. And he quotes that Delta had quite a profitable year, and 2013 will be the fourth year in a row of significant profitability.

Today, Delta is the most profitable airline in the United States, if not the most profitable airline in the world. So it is hard to fully understand the crying wolf that Delta Airlines has made about this issue that they are being unfairly competed against by other airlines, when their chairman of the board makes those kind of statements about their profitability and their use of export credit agencies.

The OECD, quickly, does—has mandated, and we work closely with them to do so, to raise the fees that airlines pay. So an airline will pay, depending on their creditworthiness, some—generally speaking, between about 8 percentage points to 15 percentage points for the privilege of borrowing money through our guarantee program. So on a $100 million loan, they are going to pay points, like you pay on a mortgage, between $8 million and $15 million to get that loan.

I promise you, if they can find it cheaper or better someplace else, they are doing so. That is why we raised the rates, to make sure there was capacity to keep the flow of trade and keep jobs in the United States. Not in any way to displace the private sector or in any way to advantage a foreign carrier over a domestic carrier.

Mr. CLAY. Let me follow up. I believe that U.S. domestic carriers are not able to access export credit assistance from Ex-Im. However, can you tell me, Chairman Hochberg, are U.S. domestic carriers able to access export credit assistance from other governments? And if so, to what extent?

Mr. HOCHBERG. Two things happen. One, and let's—since we are talking about Delta, I will continue with Delta. Delta actively uses export credit agency support from both Brazil and Canada. They have purchased over $4 billion worth of aircraft with the assistance of those two governments to supply them with regional jets. Furthermore, Delta has a—technical services, where they overhaul engines in Atlanta, a tour I made with Richard Anderson.

When they sell those services to foreign carriers, such as Gol which they also shareholder in, we actually financed that purchase. So in that case, Delta is using the export credit agency in the United States, the Ex-Im Bank, to finance their sales of technical services, employing people in Atlanta. They do that with Gol, they do that with Aeromexico.

Lastly, to your other question, is, the United States—this is the most rich and the most efficient capital markets in the world. U.S. carriers generally use something called "EETC, Enhanced Equipment Trust Certificates." That is the primary way they finance their aircraft. Each time a U.S. carrier makes that purchase, we compare what they pay with what a similar carrier with a similar credit profile would pay under our program. Because we want to make sure we are not underpricing.

We actually adjust our rates every 90 days to make sure they are at market and not providing an undue advantage to a foreign carry.

Mr. CLAY. Thank you so much for those responses.

And I will yield back the balance of my time.

Mr. HUIZENGA. The ranking member yields back.

With that, I think this is going to be our last question. We will try to get you out as close as we can here, at noon. Mr. Stutzman, from Indiana, has 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman. I guess I would kind of like to follow up on the airline lending and the relationship between Ex-Im and the airline industry. I guess, first of all, let me ask this. When Mr. Murphy asked about their small business portfolio, you brightened up. And I was glad to see that because I think that is something you are passionate about. And as a small business owner, I appreciate that because I know how difficult it is as a small business owner.

Do you think—is there a cap on—to limit a company to a certain amount in lending that Ex-Im currently has now?

Mr. HOCHBERG. We have no self-imposed caps. The only cap would be what is a reasonable assurance of repayment. We don't want to lend someone more money than they can reasonably pay us back.

Mr. STUTZMAN. Should there be a cap?

Mr. HOCHBERG. I think the cap is really—there is—I don't think there should be any preordained cap. What we want to do is make sure that the credit is there. We are there to fill a gap. So if, for some reason, they aren't able to secure it through the private sector, that is what we—that is why Congress created us. That is what our mission is, is to make sure that jobs are created in the United States and that we fill in that gap. So we are not going to lend somebody more money than can reasonably repay.

Mr. STUTZMAN. But here is my concern, that you look at the top 10 companies that are beneficiaries that Ex-Im Bank loans to. Just the top 2 take 65 percent of the total revenue that is loaned out, or the total lending that is loaned out in guarantees by Ex-Im Bank. And you mentioned Delta. And it looks like the—and I am just going by what I read. But it looks like Delta was complaining, but now they are involved in the Brazilian Airline deal.

When is the next company going to come along and complain? But if they are getting a piece of the pie, at some point, then they are going to be happy. And we are just—this is just going to continue to snowball. And then this only becomes a larger liability, or a larger—the program is larger than what it ever was intended to be. And that is my concern, that you have just several large companies that are the real beneficiaries to the Ex-Im Bank.

Mr. HOCHBERG. What I have learned in 4 years as president and chairman of the Bank is that our portfolio is somewhat like a barbell. We have a large concentration of small businesses that have a very hard time getting access to credit. And at the other end of the spectrum is heavy capital goods. It is things such as satellites, aircraft, locomotives, power plants, nuclear power, mining equipment. So the—and, frankly, that parallels, Congressman, what I see when I talk to my counterparts in Germany or France, and Japan. It is heavy capital equipment and small business.

Mr. STUTZMAN. Mr. Scire, I would like to ask you that same question. Should there be a cap to lending by Ex-Im Bank?

Mr. SCIRE. So this would follow along the lines of having some soft portfolio limit.

Mr. STUTZMAN. Can you pull that microphone a little closer, please, Mr. Scire? Thanks.

Mr. SCIRE. This would follow along the lines of a principle that you would find in, for example, the soft portfolio limits. And we think that makes sense. So it may not necessarily be a hard cap, but something that would cause you to give even more critical attention to underwriting and understanding the risk that might present.

Mr. STUTZMAN. Do you think that Ex-Im Bank is too dependent on some of the larger companies?

Mr. SCIRE. We haven't done the analysis that would permit us to answer that question. It you have a portfolio that is focused on a single company or is heavily influenced by a single company, that presents an additional kind of risk that you would want to therefore manage.

Mr. STUTZMAN. Thank you.

I yield back.

Mr. HUIZENGA. The gentleman yields back. And with that, I would like to thank our witnesses. You have been very generous with your time and your knowledge.

Mr. Ranking Member, yes?

Mr. CLAY. Mr. Chairman, I just wanted to include for the record a question that I was unable to ask. I would like to submit it in writing today.

Mr. HUIZENGA. Without objection, it is so ordered.

Mr. CLAY. Thank you.

