Office of Inspector General
Export-Import Bank of the United States

Actions in Response to the Financial Crisis – Direct Lending

Evaluation Report
September 30, 2009
OIG-EV-09-02

Michael W. Tankersley
Inspector General

Export-Import Bank
of the United States

September 30, 2009

MEMORANDUM

TO: Alice Albright
Executive Vice President and Chief Operating Officer

John McAdams
Senior Vice President, Export Finance

FROM: Michael W. Tankersley
Inspector General

SUBJECT: Evaluation of Export-Import Bank's Actions in Response to the Financial Crisis – Direct Lending

This memorandum transmits Evaluation Report OIG-EV-09-02, Actions in Response to the Financial Crisis – Direct Lending. This evaluation was initiated by the Office of Inspector General ("OIG") of the Export-Import Bank of the United States ("Bank") to determine whether the Bank's Direct Lending Program was responsive to the international financial crisis and to identify conditions that might restrain the Bank's ability to respond to increased demand for direct loans.

The evaluation found that the Bank responded to the financial crisis by expanding its direct lending activity, enhancing its products and adopting innovative structures to respond to the needs of U.S. exporters. However, improvements to the Bank's processes would enhance the Bank's ability to respond to the current and future financial crises. We made four suggestions to strengthen the Bank's ability to assess the demand for direct loans as a result of a financial crisis and further enhance the Bank's performance and internal controls. Management generally concurred with the suggestions.

We appreciate the courtesies and cooperation provided to the auditors during the audit. If you have any questions, please call me at (202) 565-3923 or Jean Smith at (202) 565-3944.

cc: Joseph Sorbera, Vice President, Office of the Controller/Audit Liaison
Jonathan Cordone, General Counsel

I. EXECUTIVE SUMMARY

Purpose

The Office of Inspector General (OIG) conducted an evaluation of actions taken by the Export-Import Bank of the United States (Ex-Im Bank or the Bank) since October 1, 2008 with the objectives of: (1) assessing the demand for direct loans from Ex-Im Bank by U.S. exporters and foreign purchasers of U.S. goods as a result of the international financial crisis; (2) identify the actions taken by Ex-Im Bank to utilize the liquidity provided by its U.S. Treasury funding to fill gaps in response to the international financial crisis; and (3) identifying conditions that might restrain the Bank's ability to respond to increased demand for direct loans and recommend actions to respond to those conditions. Management's response to this report appears as Appendix C.

Ex-Im Bank was created in 1934 specifically to address the long-running crisis in international trade and finance that was a central feature of the Great Depression. This report finds the Bank confronting the most significant international contraction of international trade and finance since that time. The Bank's mission is to support U.S. jobs by providing or facilitating financing for U.S. exports in cases where the private sector is unable or unwilling to provide financing, or when necessary to level the playing field for U.S. exporters facing foreign competition aided by financing provided by foreign governments. Because the Bank's management considered the Bank to be reasonably well structured and provisioned with sufficient lending authority to respond to significantly increased demand in the current environment, no additional funding or other legislative action was requested for Ex-Im Bank when Congress considered and passed the American Recovery and Reinvestment Act of 2009 in March of this year.

Results

Our evaluation showed that demand for direct lending from Ex-Im Bank had increased significantly and that the Bank responded to the financial crisis by expanding its direct lending activity, enhancing its products and adopting innovative structures to respond to the needs of U.S. exporters. Between October 1, 2008 and June 30, 2009, the volume of direct loans authorized by Ex-Im Bank increased to $3.1 billion from $12 million during the same period of the preceding fiscal year. Ex-Im Bank is providing a competitive advantage to U.S. exporters in the current environment because it can draw on U.S. Treasury funding; competing export credit agencies in other countries that have been privatized generally do not have this ability. Total authorizations for the nine months ended June 30, 2009 were $14.7 billion, compared with $7.7 billion in the prior period. Additionally, although not part of the direct loan program, Ex-Im Bank also made modifications to its Working Capital Guarantee Program requirements for letters of credit, and increased delegated authority limits to provide additional support to U.S. exporters, including small businesses during the financial crisis.

We concluded that while the above actions were responsive to the international financial crisis and consistent with the Bank's mission, opportunities exist to further improve the Bank's ability to respond to the current and future financial crises in the following areas:

- Management's ability to monitor and respond to market demand for particular services, such as the demand for direct lending during the current financial crisis, is limited because the Bank does not collect relevant and available data in a systematic and comprehensive manner. The absence of relevant data makes it difficult to assess the extent of the Bank's success in responding to increased demand for particular services or the impact of policy requirements applicable to Ex-Im Bank supported transactions such as the use of U.S.-flag ocean vessels for international shipment of the exported goods and limitations on foreign content in Ex-Im Bank supported transactions, among others.

  Suggestion 1: The Bank's management should identify and begin to systematically collect data that will support more thorough assessment of demand for the Bank's support and the effectiveness of the Bank's actions in responding to that demand.

  Management's response: Management concurred with this suggestion while noting that limited resources would present challenges in effecting it.

- The Bank does not have in place a formal policy defining the substantive and procedural requirements that must be met to support the adoption of material policies, the launch of new products or material changes in existing products. This circumstance increases the risk of mistakes, omissions, poor execution and unexpected adverse developments when actions with significant policy and risk implications are taken.

  Suggestion 2: The Bank should develop and adopt a formal written policy that provides a framework for the enactment of material policies, the launch of new products and material changes in existing policies and products that assures that all material business, operational, financial, legal and policy considerations, including a comprehensive risk analysis, are taken into account, and those determinations reasonably documented.

  Management's response: While management noted that the process for approving new products and modifications to existing products is well understood today, management concurred that there is value in developing a consistent procedure, which it intends to develop.

- Ex-Im Bank does not have a documented plan in place to guide the Bank's response to the current financial crisis or other possible economic emergencies that might arise in specific locales around the world or more broadly. Ex-Im Bank's management has relied upon consultation among senior management and with the Board of Directors and the Bank's customers and trade groups, the development of specific ad hoc project teams and institutional memory to guide management's actions to address the current financial crisis. The absence of a crisis response plan can have several negative consequences. It increases the time required to identify and plan actions that the Bank should take to provide additional support to U.S. exporters and export credit lenders in response to a financial crisis. It also increases the risk that opportunities will be missed or mistakes will be made in the course of executing the Bank's response.

Suggestion 3: The Bank's management should develop a crisis response plan that is informed by the Bank's experience in responding to the current and prior economic crises.

Management's response: Management declined to act upon this suggestion, noting that developing a crisis response plan would be difficult for Ex-Im Bank because the Bank, by design, operates in a responsive mode, reacting to events in the international export credit markets.

Evaluator's comment: We respectfully differ with management's perception of the utility and value of making a written record of the insights that have guided its response to the current financial crisis and the "lessons learned" in the process of responding.

Based on the limited resources of the OIG available for this evaluation, and the lack of comprehensive data to support further analysis as noted above in support of Suggestion 1, we determined to examine more closely the effect of one policy mandate that has been cited by exporters as limiting the effectiveness of Ex-Im Bank support for U.S. exports – the requirement for use of U.S.-flag ocean vessels to ship U.S. goods in transactions receiving Ex-Im Bank support. The administration of this requirement is overseen by the U.S. Maritime Administration (MARAD), a part of the U.S. Department of Transportation.

- Our evaluation disclosed that Ex-Im Bank and MARAD have both found that while the majority of transactions subject to the U.S.-flag shipping requirement have successfully used U.S.-flag ocean vessels to make foreign deliveries, a significant number of U.S. exporters and their foreign buyers have had difficulty and have expressed strongly negative views of the impact of the requirement. The publicly available information regarding this requirement provided by Ex-Im Bank and MARAD on their websites did not present a complete, balanced and optimally useful description of the actions Ex-Im Bank supported exporters and foreign buyers should take to most effectively manage the process. Ex-Im Bank and MARAD each reported differing views of some aspects of the requirement, infrequent communications, instances of misunderstandings of the U.S.-flag shipping requirements among Ex-Im Bank staff and an absence of joint efforts to make the process of securing U.S.-flag shipping for U.S. exporters more efficient.

  Suggestion 4: Ex-Im Bank should follow up its December 2008 discussion with MARAD officials to improve communications with MARAD and the understanding of Ex-Im Bank staff and exporters relative to the efficient management of U.S.-flag shipping requirements. Ex-Im Bank should designate a liaison to guide this process and assure a more consistently used and available line of communication with MARAD.

  Management's response: Management stated that it supports this suggestion and notes that it has, and will continue to, identify and discuss MARAD and other constraints with the interested groups.

Conclusion. We believe that while Ex-Im Bank has significantly expanded and modified its programs to aid U.S. exporters and export credit providers in responding to the international financial crisis, the conditions identified above may have limited the Bank's ability to achieve the

most prompt and effective possible response. As noted above, the data required to support a deeper analysis of this question were not available. Collecting that data was determined to be outside of the available resources of this office. We believe that the Bank's adoption of the suggestions made in this report will increase the Bank's effectiveness in responding to the remainder of the current financial crisis and to future crises that emerge.

As an example of the benefits of adopting the suggestions made in this report, consider the suggestion appearing in the 2008 Competitiveness Report that the Bank should find ways to reduce the impact of some of the requirements for obtaining Ex-Im Bank support, such as the U.S.-flag shipping requirements, in order to expand its support of U.S. exporters that have seen the availability of private sector financing contract precipitously. It is outside the scope of this report to recommend whether any changes in the application of these requirements should be made. That being said, Ex-Im Bank's ability to actively consider taking such action, to consult with affected constituencies, Congress and the White House, and to propose and execute significant legislative or policy changes to respond to the financial crisis appears to have been limited by the cited conditions.

Any action by the Bank to seek to modify or waive application of a law or policy such as the U.S.-flag shipping or U.S. content requirements in response to the financial crisis is likely to draw serious questions, if not outright opposition, from the groups most interested in supporting those requirements. Thoughtful evaluation and debate of arguments on both sides of the question would be significantly aided by the availability of timely, relevant, reliable data. As noted above, the Bank has not collected most of the sorts of data that would be most useful in addressing difficult policy questions of this nature.

