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Financial Services,
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EXPORT-IMPORT BANK

Status of GAO Recommendations on Risk Management, Exposure Forecasting, and Workload Issues

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GAO Highlights

Highlights of [GAO-14-708T](#), a testimony before the Committee on Financial Services, House of Representatives

Why GAO Did This Study

Ex-Im helps U.S. firms export goods and services by providing a range of financial products. The Export-Import Bank Reauthorization Act of 2012 increased the statutory ceiling on the agency's total exposure to \$140 billion in 2014. As a condition of raising the exposure limit, the act required Ex-Im to prepare a report with a Business Plan and analyses of key operational elements. The act also mandated GAO to evaluate the effectiveness of Ex-Im's risk management and analyze its Business Plan. GAO reported on these issues in March and May 2013, respectively (see [GAO-13-303](#) and [GAO-13-620](#)). In the reports, GAO made a total of eight recommendations—to which Ex-Im agreed.

This testimony is based on GAO's March and May 2013 reports. It discusses actions Ex-Im has taken in response to GAO recommendations on (1) estimating losses, managing financial risks, and forecasting exposure levels; and (2) managing and reporting on its workload. For the 2013 reports, GAO analyzed Ex-Im's financial data, policies and procedures, Business Plan, and processes for calculating program costs and loss reserves. GAO also interviewed Ex-Im officials and other entities involved in export financing.

View [GAO-14-708T](#). For more information, contact Mathew J. Scire` at (202) 512-8678 or sciremj@gao.gov.

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What GAO Found

The U.S. Export-Import Bank (Ex-Im) has addressed recommendations GAO made in two 2013 reports that related to processes for estimating losses, managing financial risks, and forecasting outstanding financial commitments (exposure). In these reports, GAO found weaknesses in the processes, including limitations in Ex-Im's data and models. Based on accounting standards for federal credit agencies, federal banking regulator guidance, and federal internal control standards, GAO made six recommendations that Ex-Im subsequently implemented. For example, GAO recommended that Ex-Im

- assess whether it was using the best available data for adjusting loss estimates for long-term credit transactions to account for global economic risk. In November 2013, Ex-Im replaced a 1-year forecast of global economic conditions it used in its loss estimation model with a 5-year forecast.
- retain point-in-time data on credit performance to conduct analyses to compare the performance of newer and more seasoned business at comparable points. Ex-Im began retaining such data in fiscal year 2013.
- report to Congress on scenarios used for and results of stress tests on its portfolio. In September 2013, Ex-Im began including this information in quarterly reports to Congress on the bank's default rates.
- assess the sensitivity of its exposure forecast model to key assumptions and estimates and identify and report the range of forecasts these analyses produced. In response, Ex-Im created additional statistical models to validate its forecasts and provided a range of estimates.

Ex-Im also has begun to address two recommendations in GAO's 2013 reports concerning the bank's workload. In a March report, GAO found Ex-Im faced potential operational risks because administrative budgets and staff levels had not kept pace with growth in its portfolio and Ex-Im had not formally determined the level of business it could properly manage. In a May report, GAO found the Business Plan provided limited analysis of the adequacy of Ex-Im's resources and ability to meet congressional mandates for credit transactions supporting small business and renewable energy. Based in part on federal internal control standards, GAO recommended that Ex-Im develop benchmarks to monitor and manage workload levels and provide Congress with more information on resources associated with meeting the mandates. To help address the recommendations, Ex-Im hired a contractor to develop workload benchmarks and a workload modeling tool. As of June 2014, this effort was ongoing. As a result, the two recommendations remain open.

While Ex-Im has been responsive to GAO's recommendations, it is important to note that GAO has ongoing work examining other aspects of Ex-Im operations. Furthermore, managing a large export financing portfolio and its associated risks is challenging. Therefore, it will be important for Ex-Im to sustain the improvements it has made, effectively implement future audit recommendations, and carefully manage emerging risks.