Mr. HUIZENGA. You are welcome. So as we are concluding here, I would like to thank each of you for your time and your knowledge that you have been sharing with us.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]

A P P E N D I X

June 13, 2013

Statement of the Honorable Osvaldo Luis Gratacós

Inspector General

Export-Import Bank of the United States

before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Monetary Policy & Trade

June 13, 2013 at 10:00 am

Good morning, Chairman Campbell, Ranking Member Clay, and distinguished members of this honorable Subcommittee.

Thank you for the invitation and opportunity to testify before you about the activities of the Office of Inspector General (OIG) and the programs and operations of Export-Import Bank (Ex-Im Bank) as it relates to Export-Import Bank oversight. Before I continue, I would like to thank the Almighty for this opportunity, my family, and the members of the Ex-Im OIG staff for their hard work.

I. Ex-Im Bank

Ex-Im Bank is the official export credit agency (ECA) of the United States. It supports the financing of U.S. goods and services in international markets, turning export opportunities into actual sales that help U.S. companies of all sizes create and maintain jobs in the United States. Ex-Im Bank has programs to address short, medium, and long-term needs of exporters; assuming the credit and country risks that the private sector is unable or unwilling to accept. Ex-Im Bank also helps U.S. exporters remain competitive by countering the export financing provided by foreign governments on behalf of foreign companies. At the same time, Ex-Im Bank must safeguard taxpayer resources by determining that there is a reasonable likelihood of repayment with respect to each of its transactions.

Ex-Im Bank is experiencing unprecedented growth – achieving three straight years of record authorization levels. In FY 2012, Ex-Im Bank authorized over $35 billion in export transactions – a new record high. This is in addition to the previous record high of $32 billion in FY 2011. Further, Ex-Im Bank's portfolio has increased by 82% since 2008 ($58.4 billion in FY 2008 vs. $106.6 billion in FY 2012). In the current Charter, Ex-Im Bank has authority to approve up to $140 billion in export transactions.

Naturally, this rapid growth in Ex-Im Bank's total portfolio exposure raises concerns as to Ex-Im's ability to manage this significant portfolio growth. Below in section III, we highlight some of the risks, observations, and challenges Ex-Im Bank faces as it continues this upward trend.

II. Ex-Im OIG

Ex-Im Bank OIG was statutorily created in 2002[1], but the Inspector General did not officially take office until August 2007. The OIG has achieved noticeable success in performing its statutory duties. Specifically, since FY 2008, the OIG has issued thirty-nine (39) audit and special reports containing one hundred and sixty-five (165) findings, recommendations, and suggestions for improving Ex-Im Bank programs and operations. Our investigative efforts have resulted in a number of law enforcement actions, including: sixty-seven (67) indictments and informations; thirty-two (32) convictions, thirty-five (35) guilty pleas entered in court; over three hundred and ninety-eight (398) management referrals for enhanced due diligence actions; and approximately $200 million in court imposed restitution, forfeitures, repayments, and cost savings efforts. All of this has been accomplished with a very modest annual budget of $4 million a year (since FY 2012) and a staff of twenty-one professionals.

[1] Export-Import Bank Reauthorization Act of 2002, P.L. 107-189, Sec 22 (June 14, 2002).

III. Operational Areas – Risks, Observations and Challenges

In order to manage its growing portfolio and to better meet export credit needs of the American exporters, it is our opinion that Ex-Im Bank needs to address some operational weaknesses and challenges it is facing. We believe that addressing these operational weaknesses and challenges would provide Ex-Im Bank with a more efficient and prudent capability to create and maintain jobs in the United States. Some of the most important risks, observations, and challenges Ex-Im Bank needs to address are:

- *Inefficient and Ineffective Information Technology (IT) Platform.* Ex-Im Bank still uses an ineffective, inefficient, and fragmented IT platform and infrastructure composed of several legacy systems and databases. These systems and databases do not effectively and accurately interface with each other – compromising data integrity, creating duplicative information, and creating unreliable files. Further, these systems make data mining burdensome and time consuming. Since 2012, Ex-Im Bank is engaging in an IT infrastructure modernization effort focused on replacing legacy systems and improving quality and access of its data. Under the Total Enterprise Modernization (TEM) initiative, Ex-Im is working on updating its IT infrastructure and streamlining its processes. The OIG will closely monitor this effort as new IT systems are rolled out to the staff in the future.
    - Ex-Im Bank lacks an end-to-end IT system that allows for seamless management of applications/files and flow of information within Ex-Im Bank and would allow different components within Ex-Im Bank to work on the same files at the same time from the same platform.
    - Ex-Im Bank lacks a comprehensive participant database that would allow it to capture and track all the participants (lenders, buyers, exporters, suppliers, brokers, agents, business references and others) involved at different transactions at any given moment in time. This weakness prevents Ex-Im Bank and our office from conducting effective forensic analysis to identify possible patterns in transactions.

- Because the IT platforms do not fully meet business and operational needs, Ex-Im Bank divisions and components have created subsequent data sub-systems to address the specific needs of that office or division. Some of these sub-systems require manual input of data and do not interface with Ex-Im Bank's main IT infrastructure creating additional data repositories.
- The above described IT system fragmentation creates a number of operational consequences for the Ex-Im Bank:
    - Unnecessary delays in approval of transactions;
    - data integrity issues (due to manual input or updates of data); and
    - Multiple data storage locations.

➢ *Develop a More Comprehensive Risk Management Framework to Manage Portfolio Risk and Monitor Market Trends*. Ex-Im Bank should enact a more proactive way to manage the risk of its growing portfolio in line with industry best practices. With the rapid growth of its portfolio – over $35 billion on undisbursed commitments as of end of FY 2012 – and decentralized risk management functions assigned to several parts of the organization, it will be prudent for Ex-Im Bank to develop a more comprehensive, centralized, risk management framework that is parallels commensurate with the growth of its portfolio. Specifically, Ex-Im Bank should:

- Establish a Chief Risk Officer or create a risk management office independent of program management as proposed by OMB Circular A-129, Section III.B.1.a.iii (Risk Management);
- Assign qualified and experienced staff to that office;
- Conduct periodic stress testing on its entire portfolio reflecting different market scenarios;
- Continue to refine its loss reserve allocation model; and

- Actively monitor industry, geographic, and obligor exposure levels or risk thresholds or indicators as proposed by OMB Circular A-129, Section III.B.1.a.ii (Performance and Other Indicators and Risk Thresholds).