The potential need to modify or waive policy requirements such as the use of U.S.-flag shipping in order for the Bank to most directly replace lost private sector sources of export credit is a foreseeable part of most financial crises, including the current one. A comprehensive crisis response plan like that recommended in this report should address the potential that the Bank's management, the White House and Congressional oversight committees would need to immediately begin considering the need for changes in law or policy when a crisis strikes, and should identify the process by which those actions are developed.

The availability of a pre-prepared crisis response plan will allow management to begin working sooner, with greater assurance, and with less of a need for spontaneous leadership. A key challenge faced by the Bank in dealing with the current financial crisis has been that its initial response had to be developed during a presidential transition period, which typically diminishes the range of discretionary executive and Congressional action that is available to address fast-developing problems. The Bank was also challenged by the fact that its Chairman and President and General Counsel were requested by the Treasury Department to provide leadership for the Troubled Asset Relief Program (TARP), full-time commitments, commencing in October 2008 and continuing until the Bank's new Chairman and President was confirmed in May 2009. A prepared crisis response plan would make it less likely that these sorts of events might dilute or delay the Bank's ability to mount a prompt response.

The Bank's limited engagement with MARAD, and the limited information on U.S.-flag shipping requirements available to potential new users of Ex-Im Bank support from the relevant web pages, may each contribute to a less effective response for struggling U.S. exporters during a financial crisis. The Bank's limited working relationship with MARAD also might make it more difficult for the two agencies to jointly evaluate and agree on any temporary modification to U.S.-flag shipping requirements that appeared advisable in order to respond to specific market failures resulting from the financial crisis.

The suggestions made in this report are not a panacea – they will not guarantee that the Bank will respond with maximum effectiveness to this or future financial crises affecting U.S. exporters and export credit providers. We do believe that thoughtful implementation of these actions can make important contributions by facilitating the ability of the Bank's management to respond to adverse developments promptly and effectively.

Management's response: Management states that in summary, they believed that Ex-Im Bank was as well prepared as could be expected to respond to the international financial crisis. It is agreed that there is room to improve Ex-Im Bank's data gathering and management will review what options are available with regard to data gathering, recognizing that the Bank has staffing and financial constraints. Consistent with the suggestion to maintain a dialogue with MARAD, management noted that they are in the process of scheduling a meeting with MARAD.

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II. BACKGROUND

The Bank was established in 1934, in the depths of the Great Depression, to help address the paucity of available credit to finance U.S. exports as a result of the international financial crisis existing at that time. The Bank's insurance and guarantee obligations are backed by the full faith and credit of the U. S. government. Ex-Im Bank's direct access to funding from the U.S. Treasury insulates it from adverse developments in U.S. and international credit markets, allowing it to continue to fund export credit transactions for which there is a reasonable likelihood of repayment at times when private sector lenders and exporters are unable to obtain credit from conventional sources. Ex-Im Bank has responded with significantly increased credit support for foreign buyers of U.S. exports in a variety of financial crises since its founding.

The Bank is a "self-sustaining" federal agency – it is funded by positive net cash receipts (insurance and guarantee premiums and interest collected less reserves for potential credit losses and administrative expenses). Cash requirements are funded by borrowings from the U.S. Department of the Treasury. Under the terms of the Federal Credit Reform Act of 1990, the Bank is required to set aside cash reserves for each credit transaction it supports, whether structured as a guarantee, insurance or a direct loan, based on the Bank's loss experience with the specific type of transaction and borrower. The adequacy of the Bank's cash reserves are evaluated each year and adjusted up or down to take account of increases or decreases in the perceived risk of default.

In recent years Ex-Im Bank's cash receipts have exceeded its expenditures, allowing it to return significant amounts to the Treasury. Congress does not appropriate the Bank's annual funding, but does exercise oversight and control by setting annual limits on the Bank's use of funds for program (credit transaction reserves) and administrative expenses. See the notes to the financial statements and related Management's Discussion and Analysis included in the Bank's 2008 Annual Report (http://www.exim.gov/about/reports/ar/ar2008/ExIm_AR.08_.html#) for additional information.

Prior to the current financial crisis, Ex-Im Bank has provided support for export financing of U.S. goods primarily through guarantees and insurance that protect private sector lenders and exporters from financial loss on their export loans and receivables. Ex-Im Bank relies on these lenders and exporters to handle most of the administrative requirements in insurance and guarantee transactions, including effecting cash disbursements and receipts and monitoring the borrower until the credit is repaid or defaults. At the time of a default, Ex-Im Bank pays the amount due to the insured or guaranteed lender or exporter and takes over administration and collection of the export credit. It is a policy objective of Ex-Im Bank to encourage broad participation in its export credit programs by lenders and exporters, and it relies on them to generate a significant portion of its export credit transactions. The Bank has the authority to make direct loans, and has done so in a small number of cases in recent years, but has emphasized its guarantee and insurance products. This model has allowed Ex-Im Bank to maintain a small administrative staff relative to the volume of transactions it supports.

Export Credit Products Offered by Ex-Im Bank

Ex-Im Bank's support for U.S. exports is offered through four primary product categories: direct loans, loan guarantees, working capital guarantees and export credit insurance. Products are also differentiated as short-term, medium-term or long-term based on the length of maturity of the repayment obligation. The Bank's credit exposure is generally limited to 85% of the value of the exported good, with the buyer being obligated to fund 15% of that value.

Direct Loans – Ex-Im Bank makes a loan to a foreign buyer to purchase U.S. exports. Ex-Im Bank loan disbursements go directly to the U.S. exporter as the export products are shipped to the foreign buyer. The foreign buyer signs a note payable to Ex-Im Bank obligating it to repay the principal and interest.

Loan Guarantees – Ex-Im Bank guarantees to a U.S. or foreign lender that makes a loan to a foreign buyer to purchase U.S. exports that, if the foreign borrower defaults, the Bank will pay to the lender the outstanding principal and interest on the loan. Ex-Im Bank charges the borrower a fee to guarantee the loan in a variable amount based on the duration, amount and risk characteristics of the transaction.

Working Capital Guarantees – Ex-Im Bank guarantees to a U.S. or foreign lender that makes a working capital loan to a U.S. exporter that if the exporter defaults, the Bank will pay to the lender the outstanding principal and interest on the loan that is attributable to goods held for export. Ex-Im Bank charges the borrower a fee to guarantee the loan based on the duration, amount and risk characteristics of the transaction.

Export Credit Insurance – Ex-Im Bank issues an insurance policy to a U.S. exporter that provides credit to a foreign buyer of the exporter's products. If the foreign borrower defaults, the Bank will pay to the exporter the outstanding balance owed by the foreign buyer. Ex-Im Bank charges the exporter an insurance premium in a variable amount based on the duration, amount and risk characteristics of the transaction.

Ex-Im Bank's Charter calls for an emphasis on supporting small business exporters. New authorizations for direct small-business exports in FY 2008 totaled $3.2 billion (22.2 percent of total authorizations). New small-business authorizations in FY 2007 totaled $3.4 billion (26.7 percent of total authorizations). In FY 2008, Ex-Im Bank authorized 2,328 transactions (86.1% of the total) that were made available for the direct benefit of small-business exporters, compared to 2,390 small business transactions in FY 2007 (85.6% of the total).

Congressional Mandates Impacting Ex-Im Bank Transactions

When the Bank considers an application for financing support of a U.S. export transaction, it must also consider the requirements of several competing Congressional mandates (described below) that can operate in opposition to the Bank's mission of advancing U.S. employment through exports (Congressional Mandates). These Congressional Mandates, all of long-standing, are not applicable to export financing obtained by U.S. exporters purely from private sector

sources, nor are foreign export credit agencies that compete with Ex-Im Bank by providing credit to support exports by their nations generally subject to comparable requirements. The potentially conflicting effects of the Congressional Mandates on the competitiveness of Ex-Im Bank financing and U.S. exports have been analyzed in detail in Ex-Im Bank's Annual Reports to Congress on Export Credit Competition, of which the most recent, relating to FY 2008, was published in June 2009 (2008 Competitiveness Report).[1]

Requirement to Use U.S. Flag Shipping – In Title 46 U.S.C. 55304 (sometimes referred to as Public Resolution (PR) 17), passed as a joint resolution in 1934, Congress states:

> It is the sense of Congress that any loans made by an instrumentality of the United States Government to foster the exporting of agricultural or other products shall provide that the products may be transported only on vessels of the United States unless, as to any or all of those products, the Secretary of Transportation, after investigation, certifies to the instrumentality that vessels of the United States are not available in sufficient number, in sufficient tonnage capacity, on necessary schedules, or at reasonable rates.

While not having the force of a statutory requirement, the policy objective of PR 17 has been observed to varying degrees by Ex-Im Bank and other U.S. government agencies over the intervening years.[2] PR 17, sometimes referred to as a "cargo preference" requirement, is administered by the U.S. Maritime Administration of the Department of Transportation (MARAD). Ex-Im Bank's policy statement regarding U.S.-flag shipping requirements appears on its webpage, a copy of which is attached as Appendix A to this Report. MARAD's policy statement regarding U.S.-flag shipping requirements appears on its webpage, a copy of which is attached as Appendix B to this Report. These are the principal statements of each agency that provide guidance to exporters and foreign buyers considering applying to Ex-Im Bank for support.

Ex-Im Bank and MARAD have expressed a number of disagreements over the precise scope of the cargo preference requirements applicable to transactions supported by Ex-Im Bank. Ex-Im Bank has undertaken to follow the policy described below in compliance with its reading of PR 17. MARAD has also from time to time asserted that Ex-Im Bank supported transactions are subject to the Cargo Preference Act of 1954 (Title 46 U.S.C. 55305) (1954 Act). The 1954 Act is an affirmative law, not a statement of Congressional intent. Ex-Im Bank has consistently maintained that its transactions are not subject to the 1954 Act and that the policies described below do not reflect its application.

[1] http://www.exim.gov/about/reports/compet/documents/2008_competitiveness_report.pdf

[2] PR-17 and other cargo preference legislation aim to support the U.S.-flagged commercial fleet which serves as an important national security asset during times of war or national emergency. From the perspective of U.S. exporters, however, cargo preference requirements can make U.S. goods less competitive relative to foreign goods because foreign exporters have no shipping requirements and U.S.-flagged vessels generally charge higher rates than their foreign competitors.