Chairman Hensarling, Ranking Member Waters, and Members of the Committee:

I am pleased to be here today to discuss our prior work on the U.S. Export-Import Bank (Ex-Im), which serves as the official export credit agency of the United States. Ex-Im helps U.S. firms export goods and services by providing financial products, including direct loans, loan guarantees, and insurance. Ex-Im's business volume has grown dramatically in recent years. From fiscal years 2008 through 2013, Ex-Im's exposure—that is, its total outstanding financial commitments—rose from \$58.5 billion to \$113.8 billion.¹ Factors associated with this growth included the reduced availability of private-sector financing following the 2007-2009 financial crisis. This rapid growth has challenged Ex-Im's ability to plan for and manage its portfolio.

My statement today draws on two reports we issued in March and May 2013, which were mandated in the Export-Import Bank Reauthorization Act of 2012 (2012 Reauthorization Act).² Specifically, the act mandated 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 actions Ex-Im has taken to address recommendations in our 2013 reports regarding (1) estimating losses, managing financial risks, and forecasting exposure levels; and (2) managing and reporting on the bank's 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

¹All years in this statement are federal fiscal years unless otherwise indicated.

²Pub. L. No. 112-122 § 4 and 5, 126 Stat. 350, 352 (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 on risk management and cost estimation, including federal internal control standards, Office of Management and Budget (OMB) guidance, and federal banking regulator guidance. Additionally, 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. For this statement, we also updated information on Ex-Im's overall exposure and authorizations as of the end of 2013 and updated the status of the recommendations we made in the 2013 reports.³ We conducted the work on which this testimony is based in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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's authorizations increased from \$14.4 billion in 2008 to \$35.8 billion in 2012, but declined to \$27.3 billion in 2013.

While demand for its services generally drives Ex-Im's business, Congress also mandated that Ex-Im support specific objectives. For example, since the 1980s, Congress has required that Ex-Im make available a percentage of its total export financing each year for small business. In 2002, this requirement increased from 10 percent to 20 percent. Congress further instructed that Ex-Im promote the expansion of its financial commitments in sub-Saharan Africa. Finally, in 2012 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 as the renewable energy mandate.

³An authorization is an export financing transaction for which Ex-Im has granted credit approval.

Ex-Im Has Addressed GAO's Recommendations Related to Risk Management and Loss and Exposure Estimation

Our March and May 2013 reports found that Ex-Im had been developing a more comprehensive risk-management framework and had provided exposure forecasts to Congress, but could take additional steps to improve these processes. More specifically, Ex-Im had started to address recommendations by its Inspector General (IG) about portfolio stress testing, thresholds for managing portfolio concentrations, and risk governance. We concluded that the IG's recommendations represented promising techniques that merited continued attention and recommended further steps to help improve Ex-Im's risk-management practices.

First, our March 2013 report found that Ex-Im could further improve 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.⁴ Consistent with industry practices, Ex-Im added qualitative 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 incorporated a 1-year forecast of certain bond defaults to predict possible changes in loss estimates from changed global economic conditions. However, we concluded that a short-term forecast might not be appropriate for adjusting estimated defaults for longer-term products and could lead to underestimation of credit subsidy costs and loss reserves and allowances.⁵ Thus, we recommended that Ex-Im assess whether it was using the best available data for adjusting the loss estimates. Ex-Im agreed with our recommendation and identified a 5-year forecast of the global economy to adjust loss estimates. In November 2013, Ex-Im incorporated this longer-term forecast of global economic change into its

⁴Ex-Im uses the model to build the agency's credit subsidy estimates in the President's budget and for calculating loss reserves and allowances reported in its annual financial statements. Credit risk is the risk that an obligor—an entity contractually obligated to make payments to satisfy the terms of an Ex-Im export credit product—may not have sufficient funds to service its debt or be willing to service its debt. Political risk is 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.

⁵We based our recommendation on guidance from the Federal Accounting Standards Advisory Board for federal credit agencies, which states that agencies should develop cash flow projections for their transactions based upon the best available data. See Federal Accounting Standards Advisory Board, *Federal Financial Accounting and Auditing Technical Release 6: Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (January 2004).

loss estimation model. As a result, we consider this recommendation implemented and closed.