➢ *Human Capital Planning and Resources*. In past Semiannual Reports to Congress, we have identified human capital planning and resources as one of the Management Challenges Ex-Im Bank is facing. While Ex-Im Bank's portfolio has increased by 82% since FY 2008, its staff has increased less than 11% in the same period (from 352 to 390).[2] Ex-Im Bank's portfolio growth strains Ex-Im Bank's resources in its underwriting but also in the asset monitoring function. This is particularly relevant given Ex-Im Bank's undisbursed but approved amounts as of the end of FY 2012 ($35 billion) mostly on project finance and direct loans.

➢ *Develop Performance Standards and Metrics for Programs and Products*. Ex-Im Bank has not developed annual performance plans or product performance metrics in order to properly quantify the effect and success of its products. Ex-Im Bank should develop these metrics in short and medium term products in order to determine whether:

- the product is achieving the intended results
- the product is reaching the intended audience
- the marketing strategy is effective
- the product is similar or more competitive than programs offered by other ECAs
- the product should be altered or eliminated
- acceptable levels of defaults and claims have been established
- levels of defaults and claims should be improved
- changes in original implementation strategies are needed

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[2] *Export-Import Bank: Additional Analysis and Information Could Better Inform Congress on Exposure, Risk, and Resources.* GAO-13-620 (May 2013), p. 28.

- *Continue Efforts to Expand Small Business Participation*. Ex-Im Bank's charter dictates a twenty (20) percent small business participation goal of all of the authorizations every year. Ex-Im Bank has provided record small business financing in the last two years. However, this financing has not reached the Charter goal of 20%.
- *Continue Efforts to Expand Renewable Energy Products and Create Clean Energy Export Opportunities*. Congress has set a Renewable Energy mandate of ten (10) percent of all the authorizations every year. Ex-Im Bank has not met this goal yet, mainly because the renewable energy exports have not reached significant numbers (compared with the size of Ex-Im Bank's portfolio). Nonetheless, Ex-Im Bank continues to take a proactive approach in developing renewable energy specific products such as Solar Express, as well as reaching out to local companies such as wind and solar manufacturers.
- *Absence of Systematic Approach to Measure Customer Satisfaction*. Ex-Im Bank does not conduct customer satisfaction surveys on a regular basis. Customer surveys provide valuable insight into customer priorities, perceptions of Ex-Im Bank performance, areas for improvement, and other ECA best practices. On April 27, 2011, President Obama issued Executive Order 12862 instructing Federal agencies (including independent agencies) to develop a customer service plan to streamline service delivery and improve customer experience. To this end, we have recommended that Ex-Im Bank utilize customer surveys to validate the priorities of its customers and Ex-Im Bank's performance. As of this testimony, Ex-Im Bank has taken steps to implement this recommendation.
- *Encourage Lender Partners and Participants to Conduct, at a Minimum, Industry Standard Due Diligence and Asset Monitoring Efforts on Medium and Long-Term Government Guarantees and Insurance Transactions*. One of the patterns our office has observed in conducting our investigations is the lack of due diligence and asset monitoring efforts conducted by lenders, specifically the ones who have a history of defaulted transactions. Even though there is an expectation that such efforts are taken, Ex-Im Bank does not require participating lenders to conduct due diligence or asset monitoring on their transactions. In fact, there is no real accountability or penalty for not performing such

operations. The OIG has anecdotal evidence of loan officers in lending institutions expressing their position that the lender would not devote resources on due diligence efforts when there is a government guarantee and such efforts are not required by Ex-Im Bank. Although the OIG is not in a position to state that this is a behavior demonstrated by all lenders, we can certainly state that this "moral hazard" issue has been prevalent in fraud cases involving multiple transactions. Effective implementation of "Know Your Customer" practices by lenders could help in minimizing or preventing the number of fraudulent cases Ex-Im Bank has experienced. Further, with its growth in direct loan and project finance transactions, Ex-Im Bank would have to closely monitor the performance of these credits with existing limited resources available in its asset management function. Teaming up with lenders and institutions – who offer a better understanding of the project, borrower, and knowledge of the markets – would allow Ex-Im Bank to effectively leverage its limited resources.

- *Improve Corporate Governance, Business Processes, and Internal Control Policies and Practices*. One of the consistent observations arising out of audits, evaluations, and investigations conducted by the OIG are the weaknesses in governance and internal controls, as they relate to business operations. Internal policies providing clear guidance to staff and establishing clear roles and authorities are not prevalent at Ex-Im Bank. These areas need to be addressed as part of creating a better corporate governance culture.

IV. Conclusion

Ex-Im Bank has an important role in creating and maintaining jobs by facilitating export financing to American exporters. Several years of record export authorization levels only support that role. While Ex-Im Bank continues to provide export credit and financing as part of its export credit agency functions, it should work to improve its risk management practice while enhancing operational effectiveness and efficiencies.

I have highlighted some of the challengers and weaknesses Ex-Im Bank is facing as it marches toward its new reauthorization process. The OIG will continue to enhance its independent oversight role as well as strengthen its efforts in preventing and detecting fraud, waste, and abuse.

Chairman Campbell, Ranking Member Clay, and members of this honorable Subcommittee, thank you once again for the opportunity to testify before you today. I would be pleased to respond to any questions you may have.

TESTIMONY OF
FRED P. HOCHBERG - PRESIDENT AND CHAIRMAN
EXPORT-IMPORT BANK OF THE UNITED STATES
BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE
MONETARY POLICY AND TRADE SUBCOMMITTEE
JUNE 13, 2013

I am pleased to be able to provide you with an update about the Export-Import Bank of the United States ("Ex-Im Bank" or "Bank") one year after our reauthorization was signed into law.

Since assuming the role of President and Chairman at Ex-Im Bank four years ago we have made significant strides in supporting U.S. jobs while ensuring that our comprehensive risk management practices have protected American taxpayers. In FY 2008, Ex-Im Bank authorized $14.4 billion supporting 144,800 jobs. In FY 2012, we supported 255,000 jobs with the nearly $36 billion in authorizations. And we did all this while protecting the taxpayers. In fact, we reduced the amount of claims paid out from $200 million in FY 2008 down to $37 million in FY 2012.

I am proud of the 400 employees of Ex-Im Bank for turning in such a strong report card. On top of that, they did this work at no cost to U.S. taxpayers. At Ex-Im, we fill in the gaps when commercial lending is unavailable. Many of these sales—and the quality American jobs they support—would not have been possible without the support of the Bank.