Current Ex-Im Bank policy states that a provision will be included in the terms of Ex-Im Bank supported transactions specifying that exported goods requiring ocean transport must be shipped on American flag ocean vessels in the following categories of transactions:[3]

1. Direct loans regardless of term or amount; and
2. Guarantees in excess of $20 million (excluding Ex-Im Bank exposure fee) and having a repayment period of greater than seven (7) years.

The following transactions are described in Ex-Im Bank policy as not subject to the provisions of PR 17:

1. Credit guarantee facilities, regardless of amount;
2. Short-term insurance, regardless of amount;
3. Medium-term insurance, regardless of amount or term;
4. Guarantees of up to $20 million (excluding Ex-Im Bank exposure fee) and having a repayment period of seven (7) years or less; and
5. Guarantees of up to $20 million under the Bank's Environmental Exports Program, Transportation Security Export Program or Medical Equipment Initiative, regardless of term.

By contrast, MARAD's website[4] states its view of the application of PR 17 as follows:

> What percent of cargo is required to be carried on U.S.-flag vessels?
> - Export Import Bank = 100% (governed by Public Resolution 17);
> - Civilian Agencies Cargo = at least 50% (governed by Cargo Preference Act of 1954); and
> - Agricultural Cargoes = at least 75% (governed by the Food Security Act of 1985).

MARAD monitors shipping rates, routes and cost structures of U.S. flag shipping and responds to requests for waivers of U.S. shipping requirements contemplated by PR 17 when ". . . vessels of the United States are not available in sufficient number, in sufficient tonnage capacity, on necessary schedules, or at reasonable rates." See 2008 Competitiveness Report, Section E, for additional information on this requirement.

<u>Limitation of Foreign Content</u> – It has long been the policy of Ex-Im Bank to decline to finance foreign content in export transactions.[5] Foreign content refers to components, goods and

[3] Ex-Im Bank's policy appears in Appendix A to this report.
[4] See Appendix B.

services included in a U.S. export transaction that originate in countries other than the U.S. or the foreign buyer's country. For example, if a transaction includes 70 percent U.S. content and 30 percent foreign content, Ex-Im Bank policy limits its financing support to the 70 percent value of the U.S. content, thereby requiring the buyer to obtain alternative financing for the 30 percent of foreign content value of the transaction. See 2008 Competitiveness Report, Chapter 6, Section C, for additional information on this requirement.

Limitation on Local Costs – Local costs are costs related to a U.S. export transaction that are incurred in the foreign buyer's market. Under guidelines established by the Organisation for Economic Cooperation and Development (OECD), Ex-Im Bank can cover up to 30% of the U.S. export transaction value in local costs in long-term transactions (e.g., projects). However, medium-term transactions can only obtain local cost support if the exporter meets requirements specified by the OECD (e.g., confirmation that a competitor is benefiting from officially supported local cost cover or financing for such costs would be difficult to obtain locally). See 2008 Competitiveness Report, Chapter 6, Section D, for additional information on this requirement.

Review of Economic Impact on U.S. Economy – Section 2(e) of the Bank's Charter requires that the Bank analyze any adverse impact that might result for the U.S. economy from a proposed Ex-Im Bank supported transaction where the exported goods will result in an increase in foreign production of a product that will then compete with U.S. produced products. If the economic impact evaluation yields a net negative finding, that can be a basis for withholding Ex-Im Bank financial support. Transactions involving less than $10 million of Ex-Im Bank support are generally not subject to economic impact review. While only a small number of transactions in any given year are subjected to a full economic impact review, those that are require public notice and substantial effort by the Bank's staff which can require several months to complete. See 2008 Competitiveness Report, Chapter 6, Section B, for additional information on this requirement.

Environmental Review – Section 11 of Ex-Im Bank's Charter authorizes the Board of Directors to grant or withhold financing support after taking into account the beneficial and adverse environmental effects of proposed transactions. Ex-Im Bank's objective is to maintain U.S. exporters' competitiveness in the global marketplace while ensuring that the projects it supports are environmentally responsible. The Bank has established Environmental Procedures and Guidelines which identify supplemental reporting and review requirements applicable to transactions in industrial sectors subject to an increased potential for harm to the environment, which are evaluated by the Bank's Engineering and Environment Division. These policies are described on Ex-Im Bank's website at: www.exim.gov/products/policies/environment/envproc.cfm .

Congressional Notification – Section 2(b)(3) of the Bank's Charter requires that prior written notice be provided to Congress of proposed transactions (i) in an amount which equals or

[5] Section 2(b)(1)(A) of the Charter provides the basis for this longstanding policy determination by the Bank: "It is the policy of the United States to foster expansion of exports of manufactured goods, agricultural products, and other goods and services, thereby contributing to the promotion and maintenance of high levels of employment and real income, a commitment to reinvestment and job creation, and the increased development of the productive resources of the United States."

exceeds $100,000,000 or (ii) for the export of technology, fuel, equipment, materials, or goods or services to be used in the construction, alteration, operation, or maintenance of nuclear power, enrichment, reprocessing, research, or heavy water production facilities. This requirement is counter to the confidentiality that parties to significant privately funded transactions would ordinarily expect to apply in the early stages of negotiation and documentation.

Recent Events

The global financial crisis that erupted in 2008 negatively impacted the liquidity of U.S. and foreign banks that have provided the vast majority of export credit to U.S. exporters. As a result, Ex-Im Bank received increased requests for support from companies that in the past were served by private banks and other export credit providers, and in particular, requests for direct loans. These circumstances are described in the summary of the Bank's discussions with a focus group of exporters and lenders consulted during the preparation of the 2008 Competitiveness Report:

> Exporters and lenders alike characterized 2008 as a schizophrenic year with the last quarter marked by the demise of Lehman Brothers as a key turning point. The pipeline of most lenders was strong going into 2008 because of the weak dollar and healthy liquidity. By the mid-year mark, the markets were less than sanguine and by October, their outlooks had dimmed considerably. Lenders were either not able to finance anything, much less cross border risk transactions, or were quite limited in their capacity with only the best relationship customers able to obtain financing. Hampered by their own balance sheets and more rigid internal capital constraints by year end the lenders were very cautious and anxious about their own organizations' viability, and showed serious concern about their continued engagement in trade finance and export credit financing. While there was activity, the nature of that activity had changed dramatically during the year: deals that previously would not have needed export credit agency (ECA) support began turning to ECAs due to lenders' apprehensions or limited liquidity.
>
> In addition, lenders who have not historically dealt with Ex-Im in the past began coming to Ex-Im because it could provide protection in this risky and highly volatile environment and, "it is the U.S. government." Ex-Im, as other ECAs, have become critical and necessary in virtually all medium and long term cross-border risk transactions. However, lenders warned Ex-Im not to attribute the demand for Ex-Im's services to high quality service, because Ex-Im's "warts have not gone away." Moreover, the same challenges that have plagued Ex-Im Bank and its competitiveness (e.g., content, MARAD, risk aversion) are still there, but now they have to be dealt with if U.S. companies are going to benefit. In the words of one lender, "Ex-Im has not 'met' the world but instead the world has 'met' Ex-Im." If possible, lenders who deal with multinationals or companies in other countries will still opt for non-U.S. sourcing and non-U.S. ECA support.
>
> Finally, lenders noted that ECAs operating in Europe have been given a priority status by their governments who have singled out the ECAs and the roles they should fill in times of financial crisis. In particular, Troubled Asset Relief Program-like facilities have been set up by their respective governments and the ECAs seem to be using them proactively and aggressively.

> Exporters mirrored the same concerns expressed by the lenders but also believe that they have the "ECA direct loan option" as the last resort if commercial lenders could not or were not able to participate on reasonable terms, noting that pricing had spiked considerably in the private market when it was available. While most of 2008 yielded export sales levels as good as 2007, the latter part of the year had exporters ratcheting their sales projections downward. Deals that had once been assumed would go forward were either put on hold indefinitely, cancelled altogether or were being re-evaluated by private lenders as to creditworthiness and often-times being re-priced (higher), given the limited amount of liquidity (or complete lack of) in the market. Thus, between limited lending availability and foreign buyers cancelling or postponing sales, exporters were not optimistic about their export prospects going forward. As one exporter put it, they were "running full speed but then hit a wall in the 4th quarter and came to an abrupt stop."
>
> In looking ahead, participants agreed that customers are currently anticipating relatively higher levels of financing from Ex-Im Bank. However, the participants were mindful to explain that the higher demand for Ex-Im Bank products is not because ExIm's competitiveness and responsiveness are so great – which they are not. Rather, the increased utilization reflected a clear need for government intervention. Without active engagement by the government sector, neither credit nor trade will flow, and the economy and its exporters will suffer.

The 2008 Competitiveness Report was reviewed by the Bank's Advisory Committee.[6] Among the conclusions stated in their written response to the report were the following:

> Ex-Im Bank's role and mission are clear: support U.S. jobs through providing financing that is competitive with our ECA counterparts when the private sector is unwilling or unable to be involved. Never has the need for Ex-Im Bank been greater and accordingly, the Bank needs to diligently and thoughtfully pursue approaches and practices that are proactive, supportive of its mission and mandate, and are relevant to its exporting constituency.
>
> This directive may require Ex-Im Bank to reconsider if and how it is fulfilling its fundamental role as a Lender/Insurer of Last Resort and to modify its thinking and ways to manage risk differently and better. Or it may require other issues be taken into account. In any event, an opportunity to undertake a wholesale review of how its programs and approaches actually fit the Bank's core mandates has been presented – an opportunity we hope the Bank will avidly pursue.

[6] The Bank's Advisory Committee helps Ex-Im Bank review policies and programs by providing input from various sectors of the economy. The Advisory Committee holds quarterly meetings; its primary task is to advise the Bank concerning its programs, especially with respect to competitiveness. The members of the Advisory Committee are identified on the Bank's website at: http://www.exim.gov/about/leadership/advisory.cfm.

The Advisory Committee therefore, urges the Bank to seize this opportunity at a time in which the ECA world has come to a standstill to meet the economic and financial challenges that the current crisis has created. The Bank has outstanding human resources and capabilities that could be brought to bear to address these monumental issues. Once the crisis has abated, our ECA counterparts will presumably be getting "back to business." If Ex-Im Bank has not taken this moment in its history to recreate itself in a manner fitting of the U.S., the country, our exporting community, and U.S. jobs will suffer.

