

Statement of
Honorable Osvaldo Luis Gratacós
Inspector General
Export-Import Bank of the United States

before the

United States House of Representatives
Committee on Financial Services

June 25, 2014 at 10:00 am

Good morning, Chairman Hensarling, Ranking Member Waters, and distinguished members of this Committee.

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 the Export-Import Bank (Ex-Im Bank) as it relates to Export-Import Bank oversight and its pending authorization. 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

The Ex-Im Bank is the official export credit agency (ECA) of the United States. Ex-Im Bank 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 to 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. Between FYs 2012-2013, Ex-Im Bank authorized over \$60 billion in transactions. This is in addition to over \$32 billion in FY 2011. Further, Ex-Im Bank's portfolio has increased by 94% since 2008 (\$58.4 billion in FY 2008 vs. \$113.8 billion in FY 2013). In the current Charter, Ex-Im Bank has authority to approve up to \$140 billion in export transactions, subject to meeting certain credit-related performance criteria.

Naturally, this rapid growth in Ex-Im Bank's total portfolio exposure raises concerns as to Ex-Im's ability to manage and monitor this significant portfolio growth. Below in section III, we highlight the OIG's observations of some of the risks and challenges Ex-Im Bank faces and our recommendations for mitigating the issues we have identified.

II. Ex-Im OIG

Ex-Im OIG was statutorily created in 2002¹ but the Inspector General did not officially take office until August 2007. The OIG has achieved notable success in performing its statutory duties. Specifically, since FY 2008, multiple audit, evaluation

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

and special reports have been issued in the areas of risk management, domestic content, economic impact, IT systems, direct loan program, working capital delegated authority program, medium term program, sponsored travel, and performance metrics. In addition, the office has produced a number of inspection reports examining specific credit transactions approved by Ex-Im Bank. Further, our investigative efforts have resulted in a number of law enforcement actions against parties who have attempted to defraud the Bank, including 71 indictments and informations; 45 convictions; two extraditions; approximately 500 referrals of information to Bank management for enhanced due diligence actions; and over \$277 million in court imposed restitution, forfeitures, repayments and cost savings efforts. All of this has been accomplished with a very modest annual budget that started at \$1 million and is now approximately \$5 million.

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 and Congress can take steps to address some operational weaknesses and challenges facing the Bank. 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 and Congress should address are:

➤ Develop a More Comprehensive Risk Management Framework to Manage Portfolio Risk and Monitor Market Trends.

Last year, I testified before this Committee about the need for Ex-Im Bank to enhance its risk management framework. Back then, we stated that Ex-Im Bank should proactively manage the risk of its growing portfolio in line with common practices of commercial and multilateral development banks.

Specifically, we recommended that Ex-Im Bank should:

- establish a Risk Officer or create a risk management office with independent reporting requirements to the Chairman;
- assign qualified and experienced staff to that office;
- conduct periodic stress testing on its entire portfolio reflecting different market, industry, and macroeconomic scenarios; and
- actively monitor industry, geographic and obligor exposure levels.

As of today, Ex-Im Bank has taken some steps towards improving its risk management framework, however, opportunities for improvement still exist. For example, Ex-Im Bank established and hired a Chief Risk Officer (CRO) and restructured reporting lines to separate origination functions from risk management functions. However, the position of Chief Risk Officer was established as a non-career appointment and with additional management responsibilities supervising the legal and administrative functions of the Bank, which could dilute the focus of the position on credit risk issues. In addition, Ex-Im Bank has initiated some stress testing of its portfolio utilizing a top-down analysis of the portfolio as well as a bottom-up approach on some obligors. The results of the first stress testing process were conveyed

to Congress in the Default Report dated September 30, 2013. The Bank has also established an Enterprise Risk Committee and recently provided documentation on its activities to the OIG. Finally, Ex-Im Bank commenced the use of several qualitative factors in its re-estimate process to account for the impact of such factors in the portfolio. The application of such factors in the re-estimate process commenced in the fall of 2012 and resulted in an upward revision of its loss reserves.

➤ *Inefficient and Ineffective Information Technology (IT) Platform.*

In 2012, we reported that Ex-Im Bank was using 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 and analysis burdensome and time consuming. Since 2012, Ex-Im Bank has engaged in an IT infrastructure modernization effort focused on replacing legacy systems and improving quality and access of its data. We understand that key systems are scheduled to be implemented in the next several months. The OIG will continue to monitor the implementation of the IT modernization system, and we recommend that the Ex-Im Bank and Congress continue monitoring this critical initiative, including provision of necessary funding.

➤ *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 117% since FY 2008, its staff has increased at a much slower rate. Ex-Im Bank's portfolio growth strains Ex-Im Bank's resources in both the underwriting and asset monitoring functions. Ex-Im Bank is currently in the process of increasing the staffing levels for the above referenced functions. The OIG will closely monitor these upcoming staff allocations.

➤ Monitoring of Local Cost Disbursements.

The Organization of Economic Co-operation & Development (OECD) allows Export Credit Agencies (ECAs) to finance up to 30% of the "project-related costs for goods and services incurred in the buyer's country"² related to structured and/or project finance transactions. These local cost disbursements may be disbursed in lump sums without any exports directly associated to them. In two recent inspections conducted by the OIG, covering nearly \$700 million in local cost disbursements, we noted that Ex-Im Bank relies on certifications made by borrowers and contractors, but has limited ability to verify whether the amounts disbursed to cover local costs are actually used for the intended purpose and comply with Ex-Im Bank's policies and procedures. Given the countries where Ex-Im bank finances projects and the size of these disbursements, we have recommended to Ex-Im Bank management that it reserve rights of inspection in its credit agreements and allocate additional staff to monitor and validate local costs.

² <http://www.exim.gov/generalbankpolicies/index.cfm>
Page 6 of 8

➤ Continue Efforts to Expand Small Business Participation.

The Ex-Im Bank Charter dictates a small business participation goal of 20 percent of the total funding authorized each year. Ex-Im Bank provided record small business financing of around \$6 billion in both FY 2011 and FY 2012. In FY 2013, the amount decreased to \$5.2 billion. In the last three fiscal years, this financing has not reached the Charter goal of 20%.

➤ Continue Efforts to Expand Renewable Energy Products and to Create Clean Energy Export Opportunities.

Congress has set a renewable energy mandate of ten percent of authorizations every year. Ex-Im Bank has not met this goal, mainly due to the fact that the total renewable energy export market is not yet large enough to achieve this level relative to the total 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.

➤ 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 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

have not been prevalent at Ex-Im Bank. The Bank has made some progress in this area by, for example, creating a more comprehensive Loan, Insurance, and Guarantee Manual. However, these efforts must be sustained to continue improving the corporate governance culture.

IV. Conclusion

Ex-Im Bank has an important role in creating and maintaining jobs by facilitating export financing to American exporters. A 94% increase in export authorization levels since 2008 only supports 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 practice while it enhances its operational effectiveness and efficiencies.

I have highlighted some of the challenges and weaknesses facing Ex-Im Bank for consideration in the reauthorization process. The OIG will continue to perform its independent oversight role as well as strengthen its efforts in preventing and detecting fraud, waste, and abuse.

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you once again for the opportunity to testify before you today. I would be pleased to respond to any questions you may have.