PURPOSE OF EX-IM BANK

Ex-Im Bank is the official export credit agency of the United States. The mission of the Bank is to enable U.S. companies – large and small – to turn export opportunities into sales that help maintain and create U.S. jobs which contribute to a stronger national economy. The Bank achieves its mission by providing export financing through its loan, guarantee, and insurance programs in cases where the private sector is unable or unwilling to do so. Ex-Im Bank also provides support when necessary to level the playing field when financing is provided by foreign governments to their companies who compete for export sales with U.S. exporters.

COMPREHENSIVE RISK MANAGEMENT AND REVENUE FOR THE TAXPAYERS

Ex-Im Bank continues its prudent oversight and due diligence standards to protect taxpayers through its comprehensive risk management framework. As a result of provisions included in the Bank's charter during last year's re-authorization, every 90 days Ex-Im Bank submits a default rate report to Congress. Our most recent report dated March 31, 2013, indicated a default rate of 0.307 percent[1], far below the average default rate for commercial banks. In addition to this low default rate, over the past five years Ex-Im Bank has generated $1.6 billion for U.S. taxpayers, above and beyond all administrative operating costs, claims and loan loss reserves we have set aside. We operate at no cost to the taxpayers.

Moreover, we are committed to what we call, "Government at the Speed of Business." All 400 of us are committed to giving our exporters and the jobs they support top notch service. Ninety percent of all transactions are completed within 30 days and 98% within 100, larger and more complex transactions do take longer for proper underwriting, including due diligence.

Ex-Im Bank has a comprehensive risk management framework which was confirmed by the Government Accountability Office's (GAO) recent review. This framework starts with effective underwriting to ensure a reasonable assurance of repayment. More than 80% of our entire portfolio is backed by some form of collateral or a sovereign guarantee.
Our comprehensive risk management program includes detailed documentation to ensure the Bank's rights are protected legally and that the remains consistent with U.S. government policy and laws, including those concerning Iran sanctions. And it continues after a transaction is approved with pro-active monitoring efforts to minimize defaults. In those rare cases of actual defaults, Ex-Im Bank aggressively seeks recoveries. We recover roughly 50 cents on the dollar.

Ex-Im Bank engages in robust portfolio management, as well as oversight and governance, including the setting aside of adequate loan loss reserves.

The Bank continues its prudent risk management and is proud of the improvements made during the past few years. In Fiscal Year 2012, the Bank paid $37 million in gross claims on a portfolio of $106 billion. During that same year the Bank collected $1 billion in fee income and sent more than $800 million (the excess of Bank expenses and loan loss reserves) to the U.S. Treasury. On top of that, a $400 million rescission was also enacted by Congress from the Bank's unexpended balances.

Comprehensive risk management and continuous improvement is what we strive towards and our default rate reflects that. The Bank has made many improvements over the past few years including:

Modernizing credit monitoring
Creating a Special Assets unit to address emerging credit issues

[1] This default rate is different than the default rates published in the annual Budget Appendix due to differing definitions. The reported rate in the Budget Appendix reflects projected defaults over the life of the loan while the default rate in this report reflects actual defaults at a particular point in time.

Expanding our pro-active monitoring efforts
Improving our underwriting
Enhancing Reserves with qualitative factors including concentration risk
We also have plans to implement additional risk management improvements identified over the past two years from our internal analysis of best practices, outside expert advice, audit recommendations from Bank initiated audits and from our Inspector General.

I want to assure Congress that Ex-Im Bank's financials are reliable and on solid ground. Over the past 24 months the Bank's risk framework and financials have been reviewed by our auditors Deloitte & Touche, the Bank's Audit Committee, the Audit Committee's outside firm KPMG, our Inspector General, and the GAO.

MEETING REQUIREMENTS OF REAUTHORIZATION

Over the past year Ex-Im Bank has met all of the reporting requirements set forth in our reauthorization bill. We produced several reports to this committee including:

Our Business Plan
Our Small Business Report
Our Content Review
Our Report on Financing of Textiles
Our Quarterly Default Rate Reports

We have added a textile industry representative to our Advisory Committee and complied with the Iran sanctions provisions required under the reauthorization. In certain instances we have gone beyond the requirements of our reauthorization, such as expanding our economic impact policies to include alternative analysis for transactions and the review of airline services.

As part of the reauthorization we also worked in a transparent and cooperative way with GAO. Three reviews were required relating to the Bank's risk framework, the Bank's Business Plan, and the Bank's calculation of jobs supported through exports. In each of these reviews, the Bank agreed with the GAO's recommendations and we have implemented or are in the process of implementing each of them.

CONGRESSIONAL MANDATES

A critical component to job growth is small business, for which Congress has mandated we make available 20 percent of our financing. In FY 2008 Ex-Im Bank financed $3.2 billion in direct small business exports. In FY 2012 we financed a total of $7.5 billion in small business exports of which $6.1 billion was direct. (See chart 1) Total small business exports include those directly exported by small business to a foreign buyer, plus small business inputs into the supply chain of larger U.S. companies' products which are ultimately exported. At Ex-Im Bank, small business accounted for 88 percent of all transactions last year and small business is essential for job growth in coming years.

To put this in perspective, we have financed more small business in the past four years than in the previous eight years combined.

Another area that we are particularly proud of is our financing to woman and minority owned businesses. In FY2012 we were up 17% from the prior year. In fact, over the past four years we have financed more to woman and minority owned businesses than the Bank did in the previous 16 years combined. (See chart 2)

To address the needs of our small business customers, Ex-Im Bank has implemented a number of new financial products. Our most popular product, *Express Insurance,* received an innovation in government award from Harvard's Kennedy School and has helped more than 600 small businesses get a response to their application within 5 business days. Additionally, to increase liquidity for small businesses we have launched *Global Credit Express* for smaller transactions of half a million dollars or less and *Supply Chain Finance*.

And we are not stopping there. In April, we launched a new pilot program called *U.S. Global Business Solutions.* The program streamlines U.S. government trade-finance products for lenders and exporters. The programs and products will be combined into a single menu of options tailored to the exporter's needs. Working together, Ex-Im Bank, the Small Business Administration and the U.S. Department of Commerce, make it easier and more cost-effective for exporters and their lenders to avail themselves of the programs and products of multiple agencies.

The key to expanding exports is marketing and communicating to small businesses. To increase awareness, Ex-Im Bank has partnered with the U.S. Chamber of Commerce, the National Association of Manufacturers, government agencies and commercial banks to hold more than 50 *Global Access for Small Business Forums.* From Billings, Montana to Shreveport, Louisiana and from Charlotte, North Carolina to San Bernardino, California, thousands of businesses have learned how to access foreign markets and use Ex-Im Bank to give them a competitive edge when exporting.