III. OBJECTIVES

The objectives of the evaluation were to:

- Assess the demand for direct loans from the Bank by U.S. exporters and foreign purchasers of U.S. goods as a result of the international financial crisis;
- Identify the actions taken by Ex-Im Bank to utilize the liquidity provided by its U.S. Treasury funding to fill gaps in response to the international financial crisis; and
- Identifying conditions that might restrain the Bank's ability to respond to increased demand for direct loans and recommend actions to respond to those conditions.

IV. SCOPE AND METHODOLOGY

The scope of the evaluation focused on actions Ex-Im Bank took during FY 2009, commencing in October 2008, or planned for future implementation in FY 2009 or 2010 to increase activity in the direct lending programs. We conducted our fieldwork from May 5, 2009, to July 15, 2009.

We interviewed key Ex-Im Bank staff to obtain relevant information/documents pertinent to this evaluation and to clarify relevant Ex-Im Bank policies and actions. Specifically, we met with representatives from the following Ex-Im Bank offices: Export Finance, Credit and Risk Management, Chief Financial Officer, Credit Underwriting, Small Business, Policy and Planning, International Relations, Business Credit, Communications, Trade Finance and Insurance, Project and Structured Finance, Operations and Advisory Committee. In addition, we met with representatives from MARAD to discuss their view of U.S. -flag shipping requirements, their procedures for granting waivers and other related issues.

We analyzed data obtained from Ex-Im Bank staff as well as information available on the Bank's website such as the Charter and the 2008 Competitiveness Report. We also reviewed requirements and guidance provided by external sources such as the Government Accountability Office (GAO) and the Office of Management and Budget (OMB).

V. FINDINGS AND SUGGESTIONS

A. DEMAND FOR DIRECT LENDING BY EX-IM BANK

We discussed with Ex-Im Bank management their perceptions of the state of demand for direct lending by Ex-Im Bank to support U.S. exports in view of the effects of the international financial crisis. They identified the primary factors contributing to an increased demand for direct lending by Ex-Im Bank as lender concerns about decreased credit quality of borrowers and concerns for the lender's own liquidity (ability to obtain funds to meet lending and other obligations). Management described in general terms and anecdotally conversations with a range of borrowers and lenders that confirmed these conclusions. Management noted a significant increase in inquiries regarding Ex-Im Bank export credit support for exporters and foreign buyers that had found financing in the private sector prior to the financial crisis. Management also pointed to the significant increases in direct lending and in short-term insurance authorizations and applications (see Table 1 below), as well as a substantial increase in expressions of interest in Ex-Im Bank funding by sponsors of significant development projects around the world.

The demand for direct lending discussed above is solely attributed to management's input because the Bank does not accumulate data relative to indications of interest that do not turn into formal applications, applications that are withdrawn or applications that are denied, nor the reasons for withdrawals or denials. Further discussion on assessing demand for direct loans is provided in Section C of this report.

B. INCREASED EX-IM BANK AUTHORIZATIONS AND DIRECT LENDING IN RESPONSE TO THE FINANCIAL CRISIS

The dollar volume of Ex-Im Bank export credit authorizations has increased substantially in FY 2009 compared to the same period of FY 2008. For the nine months ended June 30, 2009, Ex-Im Bank reported total authorizations of $14.7 billion in 1,969 transactions, compared to total authorizations of $14.4 billion in 2,704 transactions for the entirety of FY 2008. Individual export credit products experienced varying results, with authorizations up substantially in some areas, particularly in direct loans, but down in others, such as the medium-term programs.

TABLE 1 – AUTHORIZATIONS BY EX-IM BANK

($ in millions)

Program	First 9 months FY 2009 Authorized Amount	First 9 months FY 2009 Transaction Count	First 9 months FY 2008 Authorized Amount	First 9 months FY 2008 Transaction Count	Percent Change Authorized Amount	Percent Change Transaction Count
DIRECT LOANS						
Long-term Loans	$ 3,067	15	$ 12	1	25,458.3%	1,500.0%
Tied Aid Loans	8	1	-	-		
Total Loans	3,075	16	12	1	25,458.3%	1,500.0%
GUARANTEES						
Long-term Guarantees	5,802	36	4,806	49	20.7%	-26.5%
Medium-term Guarantees	151	69	158	86	-4.4%	-19.8%
Working Capital Guarantees	851	278	595	226	43.0%	23.0%
Credit Guarantee Facilities	76	1	115	4	-33.9%	-75.0%
Total Guarantees	6,880	384	5,674	365	25.4%	-98.3%
INSURANCE						
Medium-term Insurance	179	80	200	120	-10.5%	-33.3%
Short-term Insurance	4,366	1,484	1,705	1,336	156.1%	11.1%
Total Insurance	4,545	1,564	1,905	1,456	145.6%	-22.3%
PEFCO[7] Notes	224	5	80	3	180.0%	66.7%
GRAND TOTAL	**$ 14,724**	**1,969**	**$ 7,671**	**1,825**	**91.9%**	**7.9%**

(Source: Ex-Im Bank Operations Office)

The increase in Ex-Im Bank export credit authorizations has come in the face of a significant overall drop in the volume of international trade generally and U.S. exports in particular. In the first quarter of calendar 2009, U.S. exports were reported to have dropped by 21.5%, suggesting that Ex-Im Bank's increased volume of authorizations represents an even larger increase in its market share of total U.S. export credit provided during these periods.

TABLE 2 – U S. EXPORTS: 2007 v. 2008 and 1ST QUARTER 2008 v. 1ST QUARTER 2009

($ in millions)

	2007	2008	% change 2007 to 2008	2008 thru Mar	2009 thru Mar	% change 2008 thru Mar to 2009 thru Mar
World Total	$1,148,198	$1,287,441	12.13%	$314,348	$246,770	**-21.50%**

(Source: Foreign Trade Division, U.S. Census Bureau, http://tse.export.gov)

[7] PEFCO is a private corporation owned by commercial banks, industrial corporations and financial service companies that acts as a secondary market purchaser of loans covered by Ex-Im Bank's guarantee or insurance.

Management reported that Ex-Im Bank had undertaken four initiatives during FY 2009 that made use of the Bank's certainty of funding from the U.S. Treasury to respond to increased demand for Ex-Im Bank sponsored export credit:

- Increased direct lending, using existing Ex-Im Bank authority to make direct loans. In a number of instances transactions that had begun the application process as requests for Ex-Im Bank guarantees of loans by private sector lenders were quickly converted to applications for direct loans as questions developed regarding the ability of the private sector lenders to fund their commitments. Table 3 below itemizes the specific direct loans authorized by Ex-Im Bank between October 1, 2008 and June 30, 2009.

- Restructuring a significant previously authorized guarantee transaction to provide for direct advances of loan proceeds by Ex-Im Bank. This transaction, originally authorized in FY 2008, was restructured in May 2009, with Ex-Im Bank funding $331 million of the committed total of $400 million.

- Purchasing existing Ex-Im Bank guaranteed loans from PEFCO, a private corporation owned by commercial banks, industrial corporations and financial service companies that acts as a secondary market purchaser of loans covered by Ex-Im Bank's guarantee or insurance, in order to increase its ability to fund pending Ex-Im Bank guaranteed or insured loan transactions. Three loans with a face amount of $220 million were purchased by Ex-Im Bank in December 2008.

- Creating a new product – the "take-out option" – that would allow the lender in an Ex-Im Bank guaranteed transaction to sell the loan to Ex-Im Bank at its face amount at a stated future date, while still continuing to administratively service the loan. This product, publicly announced July 16, 2009, will aid private sector lenders that are required to balance the maturities and interest rates of their assets (commercial loans) and liabilities. These lenders have had difficulty securing funding at reasonable rates at maturities of more than two to four years. The recent release of this product prevents the presentation of data on its use in the market.

Through the efforts described above and substantially increased activity in some of its other programs, Ex-Im Bank significantly increased its lending activity in the current fiscal year. The $3.1 billion of direct loans authorized represents 15 individual transactions:

TABLE 3 – AUTHORIZED DIRECT LOAN TRANSACTIONS FROM OCTOBER 1, 2008 TO JUNE 30, 2009.

Count	Date Authorized	Amt Authorized	Country	Product
1	12-Dec-08	14,703,908.00	Ghana	WATER TREATMENT SYSTEM EQUIPMENT
2	15-Jan-09	373,140.73	Morocco	AIRCRAFT

3	15-May-09	150,662,023.00	Saudi Arabia	POWER PLANT TURBINES
4	15-May-09	151,076,500.00	Saudi Arabia	POWER PLANT TURBINES
5	15-May-09	611,097,142.00	Saudi Arabia	POWER PLANT TURBINES,
6	12-Feb-09	86,504,019.00	Brazil	DIESEL ELECTRIC LOCOMOTIVES
7	05-Mar-09	99,468,476.00	Canada	HELICOPTERS
8	23-Apr-09	600,000,000.00	Mexico	OIL & GAS FIELD EQUIPMENT
9	30-Apr-09	150,000,000.00	Mexico	OIL & GAS FIELD EQUIPMENT
10	23-Apr-09	300,000,000.00	Mexico	OIL & GAS FIELD EQUIPMENT
11	21-May-09	500,000,000.00	United States	AIRCRAFT & HELICOPTERS
12	09-Apr-09	75,335,459.62	Israel	AIRCRAFT
13	23-Apr-09	270,599,813.16	United Arab Emirates	AIRCRAFT
14	11-Jun-09	18,877,645.00	Indonesia	HELICOPTERS
15	11-Jun-09	37,925,112.46	Israel	AIRCRAFT
		3,066,623,238.97		

(Source: Ex-Im Bank Operations Office)

The Bank has also made innovative changes in how some of these transactions were structured in order to meet the particular needs of borrowers that previously were able to meet their financing needs in the capital markets or using other private sector sources. An example is the $500 million facility, transaction number 11 above that was described in a Bank press release dated May 21, 2009 as supporting the ability of a U.S. company to offer financing to the foreign buyers of aircraft from its subsidiaries.