Second, our March 2013 report found that Ex-Im could improve its analysis of the financial performance of its portfolio. Ex-Im's default rate declined steadily from about 1.6 percent as of September 30, 2006, to 0.29 percent as of September 30, 2012, and, more recently, Ex-Im reported a further decline to 0.21 percent as of March 30, 2014.⁶ However, as we concluded in our report, 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. Additionally, we found that Ex-Im was not maintaining the data it 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.⁷ We concluded that the lack of point-in-time data showing when defaults occur could reduce the precision of Ex-Im's loss estimation model. We recommended that Ex-Im retain point-in-time performance data to compare the performance of newer and older business and enhance loss modeling. Ex-Im agreed and began retaining such data in 2013. We therefore consider this recommendation implemented and closed. Ex-Im said it plans to use these data to conduct an annual analysis that will compare the performance of newer books of business with older books and that the results will further enhance its loss estimation model.

Third, our May 2013 report found weaknesses in the methodology Ex-Im used to forecast future exposure levels. The 2012 Reauthorization Act increased Ex-Im's exposure limit to \$120 billion in 2012, with provisions for additional increases to \$130 billion in 2013 and \$140 billion in 2014. Although Ex-Im's forecast model is sensitive to key assumptions, Ex-Im had not reassessed these assumptions to reflect changing conditions or conducted sensitivity analyses to assess and report the range of potential

⁶Ex-Im calculates the default rate as the sum of net claims paid to date on loan guarantees and insurance transactions and unpaid past due installments to date on direct loans divided by disbursements. Ex-Im developed this calculation of the default rate in response to a provision in the Export-Import Bank Reauthorization Act of 2012, which requires Ex-Im to report default rates to Congress at least quarterly. (Pub. L. No. 122-122, § 6, 126 Stat. 350, 353 (2012)).

⁷Ex-Im is not bound by federal banking regulator guidance, but faces risk-management challenges similar to those of regulated private financial institutions.

outcomes.⁸ Because Ex-Im had not taken these steps, we concluded that the reliability of its forecasts was diminished. Based on GAO cost estimation guidance, 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 and put in place new methodologies for its 2015 budget estimates. Specifically, Ex-Im compared the results of its existing authorization forecast method with actual results and enhanced its calculation of expected repayments and authorizations by incorporating historical experience into the methodology. Additionally, Ex-Im created statistical models to validate its forecasts and provide a range of estimates. Therefore, we consider these recommendations implemented and closed.

Finally, in both our March and May 2013 reports, we recommended that Ex-Im report certain risk information to Congress. Our March report found that Ex-Im had begun to implement the IG's recommendation to develop a systematic approach to stress testing its portfolio. We concurred with the IG's recommendation and concluded that Ex-Im's reporting of testing scenarios and results would aid congressional oversight and be consistent with federal internal control standards for effective external communication.⁹ Thus, we recommended that Ex-Im report this information to Congress. Ex-Im agreed and began reporting its stress test scenarios and results in quarterly reports to Congress on default rates, beginning with the report for the fourth quarter of 2013. In that report, Ex-Im described the stress test scenarios and provided some information about results. The scenarios included an across-the-board increase in the riskiness of obligors and an assumption of zero recoveries on defaulted credit transactions. Ex-Im plans to annually update the stress testing

⁸GAO, *GAO Cost Estimating and Assessment Guide: Best Practices for Developing and Managing Capital Program Costs*, [GAO-09-3SP](#) (Washington, D.C.: March 2009). Among other things, this cost guidance calls for agencies' assumptions and forecasts to be supported by historical data and experience, and a sensitivity analysis that can assess the effect of changes in assumptions.

⁹GAO, *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). These standards indicate that agency communications with external parties, including Congress, should provide information that helps the parties better understand the risks facing the agency.

information in fourth-quarter default reports. Additionally, our May 2013 report found that Ex-Im had not routinely reported the performance or risk ratings of its subportfolios for the congressional mandates on small business, sub-Saharan Africa, and renewable energy.¹⁰ We concluded that Ex-Im could analyze additional information about its subportfolios related to the three mandates. Citing guidance from OMB and federal banking regulators, we recommended that Ex-Im routinely report the financial performance of subportfolios supporting congressional mandates.¹¹ Ex-Im concurred with our recommendation and began reporting this information in its default rate report to Congress for the quarter ending June 30, 2013. As a result, we consider both recommendations as implemented and closed.