At Ex-Im Bank we have worked to ensure significant progress in supporting our other congressional mandates to finance more renewable energy exports and exports to sub-Saharan Africa. Our support for renewable energy has increased more than tenfold from $30.4 million in FY 2008 to $355.5 million in FY 2012.

I am proud of our work in sub-Saharan Africa which is home to seven of the ten fastest growing economies in the world. Many countries in the region have developed to the point where they are now eligible for Ex-Im Bank financing. The Bank has grown sub-Saharan Africa financing from $576 million in FY 2008 to $1.5 billion in FY 2012 (See chart 3). While Ex-Im Bank supports approximately 2 percent of all U.S. exports, we financed approximately 7 percent of all U.S. exports to sub-Saharan Africa.

CONCLUSION

I want to thank this committee for their work on our reauthorization last year and assure you that Ex-Im Bank is filling the gap when U.S. exporters face foreign financing competition and when commercial lenders and insurers are unwilling or unable to step in.

The thousands of businesses that benefit from Ex-Im Bank financing –88 percent of which are small businesses - appreciate the fact that Congress was able to reach an agreement to reauthorize the Bank last year. I thank you for this opportunity to provide you with an update as to the excellent work Ex-Im Bank is doing to support U.S. jobs and I look forward to working with you to continue to grow U.S. exports.

Ex-Im Bank Small Business Authorizations

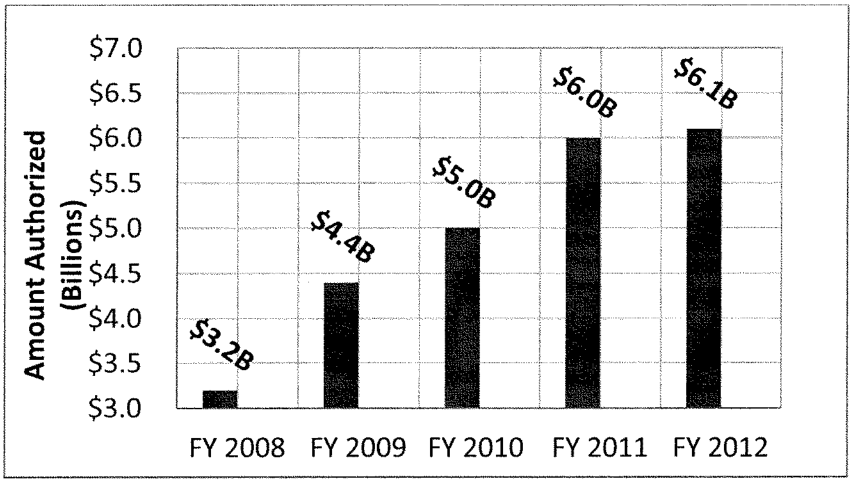
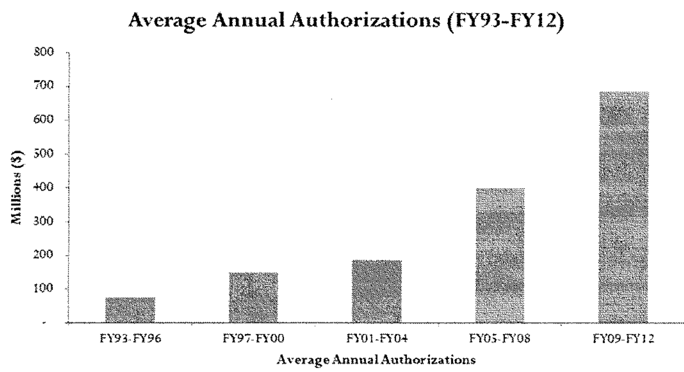


Chart 1

Minority and Woman Owned Business



FY 1993 – FY 2008 Total Authorizations

$3,234 million

FY 2009 – May 2013 Total Authorizations

$3,237 million

Chart 2

Ex-Im Bank Support In Sub-Saharan Africa

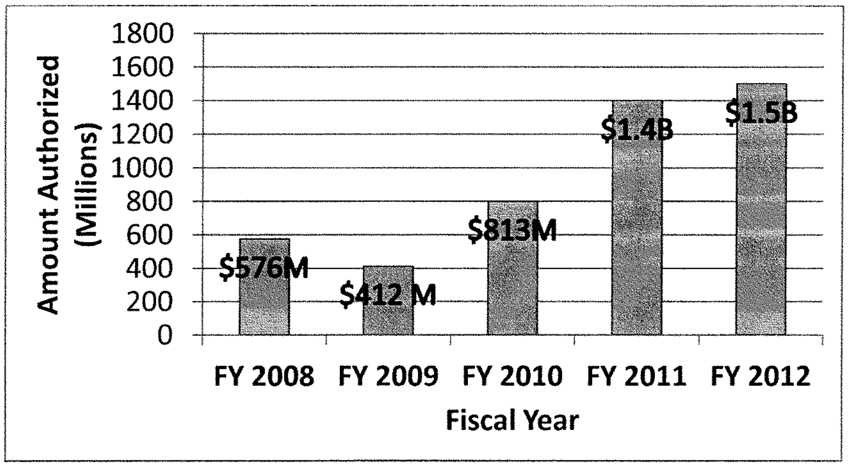


Chart 3

United States Government Accountability Office

GAO

Testimony
Before the Subcommittee on Monetary Policy and Trade,
Committee on Financial Services, House of Representatives

For Release on Delivery
Expected at 10 a.m. EDT
Thursday, June 13, 2013

EXPORT-IMPORT BANK

Recent Growth Underscores Need for Improved Risk Management and Reporting

Statement of Mathew J. Scirè, Director
Financial Markets and Community Investment

GAO U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

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.