In view of the Bank's limited administrative resources, and in order to encourage continued participation of lenders in Ex-Im Bank programs, management reported that private sector lenders would handle the administrative servicing of substantially all of the directly funded loans described above.

Additionally, although not part of the direct loan program, management reported other actions to assist exporters and lenders in responding to the financial crisis. Specifically, among other actions, Ex-Im Bank:

Enhanced the Working Capital Guarantee Program to increase funds available to exporters;

Authorized substantially increased letter-of-credit support facilities, with larger pre-approved limits, for banks in South Korea, India and Angola;

Reduced cash collateral requirements for letters of credit to 10% of face value from 25%, on a case-by-case basis, compared to the 100% coverage typically required by private sector lenders;

Combined the financing limits of the Bank's Super Delegated Authority Program ($150 million limit) with the Bank's Fast Track Program ($300 million) to allow lenders

> participating in both programs to increase support for small and medium-sized businesses; and
>
> Expanded the Bank's working capital loan guarantee program to cover goods produced by small businesses that are then sold to a U.S. company that will export them.

Impact of Congressional Mandates

Some members of Ex-Im Bank management and transaction participants – exporters, lenders, agents, members of the Bank's Advisory Committee and participants in the focus groups supporting the 2008 Competitiveness Report –have identified the Congressional Mandates described in Section II of this report (U.S.-flag shipping, economic impact review, U.S. content restrictions, local content restrictions, environmental review, Congressional notification) as imposing significant limitations on Ex-Im Bank's ability to respond to increased demand for export credit to support U.S. exports. This was noted to be particularly the case with respect to Ex-Im Bank direct lending transactions which are subject to U.S.-flag shipping requirements regardless of size or maturity. By comparison, U.S.-flag shipping is not required for guarantee transactions of $20 million or less or having a repayment period of 7 years or less, or for insurance transactions of any size.

In the 2008 Competitiveness Report, the Bank describes the conflicting policy interests resulting from the Congressional Mandates:

> The limits on Ex-Im Bank financing that result from these public policy considerations are sometimes unique to the United States. These unilateral requirements have the potential to create tensions between the goals of maximizing U.S. exporter competitiveness vis a vis foreign ECA (and maximizing Ex-Im Bank financing) and satisfying public policy mandates (which may limit Ex-Im Bank financing).
>
> Ex-Im Bank stakeholders are split in their views on how Ex-Im Bank should balance competing mandates. On one hand, exporters contend that they are disadvantaged by requirements that curb Ex-Im Bank financing; they believe that Ex-Im Bank's U.S. jobs mission is best served by maximizing U.S. exporter competitiveness. On the other hand, Organized Labor maintains that, as a public institution, Ex-Im Bank should broadly evaluate the overall effects of its financing on U.S. jobs (including any negative effects); they believe Ex-Im Bank's U.S. jobs mission is best served by considering the net impact of Ex-Im Bank financing.

The Advisory Committee's response to the 2008 Competitiveness Report confirms management's perspective:

> The Advisory Committee notes that the issues of content, economic impact, and MARAD/PR 17/shipping requirements have repeatedly been identified by the U.S. exporting community as hurdles to Ex-Im Bank's ability to provide a full range of competitive financing as compared to other ECAs. Accordingly, the Advisory Committee urges the new Administration to pursue possible solutions that would achieve more balance

> along both the competitiveness and employment vectors. Such an effort needs to include all stakeholders, including Congress, labor and the business community.

While at the same time the Advisory Committee's response acknowledged that:

> . . . the two members representing labor have expressed concern about how the Report addresses the issues of content, economic impact and U.S. shipping requirements, including the methodology. In particular, the labor members neither concur with the Report's description of these issues nor the description of, or the impact on, the U.S. exporting community's experience with these factors as an important element in their overall competitiveness.

Impact of U.S.-Flag Shipping Requirements

Based on the limited resources of the OIG available for this evaluation and anecdotal reports of particular challenges associated with the U.S.-flag shipping requirements, we focused our resources on the examination of the effect of one of the Congressional Mandates, that requiring the use of U.S.-flag ocean vessels to carry U.S. exports supported by Ex-Im Bank (PR 17), on the Bank's export credit transactions generally and specifically in the context of the Bank's response to the international financial crisis. U.S.-flag ocean vessel shipping requirements were one of a number of Congressional Mandates identified in the Bank's 2008 Competitiveness Report summary of exporter perspectives that were identified as having a negative impact on the competitiveness of U.S. exports.

As discussed above and in Section C., Ex-Im Bank does not maintain comprehensive data regarding exporter experience with U.S. shipping requirements administered by MARAD. One Export Finance Vice President (VP) identified anecdotally 21 transactions over the past six years that were believed to have been negatively affected by U.S. shipping requirements (see Table 4). This VP stated that of the 21 transactions, some companies hired consultants to assist in meeting MARAD requirements or obtaining a waiver, while others cancelled transactions or refused to use Ex-Im Bank for future business.

TABLE 4 – TRANSACTIONS IN WHICH U.S.-FLAG SHIPPING REQUIREMENTS WERE REPORTED TO NEGATIVELY IMPACT EX-IM BANK TRANSACTIONS BETWEEN JANUARY 2003 AND MAY 2009.

	Ex-Im finance portion ($MM)	Consultant hired to assist in obtaining a waiver	Cancelled	Not cancelled but significant shipping problems or cost	Not cancelled but refused to use Ex-Im Bank again due to U.S.-flag shipping requirements
1	$ 405	X			
2	404	X			
3	40		X		
4	80	X			
5	55				X
6	54				X
7	90		X		
8	500	X			
9	400	X			
10	900			X	
11	63		X		
12	200	X			
13	500			X	
14	400	X			
15	60			X	
16	48			X	
17	1,000		X		
18	unknown		X		
19	61		X		
20	54				X
21	unknown		X		
	$ 5,314	7	7	4	3

(Source: Export Finance VP)

The Bank's 2008 Competitiveness Report includes the following discussion of U.S.-flag shipping requirements based on interviews of focus groups of Ex-Im Bank lenders and exporters consulted by the Bank:

> Most exporters and lenders noted that the MARAD requirement is a factor that places them at a competitive disadvantage. Critics of this requirement explain that the higher shipping costs (sometimes 40%+ higher) and route scheduling challenges associated with shipping via U.S.-flagged vessels is a prohibitive aspect of using Ex-Im Bank support. They note that in some cases U.S. shipping requirements may be the sole reason why a U.S. exporter may lose business to a foreign competitor. One exporter noted that the MARAD requirements are impractical and do not reflect real world shipping cost scenarios. These requirements can actually hinder the realization of U.S. exports by mandating shipping logistics and/or costs that make sourcing U.S. equipment prohibitive. Other exporters noted that obtaining a waiver from MARAD is often a 2-3 month process which, in such cases, leads the exporter and lender to give up and source product from another country.

For U.S.-domiciled multinationals with significant existing manufacturing operations already overseas, the MARAD requirements are so onerous that they are considering moving major U.S. manufacturing lines overseas, enabling them to access foreign ECA financing without the burden of the MARAD requirements.

However, there is also an alternative perspective voiced by the transportation and logistics departments of a number of U.S. exporters who use Ex-Im Bank financing. These individuals who work with MARAD staff and MARAD's published Policies and Procedures, explained that they found waiver requests less burdensome when they closely conformed to MARAD's own guidelines. In addition, they noted that their general experience was that MARAD's waiver processing staff endeavors to process waivers in a timely manner and is sensitive to the time constraints of each individual ExIm-supported deal.

In view of the reported difficulties of exporters in obtaining competitive shipping schedules and costs using U.S.-flag vessels, a significant number of them are reported to request waivers of the PR 17 requirements from MARAD. MARAD administers the waiver process based upon an exporter filing a written request for waiver that provides evidence supporting one of four categories of qualification based on the express terms of PR 17:

- "Statutory" waivers may be granted when U.S.-flagged vessels will not be available within a reasonable time or at reasonable rates. "Reasonable rates" are rates that are deemed by MARAD to be reasonable for a U.S.-flagged vessel based on MARAD's monitoring of the operating costs of the U.S. merchant marine fleet, and do not take into account lower prices that may be offered by a foreign-flagged vessel.

- "Conditional" waivers may be granted for cases where no U.S-flagged vessel is available to accommodate multiple shipments of "critical item" cargoes during a required project time period.

- "General" waivers may be granted in situations where a U.S.-flagged vessel may be available, but recipient-nation vessels are authorized to share in the ocean carriage (the recipient nation must give similar treatment to U.S. vessels in its foreign trade).

- "Compensatory" waivers may be granted when foreign borrowers or U.S. exporters ship goods on non-U.S.-flagged vessels and subsequently enter into an Ex-Im Bank-supported financing agreement for those goods. In such cases, a compensatory waiver may be granted directing that an equivalent amount of non-Ex-Im Bank-supported goods to be shipped on U.S.-flagged vessels within a specified time period.

Based on the information shown in Table 5, it appears that MARAD approves a high percentage of the waiver applications submitted (approval rate ranged from 92 to 100 percent). For calendar year 2007, MARAD identified 211 individual bills of lading associated with Ex-Im Bank supported transactions, compared to the 13 individual waivers granted during that year.[8]

[8] A single Ex-Im Bank supported transaction can result in more than one shipment.

According to MARAD, waiver denials have been consistently kept to a minimum as a result of MARAD's proactive assistance in finding suitable U.S.-flag service. MARAD explains that this is intentionally accomplished through its efforts to educate Ex-Im Bank's prospective customers so they understand that if no reasonably competitive U.S.-flag service exists, a waiver will be granted expeditiously.

TABLE 5 – NUMBER OF EX-IM BANK RELATED PR 17 WAIVERS FROM FY 2002 TO FY 2008.