Ex-Im Has Begun to Address GAO's Recommendations to Improve Workload Management and Reporting

In both our March and May 2013 reports, we found that Ex-Im faced potential operational risks because administrative budgets and staff levels had not kept pace with the growth in its portfolio.¹² Ex-Im reported in its 2012 Business Plan that its resource levels could not sustain the bank's current level of activity or meet expected demand in coming years.

Our March report found that while Ex-Im determined that it needed more staff, it had not formally determined the level of business it could properly manage with its current resources.¹³ We concluded that without benchmarks to determine when workload levels have created too much

¹⁰Ex-Im reviews each credit transaction and assigns a numerical risk rating based on assessments of credit, political, and market risks. In our May 2013 report, we found that the performance of the small business, sub-Saharan Africa, and renewable energy subportfolios differed from the performance of Ex-Im's overall portfolio. For instance, the higher risk ratings of the subportfolios suggested these transactions generally were more risky than Ex-Im's overall portfolio.

¹¹OMB 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.

¹²Operational risk is the risk that loss may result from inadequate or failed internal processes, people, and systems, or from external events.

¹³Federal internal control standards state that agencies should develop a risk-management approach based on how much risk can be prudently accepted. See [GAO/AIMD-00-21.3.1](#) and [GAO-01-1008G](#).

risk, Ex-Im's ability to manage its increased business volume might be limited. Further, we concluded that monitoring workloads against such benchmarks would help Ex-Im determine when additional steps—such as tightening underwriting standards or increasing requirements for lender participation—might be needed to mitigate Ex-Im's increased risk. Accordingly, we recommended that Ex-Im develop benchmarks to monitor and manage workload levels. Ex-Im agreed with this recommendation and hired a contractor in September 2013 to develop workload benchmarks and a workload modeling tool. As of June 2014, benchmarks had been established for certain activities in three Ex-Im divisions. According to Ex-Im, the agency plans to use the modeling tool to develop benchmarks for the remaining activities and divisions. Because Ex-Im's actions to implement this recommendation are ongoing, this recommendation remains open.

Our May 2013 report found that Ex-Im 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 the mandate, as Ex-Im authorizations have grown, the growth in the value of the mandated target has outpaced Ex-Im's increasing support. According to Ex-Im officials, processing small business transactions and bringing in new small business customers is resource-intensive. 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. We concluded that it was important for Ex-Im to communicate to Congress the effect of percentage-based mandates on its operations, as well as the potential impacts such mandates might have on the agency's resources and ability to achieve its goals. Therefore, based on OMB guidance and federal internal control standards, we recommended that Ex-Im provide Congress with additional information on the resources associated with meeting its percentage-based mandates.¹⁴ Ex-Im agreed with this recommendation and told us

¹⁴OMB, Circular No. A-11 Revised, *Preparation, Submission, and Execution of the Budget* (August 2012). The 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.

that it plans to use the workload modeling tool noted previously to provide information in its next budget submission on resources associated with meeting such mandates. Because Ex-Im is in the process of addressing this recommendation, it remains open.

While Ex-Im has been responsive to the recommendations we made, it is important to note that we have ongoing work examining different aspects of Ex-Im's operations. Furthermore, managing a large export financing portfolio and the wide variety of associated risks is challenging. Therefore, it will be important for Ex-Im to sustain the improvements it has made, effectively implement future audit recommendations, and carefully manage emerging risks. We look forward to continuing to assist the Committee in its oversight of Ex-Im.

Chairman Hensarling, Ranking Member Waters, and Members of the Committee, 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 statement, 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; Christine Houle, Analyst-in-Charge; Michael Simon, Analyst-in-Charge; Joshua Akery; Kathryn Bolduc; Marcia Carlsen; Anna Chung; Michael Hoffman; Melissa Kornblau; Risto Laboski; Felicia Lopez; Grace Lui; Colleen Moffatt Kimer; Barbara Roesmann; and Jessica Sandler.

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