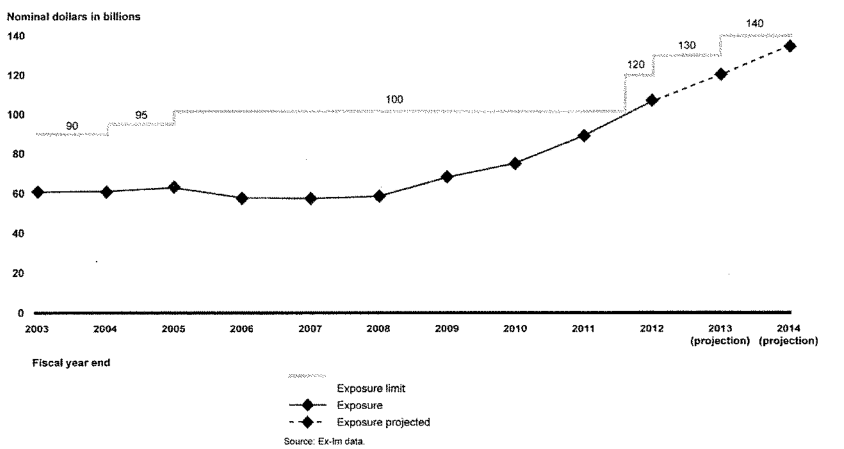
Ex-Im faces multiple risks when it extends export credit financing. These risks include (1) credit risk (the risk that an obligor may not have sufficient funds to service its debt or be willing to service its debt), (2) political risk (the risk that expropriation of the obligor's property, war, or inconvertibility 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.

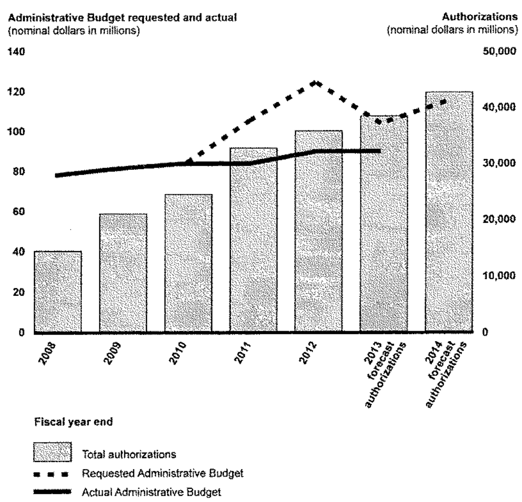
[5]Ex-Im reviews each credit transaction and assigns a numerical risk rating based on assessments of credit, political, and market risks.

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.

Contacts and Staff Acknowledgments

For further information about this testimony, please contact me at 202-512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Lawrance L. Evans, Jr., Director; Juan Gobel, Assistant Director; Steve Westley, Assistant Director; Joshua Akery; Kathryn Bolduc; Marcia Carlsen; Anna Chung; Pamela Davidson; Martin De Alteriis; Cole Haase; Carol Henn; Michael Hoffman; Christine Houle; Susan Irving; Melissa Kornblau; Risto Laboski; Felicia Lopez; Grace Lui; Yesook Merrill; Colleen Moffatt Kimer; Barbara Roesmann; Jessica Sandler; Michael Simon; Jena Sinkfield; and Celia Thomas.

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Chairman Fred P. Hochberg

House Financial Services Subcommittee on Monetary Policy and Trade

Hearing on "Assessing Reform at the Export-Import Bank"

Responses to Questions for the Record

June 13, 2013

Questions for The Honorable Fred P. Hochberg, President, Export-Import Bank of the United States, from Rep. Spencer Bachus and Rep. Shelley Moore Capito

Question: The Export-Import Bank (Ex-Im Bank) has been criticized for providing favorable credit terms to the overseas competitors of U.S. firms. A notable example of this is Ex-Im Bank financing to foreign mining corporations that compete fiercely with U.S. competitors. What procedures are in place to protect against the potential harm domestic companies face when their competitors are financed through Ex-Im Bank?

Answer: For more than four decades Ex- Im Bank has had in place economic impact procedures to protect American businesses. Over that time, the economic impact procedures have been reviewed and modified by the Bank's Board of Directors many times. In November 2012, the Bank's Board reviewed and amended its Economic Impact Procedures and Methodological Guidelines, which can be found on our website at http://www.exim.gov/generalbankpolicies/economicimpact/.

Ex-Im Bank's economic impact policy is the Bank's mechanism to weigh the benefits of U.S. exports against the projected potential harm to domestic manufacturers when their overseas competitors may receive Ex-Im Bank financing.

The Bank reviews all applications it receives for potential adverse economic impact in accordance with the Bank's Charter. The Charter sets both the standard for review of transactions to ascertain risk of substantial injury to the U.S. economy (defined by Congress as new or expanded foreign production in excess of 1% of U.S. production) as well as procedures to publicly notify and receive input from stakeholders.

The Charter requires the Bank staff to both identify those transactions associated with specific legislative prohibitions (e.g., applicable Anti-Dumping and Countervailing Duty orders), and to determine the potential of a transaction to cause substantial injury to the U.S. economy. When a transaction meets the substantial injury threshold (as designated in the Bank's Charter), the transaction triggers a detailed economic impact analysis. As part of the analysis, staff examines projected supply and demand to assess whether the new foreign production will result in structural oversupply in the world markets, and conducts trade flow analysis to both quantify the potential harm to U.S. manufacturers of the same (or similar) goods and to compare the estimated value of any harm to the value of the benefits of the exports to be supported by the Bank.

The Charter's procedures for stakeholders enable the public to weigh in on the transaction as well. When a proposed transaction triggers a detailed economic impact analysis the Bank issues a Federal Register Notice (FRN) that solicits comments from the public. Simultaneously with submittal of the FRN, staff notifies the Committee on Financial Services in the House of Representatives and the Committee on Banking, Housing, and Urban Affairs in the Senate and several U.S. Government agencies (Commerce, Treasury, State, OMB, and USTR). Stakeholders may submit comments—including information on the projected potential harm that could or would be experienced by domestic industry if Ex-Im Bank provides financing to a foreign competitor. All public and congressional comments are then included in the draft detailed economic impact analysis that is sent to other U.S. government agencies for comment. All comments are also included in the final economic impact analysis, which is submitted to the Bank's Board to inform their decision on the proposed transaction.

Question: In a report by the Ex-Im Bank Inspector General on risk management at the Bank, the absence of a risk premium for the additional portfolio concentration risk was brought to light. In addition, it was noted that a majority of Ex-Im Bank financing dollars is concentrated in a small group of sectors. Does the Bank's economic impact analysis include a cumulative impact of transactions in the same sector?