Waiver Type		2002	2003	2004	2005	2006	2007	2008	Total	Percentage of Waivers Approved
General	Approved	3	0	0	1	0	1	0	5	100%
	Denied	0	0	0	0	0	0	0	0	
Statutory	Approved	22	29	26	19	17	6	12	131	92%
	Denied	1	5	2	2	1	0	0	11	
Compensatory	Approved	10	11	5	3	2	6	9	46	100%
	Denied	0	0	0	0	0	0	0	0	
Conditional	Approved	0	0	0	1	0	0	0	1	100%
	Denied	0	0	0	0	0	0	0	0	
Total	Approved	35	40	31	24	19	13	21	183	94%
	Denied	1	5	2	2	1	0	0	11	

(Source: MARAD)

Given the conflicting perspectives relating to U.S.-flag shipping requirements, we performed additional work to identify opportunities to improve the Bank's effectiveness in supporting U.S. exporters and their foreign buyers in understanding and complying with the U.S.-flag shipping requirements. The results of our work are presented below in Section C, Objective 3.

C. OPPORTUNITIES TO FURTHER ENHANCE EX-IM PERFORMANCE AND INTERNAL CONTROLS

OBJECTIVE 1: ASSESS THE DEMAND FOR DIRECT LOANS FROM EX-IM BANK BY U.S. EXPORTERS AND FOREIGN PURCHASERS OF U.S. GOODS AS A RESULT OF THE INTERNATIONAL FINANCIAL CRISIS.

Suggestion 1:
Develop a systematic and comprehensive approach to collecting and reporting data relating to market demand and related factors impacting Ex-Im Bank performance.

Management Response:
Ex-Im Bank will review what options are available with regard to data gathering, recognizing that Ex-Im Bank has staffing and financial constraints.

It is clear from the rapid increase in the rate of Ex-Im Bank's authorizations of direct lending transactions during FY 2009 as presented above in Table 1 that the demand for direct lending has increased substantially and that Ex-Im Bank staff have been active and successful in responding to increased demand for direct lending. It was not possible for us to assess the aggregate demand for Ex-Im Bank direct lending support, the causes for that increased demand, nor whether Ex-Im Bank has responded to 100% of the increased demand or some lesser percentage because individual participants determined not to apply, withdrew applications or had applications rejected. While management provided anecdotal reports of individual exporters or lenders determining not to seek Ex-Im Bank support because of challenges associated with the Congressional Mandates described in Section II of this report (U.S. shipping, economic impact review, U.S. content, local content, environmental review, Congressional notification), comprehensive data were not available.

Management's ability to gauge and report market demand for particular services, such as the demand for direct lending during the current financial crisis, the impact of various conditions on that demand, such as the impact of the Congressional Mandates, and the Bank's success in meeting market demand and assisting exporters and lenders in navigating the full range of requirements for Ex-Im Bank support is limited because the Bank does not collect and record relevant and available data in a systematic manner.

Our discussions with management in the course of preparing this report indicated that there was extensive and frequent communication between management and leading exporters and lenders, as well as other participants in Ex-Im Bank supported transactions. However, because this data is not collected, recorded and reported in any systematic manner, it is difficult for management and other interested parties, such as the Office of Inspector General, to obtain other than anecdotal data. The absence of comprehensive data also makes it difficult for the Bank to approach OMB, Congress or the constituencies supporting each of the Congressional Mandates to engage in a discussion of whether any modifications of those requirements might be justified, generally or more narrowly in response to specific circumstances existing in the market.

The Bank does track transactions authorized and transactions for which applications have been submitted that are pending, including the elapsed time of the Bank's response to the applications. The Bank does not accumulate data relative to inquiries and indications of interest that do not turn into formal applications, inquiries and indications of interest that the Bank's staff refer to private sector export credit providers for action, the nature of exporters making inquiries (for example, small and disadvantaged businesses), applications that are submitted but later withdrawn, including whether early adverse reaction by the Bank's staff or further information about requirements and conditions to Ex-Im Bank support contributed to the decision to withdraw the application, applications that are denied and the reasons for denial, nor the reasons for failures to proceed with applications, withdrawals or denials. Comprehensive quantitative data regarding the impact of the Congressional Mandates on the demand for Ex-Im Bank financing is not available.

This sort of data is collected by other government agencies, and also by private sector lenders, in order to allow them to more closely track and respond to trends in the demand for and reaction to their offered services. This data will support a more focused and potentially effective outreach to

parties that have not used the Bank's support. Establishing a formal tracking system would assist management by providing a clear, centralized overview of the Bank's workload. From the standpoint of the Bank's mission of advancing U.S. jobs through exports, the time that staff spends successfully referring an exporter to a private source of export credit is just as valuable as time spent approving a submitted application. A formal system would provide managers with visibility into staff workload and volume and measurable application approval and denial data on which to base performance evaluations and resource allocation decisions. It would provide routine accessibility to information from which to identify trends, challenges and recurring issues warranting management attention. The information retained could also provide a useful teaching tool to increase efficiency and accuracy in responding to inquiries and reduce loan application error rates.

OBJECTIVE 2: IDENTIFY THE ACTIONS TAKEN BY EX-IM BANK TO UTILIZE THE LIQUIDITY PROVIDED BY ITS U.S. TREASURY FUNDING TO FILL GAPS IN RESPONSE TO THE INTERNATIONAL FINANCIAL CRISIS.

Suggestion 2:
Adopt a policy for Ex-Im Bank setting forth clear written requirements for approving material policies, new export credit products and material changes in existing export credit products.

Management Response:
Ex-Im Bank is currently reviewing the policy approval process to be sure consistent procedures exist for modifying or creating financing products.

During the course of our evaluation of Ex-Im Bank's actions to respond the financial crisis, and particularly the use of its direct lending authority supported with liquidity provided by the U.S. Treasury, we noted a number of instances of management identifying and responding to changes in the market in order to better serve U.S. exporters and export credit users. Examples included converting a number of pending applications for guarantee support to direct lending transactions, the innovative structuring of a transaction supporting the exporting subsidiaries of a parent company and the creation of the "take-out" option, all described previously.

When we asked to review the policy support and documentation for these actions, management was not able to direct us to any particular statement of the Bank's policy that supported the actions taken. It should be noted that the Board of Directors considered and voted on each of the listed transactions after detailed briefings by the Bank's staff. The current practice at the Bank, as evidenced in the case of the three actions described above, appears from our review to consist of developing material policies, new export credit products and material changes in existing export credit policies based upon consultations among senior management, including in some cases consultation with the Board of Directors on a formal or informal basis, and approval by the relevant division head or the Chief Operating Officer or Chairman/President of the Bank. In each of the instances we reviewed there was not a formally specified decisional and documentation structure that assures that all material business, operational, financial, legal and policy considerations, including a comprehensive risk analysis, are taken into account, and those determinations documented, before the relevant policy is adopted by the Bank.

In the case of the $500 million transaction (No. 11 of Table 3) mentioned above, its innovative structure was reported to have been developed by management in direct negotiations and discussions with the parent company borrower. The transaction was duly presented to and approved by the Board of Directors, assuring that all formal legal requirements for approval by the Bank were met. It did not appear from the information presented to us that management consideration was given to whether the innovative features of the transaction represented a sufficient deviation from existing practice at the Bank that additional, more general, consideration of its advantages and risks, and its potential for use by other U.S. exporters, would be beneficial.

It is a generally accepted practice among private sector financial institutions that new policies, new lending products and material changes to existing lending products are considered by an established committee including representatives of all areas of the institution that will have responsibility for implementing the relevant action and dealing with its requirements and consequences. This approach produces a number of benefits:

- It provides greater assurance that unanticipated problems do not plague the execution of new policies or products;
- It provides greater assurance that all interested constituencies within the institution have been consulted regarding the impact of the proposed action on them and what they will be called upon to do to assure its success;
- It increases the efficiency of the process of creating new policies or new products – in many cases the amount of work associated with creating a single innovative transaction will be nearly as great as would be a more general consideration of creating an innovative product that can be offered to other customers;
- It more effectively manages risk by calling on each affected area of the Bank to suggest and evaluate sources of risk on a collaborative basis – when innovation occurs on an unstructured, "one-off" basis, for the benefit of parties having specific risk characteristics that are addressed by skilled advocates, the result can be terms that manage risk reasonably for the specific case, but much less effectively for other parties that might request similar treatment; and
- It allows the Bank's public relations and client relationship teams to understand the general features of the innovative structure and to more rapidly spread the news of its availability among potential users.

The Bank's Senior Vice President (SVP) of Policy and Planning reported to us that it had been the historical practice of the Bank to use a formally convened committee as a policy/new product centralizing and processing entity, with some of its conclusions being shared with the Board. However, in later years the Bank's senior management was reported to have emphasized the operational primacy of line functions, allowing the Bank's operating divisions to independently issue a policy if the applicable division head deems it appropriate.

Chairman James Harmon, in March 1999, created a Policy Committee "…to review significant policy and program issues and develop possible resolutions; work with management to efficiently allocate policy development duties to line staff; prioritize policy topics with the broad

priorities established for the Bank and act as a responsive body that will help staff get efficient answers to pressing questions." The Committee has been discontinued.

GAO's "*Standards for Internal Control in the Federal Government*" identified Control Environment as one of the five standards for internal control. GAO stated "a good internal control environment requires that the agency's organizational structure clearly define key areas of authority and responsibility and establish appropriate lines of reporting. The environment is also affected by the manner in which the agency delegates authority and responsibility throughout the organization. This delegation covers authority and responsibility for operating activities, reporting relationships, and authorization protocols."

We believe that for the Bank to have the sort of good control environment described by GAO, it is necessary to have a clear line of authority for the adoption of material policies, new products and material changes to existing products that runs from the Chairman and that assures that all relevant operating divisions of the Bank have been consulted regarding the effects of the proposed action on them, associated risks and their capacity to execute the action taken.

Suggestion 3.
Develop a plan to guide the Bank's response to financial crises generally based upon evaluation of the Bank's response to the current financial crisis.

Management Response:
The suggestion of developing a crisis response plan would be difficult for Ex-Im Bank to implement since Ex-Im Bank operates in a responsive mode. As a result, Ex-Im Bank's products are designed to address gaps in the market, be they immediate or longer term crisis gaps.

Evaluator's Comment:
We respectfully differ with management's perception of the utility and value of making a written record of the insights that have guided its response to the current financial crisis and the "lessons learned" in the process of responding.