Answer: Starting in October 2012, the Bank quantified a cost associated with one type of concentration risk, a cost that is added to the Bank's reserves. Over the past year, this approach was reviewed or audited by various outside and independent experts including KPMG (internal auditors), Deloitte & Touche (external auditors), the Office of Management and Budget (OMB), and the Government Accountability Office (GAO). We have also begun examining our underwriting from the perspective of concentration risk. The Bank will continue this effort as part of the newly established Enterprise Risk Committee in FY 2013 and FY 2014. We will work with the Bank's Inspector General during this time to address this issue. In regards to your specific question about inclusion in Economic Impact Analysis, Ex-Im Bank's Economic Impact Procedures and Methodological Guidelines do include two instances of analysis of "cumulative" effects, but both are for limited time frame and neither is by sector. First, for the medium term transactions, the Bank aggregates on a "rolling" basis the cumulative value of transactions that Ex-Im Bank financed in the past 24-month period for specific product to a specific foreign buyer. Second, in regard to Ex-Im Bank's support for aircraft transactions, the Bank analyzes the expected financing of commercial jet aircraft over the future 12-month period.

Question: In your Economic Impact Procedures and Methodological Guidelines published in November 2012, there was a section called "Proportionality and the Trade Flow Analysis" where in circumstances when Ex-Im Bank financing represents 10% or less of the total project capital cost the trade flows analysis performed will limit displacement to the proportion of Ex-Im involvement in the project. Given that many projects may not go forward without Ex-Im Bank financing, how do you justify the application of the proportionality test instead of counting the full production of the project's impact on U.S. industry?

Answer: A key consideration in economic impact policy is that almost all the U.S. goods and services exports related to medium- and long-term applications for Bank support could be provided by foreign suppliers and supported by their export credit agencies (ECAs) if Ex-Im Bank support were unavailable.

In other words, there is a likelihood that the project under review would go forward whether Ex-Im Bank finances it or not, and any adverse impact from new or expanded foreign production would occur whether Ex-Im Bank supports the project or not. Therefore, for transactions where Ex-Im Bank support is *de minimus* (10% or less of the total project capital costs), the Bank limits the trade flow analysis displacement in proportion to the Bank's involvement in the project.

In accordance with footnote 24 of the April 2013 procedures (http://www.exim.gov/generalbankpolicies/economicimpact/) even when proportionality applies to a transaction, the Bank also provides the Board with a trade flow analysis that considers the impact of the project's full production in order to assist the Board in evaluating the transaction.

Question: The Bank has the ability to proceed with a transaction that may cause substantial harm if it determines that the short- and long-term benefits outweigh the harm to the relevant U.S. producers. Will you describe the procedures the Bank has established to determine that the benefits outweigh the costs in these instances? Has the public had the opportunity to comment on these procedures to ensure that the Bank is in compliance with industry best practices?

Answer: When doing a detailed economic impact analysis, one of the key questions is whether the value of the benefits of the original exports to be supported by Ex-Im Bank is equal to or greater than the projected potential negative trade flow impacts that result from the new or expanded production supported by the transaction. Therefore, Ex-Im Bank has developed a disciplined standard approach to those calculations and applied that approach in every detailed economic impact analysis. See Attachment 1 for the core assumptions.

When establishing the Bank's Economic Impact Procedures and Methodological Guidelines, Ex-Im Bank solicited input from Bank customers as well as from the general public through Federal Register Notice (FRN). The Bank gathered input through the FRN process and the Bank's Board held an open meeting at which the public was invited to attend and address any concerns. In addition, the Bank posts an FRN and notifies Congress for each transaction over $100 million, which gives Congress the opportunity to weigh in on the specific transaction.

Question: In the economic impact notices the Bank publishes when considering whether to finance a request, is the value of the application listed in the notice, the total dollar value of the project being funded, or the portion of the project the Ex-Im Bank would finance? If it is the portion the Bank is financing, how is an industry supposed to adequately comment on the potential harm a project could have on its sector without knowing the full dollar value of a project?

Answer: Ex-Im Bank follows the legislative requirements outlined in the Bank's Charter as they relate to the content of the Federal Register Notice (FRN). The Bank's Charter states that the following nonproprietary information be included in the notice: 1) the country to which the goods involved in the transaction will be shipped, 2) the type of goods being exported, 3) the amount of the loan or guarantee involved, 4) the goods that would be produced as a result of the provision of the loan or guarantee, 5) the amount of increased production that will result from the transaction, 6) the potential sales market for the resulting goods, and the value of the transaction. Ex-Im Bank does provide the value of its financing in the FRN, per item 3 above.

Transactions are not finalized prior to receiving public and Congressional input and divulge proprietary information through the FRN process might increase the possibility that foreign competitors could use the information to step in and try to undercut the U.S. exporters. In order to follow the statute and not include proprietary information, the portion of Bank financing to an overall project and the names of the exporting and purchasing companies are absent from the Bank's economic impact FRN. However, that business confidential information is provided to Congress through the 35-day notices that are sent to the Committee on Financial Services in the House of Representatives and the Committee on Banking, Housing, and Urban Affairs in the Senate.

Question: Do you believe that the parties of the potential transaction are not relevant to an industry's ability to comment on the transaction's potential impact?

Answer: Ex-Im Bank follows the legislative requirements outlined in the Bank's Charter as they relate to the content of the Federal Register Notice (FRN). Transactions are not finalized prior to receiving public and Congressional input and, prior to that time, there is the potential that divulging proprietary information through the FRN process would allow foreign competitors to use the information to step in and try to undercut U.S. exporters.

In order to follow the statute and not include proprietary information, the name of the exporting company and the purchasing company are considered business confidential, and are not included in the FRN. However, that business confidential information is provided to Congress through the 35-day notices that are sent to the Committee on Financial Services in the House of Representatives and the Committee on Banking, Housing, and Urban Affairs in the Senate.

Question for the record from Representative Clay:

Question: "I note that the GAO found that Ex-Im Bank's methodology for forecasting its needed exposure limit could be improved. It seems that any formula for predicting the future is going to have flaws, so what I would like to know is -- what would Ex-Im do if it begins to come close to its exposure cap? Do you have a process by which you would formally inform Congress of your need for a higher limit? And if your exposure cap is not raised, what would Ex-Im then do?"

Answer: The Bank agrees that any methodology to forecast future exposure will have its limits. We do work to continuously update and improve our forecasts. We currently do not anticipate exceeding our exposure cap during our current authorization period.

The Bank is able to track exposure on a monthly basis and if necessary can provide daily exposure levels. At no time will the Bank ever exceed the exposure cap limit set by Congress. If the Bank approached the exposure cap, we would not be able to approve new transactions until Congress increased our exposure cap or repayments or cancellations of pending transactions allowed for new authorizations to occur. At the end of each month when we process repayments and any cancellations the Bank could only approve new transactions equal to that amount.

We will also have sufficient lead time to inform Congress if the Bank is coming close to hitting its exposure cap. In this particular scenario, the Administration could propose a new exposure cap to Congress in order for the Bank to continue approving transactions which support U.S. jobs. However, having a "just in time" increase to the exposure cap sends a message to competing export credit agencies and foreign purchasers of U.S. goods and services around the globe that that Ex-Im Bank financing may not be available for purchases. We observed during our reauthorization last year how foreign competitors used that uncertainty to encourage export-credit supported transactions from abroad rather than from the United States. The uncertainty surrounding the exposure cap puts American businesses at a disadvantage when securing reliable financing.

Questions for the Record Submitted by Rep. Bill Huizenga "Assessing Reform at the Export-Import Bank" Thank you for your appearance before the June 13, 2013, House Financial Services Subcommittee on Monetary Policy and Trade hearing entitled, "Assessing Reform at the Export-Import Bank." To follow up on the discussion, I would like to submit the below questions to the aforementioned witness and have the answers included in the official hearing record.

Question: Airbus has broken ground on a new A320 final assembly facility in Mobile, Alabama where it will employ over 1000 people. Will the Export-Import Bank work as closely with Airbus on export financing as it does other commercial aircraft manufacturers?

Answer: At Ex-Im Bank, our mission is to support U.S. jobs through exports. As long as the export meets the Bank's financing criteria, we will give full consideration to the application regardless of the parent company's ownership. For example, Ex-Im Bank finances helicopters from the Italian company Agusta Westland which are manufactured in the U.S. for export. We also finance German-owned Seimens Corporation turbines in North Carolina that are exported around the globe. I have already personally met with the head of Airbus North America on a couple of occasions to discuss their operations and the Bank's criteria for supporting exports from the United States.

Question: When discussing aircraft financing in March 2012, the Export-Import Bank's Senior Vice President for Transportation, Robert Morin, stated: "Clearly, it's not healthy in the long-term for export credit agencies [like EX-IM and its European counterparts] to be doing so much." Do you agree with Mr. Morin?

Answer: I agree with Mr. Morin's statement, which he made at an aviation industry conference and he directed specifically to export credit agency support for commercial aircraft.

It is important to understand that the last four years were an extraordinarily challenging period for the global economy as countries attempted to limit the severity and duration of the global recession which resulted from the credit crisis. As a result of the credit crisis, a significant percentage of commercial banks that had been active in financing aircraft for the airline and aircraft leasing industries either significantly reduced the amount of aircraft financing they were willing to extend to these industries or withdrew from this market altogether. Geographically speaking, the most widespread aircraft financing market exit came from the European commercial banks.

I think it is also important to highlight that these commercial banks' exit or contraction of aircraft financing was a result of losses in other sectors and not due to any significant change in the actual or expected losses in their aircraft financing portfolios.

Accordingly, Ex-Im Bank and the European export credit agencies that support European-manufactured Airbus aircraft needed to fill the financing gap that resulted from this significant change in the financing environment. Export credit agencies either could have increased the amount of aircraft financing support they provided in an attempt to limit the banking industry crisis from becoming a broader aircraft manufacturing and airline industry crisis or allowed the banking industry crisis to spread to other parts of the global economy. Ex-Im Bank and other export credit agencies chose the former by guaranteeing an increasing number of commercial bank-funded aircraft financing transactions and, applicable to Ex-Im Bank in particular, by guaranteeing structures that tapped other sources of liquidity, such as the capital markets. As a result of these efforts, the commercial aircraft manufacturing industry did not have to cut production and lay off workers simply because airlines could no longer obtain commercial financing for their already-arranged aircraft purchases.

During the initial year of the financial crisis, we thought this increase would be a short-term spike in the amount of support Ex-Im Bank provided to the aircraft manufacturing and airline industries. However, due to the anemic recovery of the European banking industry and bank regulatory changes, export credit agencies have had to continue to provide such increased amount of support for a longer period of time than originally anticipated.

In light of this historical background, Ex-Im Bank and other export credit agency support for the aircraft manufacturing industry continues to be above the expected "normal" level associated with a stable and well-functioning commercial financing market. Given the fact that financiers have been unable to fund or arrange funding for the higher volume of export credit agency-guaranteed financings in recent years, it is clear that an industry adjustment is required to adapt to a new long-run financing environment. Accordingly, Mr. Morin's comment at this industry conference was intended as a signal that the aircraft manufacturing industry, the airline industry, and the aircraft finance and leasing industries needed to redouble their efforts to find new sources of financing other than export credit agencies.

I will note that during the past few months, we have begun to see the encouraging results of such efforts, as evidenced by the fact that some non-U.S. airlines (including Air Canada, British Airways and Emirates) are now beginning to finance some of their aircraft through the U.S. capital markets on a purely commercial basis (instead of through commercial banks), in the same way that U.S. airlines generally finance their aircraft. We are optimistic that this reflects the beginning of a long-term trend that will allow higher-quality borrowers to access new sources of funding in lieu of using export credit agency support.

Question: In the 2012 reauthorization of the Export-Import Bank, Congress mandated that the Administration immediately enter into negotiations with Europe to eliminate or substantially reduce export credit agency financing of all wide-body aircraft – both Boeing and Airbus. What negotiations were you involved with or aware of regarding compliance with this particular mandate?

Answer: The legislation reauthorizing the Export-Import Bank required that the Secretary of Treasury enter into negotiations with Europe regarding aircraft financing, which he has done. The Secretary sent his report to Congress as required and I know that Treasury officials are aware that this is to be an ongoing negotiation.

While not required to do so by the legislation, I have brought this issue up on numerous occasions with my counterparts at meetings such as the G8 and G11, but there was significant opposition by other ECAs to end export credit financing.

Attachment 1
Standard Trade Flow Assumptions

1. There is no change in the supply/demand balance within the relevant or the global market for this product;

2. The potentially displaced U.S. manufactured production cannot be sold anywhere else at any price;

3. The potential displacement of U.S. production is based on the U.S. market share in the country or region where the foreign buyer intends to sell its output;

4. The net present value of the potential displacement uses the most recent discount rate, (CIRR);

5. The value of the potential displacement each year is based on the average price of the good over the past 3-5 years; and

6. To bring some balance to the aggregate effect of the conservative bias in the above five assumptions, displacement is presumed to occur every other year to mimic the effect of normal economic cycles.