Ex-Im Bank was created in the 1930's specifically to address the long-running crisis in international trade and finance that was a central feature of the Great Depression. This report finds the Bank confronting the most significant international financial crisis and contraction of international trade and finance since the 1930's. Interestingly, because the Bank's management and Board considered the Bank to be reasonably well structured and provisioned with sufficient lending authority to respond to significantly increased demand in the current environment, no additional funding or other legislative action was requested for Ex-Im Bank when Congress considered and passed the American Recovery and Reinvestment Act of 2009.

Our interviews with management disclosed that Ex-Im Bank did not have a documented plan in place to guide the Bank's response to the current financial crisis or other possible economic emergencies that might arise in specific locales around the world or more broadly. Rather, Ex-

Im Bank's management has relied upon consultation among senior management and with the Board of Directors and the Bank's customers and trade groups, the development of specific ad hoc project teams and institutional memory to guide management's actions to address the current financial crisis. The Bank is fortunate that its institutional memory reaches back to events such as the Asian debt crisis of the late 1990's and previous financial crises in Argentina and Mexico. However, many of the employees who carry those memories are approaching retirement age and the Bank cannot assume that the benefit of their experience, and the experience of the current financial crisis, will remain easily accessible for the next financial crisis the Bank encounters.

The absence of a crisis response plan can have several negative consequences. It increases the time required to identify and plan actions that the Bank should take to provide additional support to U.S. exporters and export credit lenders in response to a financial crisis. It also increases the risk that opportunities will be missed or mistakes will be made in the course of executing the Bank's response. While the specific facts or timing of a particular financial crisis that impacts international trade credit cannot be predicted with confidence, many of the features of such events can be anticipated, and their potential effects on the Bank's operations and its various product lines and stakeholders analyzed, before the crisis occurs, allowing the creation of tentative responses and action plans. It generally will take less time and effort to modify a thoughtfully prepared crisis response plan to fit the specifics of a particular crisis than it does to develop an effective response from a standing start.

It is a generally accepted practice among crisis managers that an organization's response to each crisis that it confronts should be reviewed after the fact to assess the effectiveness of the organization's response and to take note of "lessons learned" to improve the organization's level of crisis planning and preparedness for the future. The current financial crisis provides the Bank's management with an opportunity to assess the Bank's performance in the current environment and also to identify actions, modifications to products and policies and possibly changes to the Bank's Charter that might improve its response in the near- and longer-term future. Because the end of the current financial crisis is not yet in sight, and in view of management's current engagement in the development of a strategic plan for the Bank, we believe it advisable that management undertake an interim assessment of these questions at this time rather than waiting for conditions to improve to a degree that the financial crisis will be considered to have passed.

Among the subjects that should be addressed by a crisis response plan would be:

- Likely early indicators of a particular type of crisis that the plan is intended to address and indicated actions to confirm that data and to initiate the Bank's response.

- A description of the international trade and export credit market scenarios that would constitute a crisis and their anticipated effects on the Bank and its stakeholders, indicating anticipated effects on each of the Bank's product lines (including material shifts in risk profiles), anticipated effects of private sector export credit lenders and insurers and possible demand for the Bank to supply new or modified products.

- Specification of the team of Bank employees and possibly outside advisors (including retired Bank staff with relevant experience) that the Bank would expect to assemble to respond to the particular elements of the crisis.

- Action plans guiding the specified team(s) in evaluating, planning and executing the necessary actions to respond to the crisis, including any action from Congress that might be required to support the Bank's response.

- A communications plan guiding the Bank's inbound and outbound communications strategies with each of its stakeholders.

We would also recommend that management consider including "being prepared to respond promptly and effectively to financial crises in the U.S. or in any part of the world" as one of the Bank's strategic objectives during management's development of the Bank's strategic plan in coming months.

OBJECTIVE 3: IDENTIFY CONDITIONS THAT MIGHT RESTRAIN THE BANK'S ABILITY TO RESPOND TO INCREASED DEMAND FOR DIRECT LOANS AND RECOMMEND ACTIONS TO RESPOND TO THOSE CONDITIONS.

Based on the limited resources of the OIG available for this evaluation, and the lack of comprehensive data to support further analysis as noted above in support of Suggestion 1, we determined to examine more closely the effect of one of the Congressional Mandates, that requiring the use of U.S.-flag ocean vessels to ship Ex-Im Bank supported exports (PR 17), on the Bank's export credit transactions generally and specifically in the context of the Bank's response to the international financial crisis.

The focus groups and a majority of the Bank's Advisory Committee who contributed to the Bank's 2008 Competitiveness Report expressed consistent views that the U.S.-flag shipping requirements and other Congressional Mandates (economic impact review, U.S. content, local content, environmental review, Congressional notification) did lessen the competitiveness of Ex-Im Bank support for U.S. exports and that they should be addressed by the Bank, particularly in times such as the present international contraction of exports and export credit availability.

Suggestion 4:
Action by Ex-Im Bank is needed to actively work with MARAD in order to improve the efficiency of U.S.-flag ocean vessel shipping requirements so as to minimize any negative impact on Ex-Im Bank support for U.S. exports and maximize the use of U.S.-flag ocean vessels during the international financial crisis.

Management Response:
Management supports this suggestion and notes that it has been, and will continue to be, identifying and discussing such constraints. Ex-Im Bank is in the process of scheduling a meeting with MARAD.

Our discussions with Ex-Im Bank senior management and the representatives of MARAD, and our review of the publicly available information provided by each to guide transaction participants in complying with the U.S.-flag ocean vessel requirements of PR 17 (see Appendices A and B), indicated that there was substantial opportunity for improvement in the efficiency of the explanation and implementation of these requirements for the benefit of U.S. employment. We have concluded that improved Ex-Im Bank staff knowledge of the requirements and how to best manage them, improved communications between Ex-Im Bank and MARAD and improved joint communications to participants in Ex-Im Bank supported transaction should each contribute to improved results.

Management reported that in December 2008, the Bank's SVP Export Finance and VP of Project and Structured Finance met with representatives of MARAD to discuss ways to limit adverse impacts on Ex-Im Bank transactions attributable to PR 17 shipping requirements while maintaining compliance and producing better results for U.S. exporters. This discussion was driven in part by concern that an increase in interest by exporters and foreign buyers in obtaining direct loans from Ex-Im Bank to replace a significant decline in the availability of export credit loans from private sector lenders would result in significant numbers of smaller direct loan transactions being subject to U.S.-flag ocean vessel shipping requirements.[9]

Key points addressed in the discussion were reported to include increasing communication between MARAD and Ex-Im Bank and arranging for Ex-Im Bank staff to provide additional guidance to exporters and encourage them to contact MARAD as early as possible for assistance in arranging reasonably priced U.S.-flag ocean vessels. The SVP also requested that MARAD agree that direct loans under $20 million would not be subject to the U.S.-flag shipping requirements, resulting in comparable treatment for direct loans, guarantees and insurance transactions. In contemporaneous correspondence addressed to MARAD's Administrator, Ex-Im Bank's SVP stated that Ex-Im Bank would in the future provide guidance to exporters, and "… will strongly encourage sponsors/exporters to be in contact with MARAD as early as possible (at least 2 months prior to shipment) and will make formal introductions or arrange appointments as necessary…."

The Bank's VP of Project and Structured Finance Office has served as an unofficial point of contact between Ex-Im Bank and MARAD. She has maintained anecdotal records of Ex-Im Bank customer challenges in complying with the PR 17 shipping requirements and reported assisting customers in meeting MARAD requirements by providing limited guidance and directing her staff to encourage exporters, borrowers and bankers to meet with MARAD as early as possible in order to promptly go through the competitive analysis of bids submitted by U.S.-

[9] Ex-Im Bank policy provides that direct loan transactions are subject to U.S.-flag shipping requirements regardless of size or maturity. By comparison, U.S.-flag shipping is not required for guarantee transactions of $20 million or less or having a repayment period of 7 years or less, or for insurance transactions of any size. As events have transpired, significant demand for direct export credit loans from Ex-Im Bank of less than $20 million has not materialized – as Table 3 above indicates, only 3 of 15 direct loan transactions authorized by Ex-Im Bank between October 1, 2008 and June 30, 2009 fell below the $20 million threshold. Data indicating whether the small number of direct loans below the $20 million threshold was attributable to the negative impact of U.S.-flag shipping requirements was not available.

flag carriers. She also reported suggesting to Export Finance loan officers that they participate in MARAD meetings relating to Bank supported transactions when possible.

During our fieldwork, we found that a Direct Loan Working Group (DLW Group) was formed to revise the Bank's direct loan policy to accommodate changes made advisable by the financial crisis and the increased use of direct loans. The DLW Group had not been advised of the SVP's December meeting with MARAD officials or the intention to advise transaction participants to contact MARAD early in the Ex-Im Bank application process prior to our discussion with a member of that committee. Following that conversation, on June 3, 2009, Ex-Im Bank issued a policy on the Direct Loan Program stating that "Loan Officers are to encourage sponsors/exporters to contact MARAD as early as possible for best pricing on U.S. flag ocean vessels."

In order to obtain a more thorough understanding of PR 17 U.S. shipping requirements and MARAD's policies relative to Ex-Im Bank supported transactions and related waiver requests, we reviewed the history of communications between MARAD and Ex-Im Bank addressing the scope of the U.S. shipping requirements applicable to Ex-Im Bank transactions and interviewed senior MARAD officials responsible for oversight of Ex-Im Bank transactions. This review and interview cast a somewhat different light on the subject, with senior MARAD officials conveying the following information:

> MARAD has consistently maintained that all Ex-Im Bank supported transactions are subject to the U.S.-flag shipping requirements of PR 17 and related statutes, a position that Ex-Im Bank has declined to accept. This difference of opinion is reflected on the parties' respective websites, with Ex-Im Bank's description emphasizing the exceptions to U.S.-flag shipping requirements described in Section II of this report, while MARAD's website states that all Ex-Im Bank supported transactions are subject to U.S. shipping requirements unless a waiver is granted. In partial compromise of this difference of opinion, MARAD and Ex-Im Bank have operated for many years under a series of non-binding memoranda of understanding that have been substantially consistent with Ex-Im Bank's view of the coverage of PR 17. Based upon their experience in working with Ex-Im Bank in recent years and a modification to 46 USC 53305 by Congress in 2008, MARAD officials indicated that they were considering re-engaging with Ex-Im Bank staff with the objective of narrowing the exceptions from coverage of PR 17's requirements applicable to Ex-Im Bank sponsored transactions.
>
> MARAD has received anecdotal reports of individual Ex-Im Bank employees informing exporters that they need not worry about U.S.-flag shipping requirements for their transactions, or that the exporter could wait "until the last minute" and then expect MARAD to provide a waiver. MARAD officials also indicated that their work to help U.S. exporters secure U.S.-flag shipping at reasonable cost, or consider the availability of a waiver, was sometimes hindered by receiving incomplete data or finding that U.S.-flag carrier shipping bids received by an exporter and submitted to MARAD differed from the scope of a waiver request. MARAD officials expressed their strong commitment to working with exporters to ensure the U.S.-flag requirement does not unnecessarily delay

the process and to maintain a high level of customer sensitivity to the statutory requirements so they do not lose the beneficial Ex-Im Bank support for their financing.

MARAD officials indicated that while they had spoken with members of the Bank's management and staff from time to time in connection with their efforts to effectively implement the U.S.-flag shipping requirements, communications between MARAD and Ex-Im Bank senior management occurred infrequently. Other than the contact with MARAD by the Bank's SVP in December 2008 described above, MARAD officials indicated that there were no ongoing joint initiatives to improve the functioning of the U.S.-flag shipping requirements for Ex-Im Bank supported export transactions during the international financial crisis.

Both the MARAD and Ex-Im Bank website pages that address U.S.-flag shipping requirements (including data from those sources presented in this report) give the impression that the most relevant questions for the exporter in an Ex-Im Bank supported transaction are whether and how to obtain a waiver of those requirements. Contrary to this impression, MARAD officials informed us that in fact, a significantly larger volume of U.S. exports supported by Ex-Im Bank are shipped successfully on U.S.-flag vessels than are granted waivers. MARAD officials stated that the number of waivers indicated as having been granted in Table 5 above represent a small fraction of the total number of transactions that in fact use U.S. shipping. They also noted that the high number of waivers granted in several of the reported years reflected the global high demand for export shipping and that with the recent contraction of international trade, operators of U.S.-flag vessels had substantially more available capacity, making it less likely that a basis for a waiver could be established currently or in the near-term future.

MARAD's officials indicated that in their experience the ocean vessel portion of shipping costs for Ex-Im Bank supported transactions offered by U.S.-flag ocean vessel operators typically falls in a range of between 4% and 20% of the total value of a particular transaction, depending on variables such as the nature of the shipped goods, their size and weight, their destination and the flexibility of the parties in setting a delivery date. The experience of MARAD officials is that it is possible for U.S. exporters required to use U.S.-flag carriers under PR 17 to obtain responsive carriage proposals that will not exceed competing commercial bids significantly when taken as an overall percentage of the entire project.

MARAD officials acknowledged that arranging the necessary logistics can be challenging and that many U.S. exporters and freight forwarders may not have the knowledge and experience to obtain the lowest possible rate for a timely shipment on a U.S.-flag carrier. To counter this, MARAD offers free advice and assistance to exporters in Ex-Im Bank transactions in obtaining the lowest possible competitive bids. MARAD officials emphasized that it is critical that the exporter begin seeking bids from U.S.-flag carriers, and approach MARAD for assistance, at the earliest possible time – even at or before the time that a formal application for Ex-Im Bank support is made – in order to maximize the potential number of competitive bids that operators of U.S.-flag ships might submit. The MARAD officials cited actions such as combining partial cargoes with other shipments to

support a much lower "full cargo" bid relative to partial cargo bids that require the vessel to arrange other shipments.

We reviewed the webpages for both MARAD and Ex-Im Bank that address U.S.-flag shipping requirements (see Appendices A and B to this Report). Neither site provided a detailed explanation of how to successfully work with MARAD and U.S.-flag shipping requirements in order to obtain a positive result for the export transaction nor explained the importance of beginning the process at the earliest possible date. Neither web site disclosed that a substantial volume of Ex-Im Bank supported exports were successfully carried by U.S.-flag vessels.

Follow-up to December 2008 Meeting – We suggest that Ex-Im Bank senior management follow up on the December 2008 meeting with MARAD officials and related correspondence to confirm actions that each of the Bank and MARAD has taken or may take in response and to identify other areas for joint or individual action to address the issues identified in this report. Ex-Im had not followed-up on the proposal to remove the U.S. shipping requirement on direct loans under $20 million. At our July 2009 meeting with MARAD's Deputy Associate Administrator, Director of Cargo Preference and Domestic Trade, we asked about the status of this request. The Deputy Associate Administrator responded that MARAD's legal counsel will review Congress' change to the rules on exemptions, which occurred last year, and will notify Ex-Im of any changes.

Liaison - Ex-Im Bank has not formally assigned responsibility to a member of its management or staff to work with MARAD as a liaison on a regular basis to address the sorts of issues identified in this report. The VP of Project and Structured Finance has served as an unofficial liaison with MARAD but we believe that a more regular and consistent management of the U.S.-flag shipping requirements between Ex-Im Bank and MARAD would result from a formal designation of a liaison. The chosen liaison should be directed to achieve a high degree of familiarity with the U.S.-flag shipping requirements and MARAD's operational requirements in order to provide optimal assistance to U.S. exporters in securing U.S.-flag shipping for their products or, in appropriate cases, waivers of the requirements.

Policy & Communications - Ex-Im Bank should evaluate its existing policies, and the communication of its policies and MARAD's policies to the public, with a view to achieving improved efficiency in its management of U.S.-flag shipping requirements for the benefit of U.S. exporters and improved communication and cooperation with MARAD. In particular, we recommend that Ex-Im Bank consider establishing policies that:

- Call for the regular dissemination of accurate information regarding the Bank's policies with respect to U.S.-flag shipping requirements among its staff and customers; and
- Assure that customers are made aware of those requirements and how to most effectively manage them at the earliest possible time in order to improve their ability to secure U.S.-flag ocean vessels at competitive pricing.

We also suggest that Ex-Im Bank management obtain from MARAD its existing detailed reports of U.S.-flag ocean vessel usage in connection with Ex-Im Bank supported transactions and use

that data and other Ex-Im Bank customer data that is available or that might be reasonably obtained to track usage of U.S.-flag vessels and related costs in order to monitor the impact of the U.S.-flag shipping requirements on U.S. exporters on a more systematic and comprehensive basis, as addressed above in Suggestion 1.

Appendix A – U. S. Shipping Requirements – Ex-Im Bank Internet Disclosures

Ex-Im Bank's Web page dedicated to U.S.-flag ocean vessel shipping requirements appears at http://www.exim.gov/products/policies/shipping.cfm (August 11, 2009):

Shipping Requirements (MARAD)

Ex-Im Bank's shipping regulations are subject to Public Resolution 17 of the 73rd Congress (PR 17), which indicates that in any loans made by Ex-Im Bank to support the export of U.S. made products a provision be made that such products be carried exclusively on U.S. vessels. The purpose of PR 17 is to support the U.S. strategic objective of maintaining a merchant marine sufficient to carry a substantial portion of its waterborne export and import foreign commerce.

The following transactions are subject to the provisions of PR 17:

1. Direct loans regardless of term or amount; and
2. Guarantees in excess of $20,000,000 (excluding Ex-Im Bank Exposure Fee) and the repayment period of greater than seven (7) years.

The following transactions are not subject to the provisions of PR 17:

1. Credit Guarantee Facilities, regardless of amount;
2. Short-term insurance, regardless of amount;
3. Medium-Term Insurance, regardless of amount or term;
4. Guarantees of up to $20,000,000 (excluding Ex-Im Bank Exposure Fee) and the repayment period of seven (7) years or less; and
5. Guarantees of up to $20,000,000 under the Environmental Exports Program, Transportation Security Export Program, or Medical Equipment Initiative, regardless of term.

Requests for Waivers of PR No. 17 may be submitted to the Maritime Administration, a branch of the U.S. Department of Transportation. Waivers can be obtained for a variety of reasons (e.g. if a U.S. vessel is unavailable or unsuitable, etc.). If a waiver is obtained, goods shipped on vessels of non-U.S. registry are eligible for financing by Ex-Im Bank.

Exports shipped by air are <u>not</u> required to be transported on U.S. airlines since the purpose of PR No. 17 is to maintain a viable merchant marine in the U.S.

- Maritime Adminstration (MARAD) issues waivers (http://www.marad.dot.gov/ships_shipping_landing_page/cargo_preference/cargo_civilian_agencies/cargo_pr17_waivers/PR_17_Waivers.htm).

- www.marad.dot.gov

Last updated: February 6, 2009

Ex-Im Policy Handbook, "Shipping Requirements MARAD," dated June 2005, states:

Policy

The following transactions are required to be shipped exclusively in U.S.-flag vessels in order to be eligible for Ex-Im Bank support:

1) Direct loans, regardless of term or amount; and

2) Guarantee transactions with either
a) a financed amount in excess of $20 million (excluding Ex-Im Bank's exposure fee, if financed), or
b) a repayment period of greater than seven (7) years.

The following transactions are not required to be shipped exclusively in U.S.-flag vessels in order to be eligible for Ex-Im Bank support:

1) Credit Guarantee Facilities, regardless of amount;

2) Short-term insurance, regardless of amount;

3) Medium-term insurance, regardless of amount or term;

4) Guarantees with both a financed amount up to $20 million (excluding Ex-Im Bank's exposure fee, if financed) and a repayment period of seven (7) years or less;

5) Guarantees with a financed amount up to $20 million (excluding Ex-Im Bank's exposure fee, if financed) under the Environmental Exports program, the Transportation Security Export program, or the Medical Equipment initiative, regardless of term.

6) Exports shipped via non-marine transportation equipment, regardless of registration and/or ownership of the shipping company or equipment.

Rationale
Public Resolution 17 ("PR 17"), originally adopted in 1934, reflects a sense of Congress that certain transactions supported by Ex-Im Bank should be subject to U.S.-flag shipping requirements. Ex-Im Bank and the U.S. Maritime Administration ("MARAD") have periodically come to mutual understanding about the proper application of PR 17 to Ex-Im Bank's programs, most recently, in October 2004.

The purpose of PR 17 is to support the U.S. strategic objective of maintaining a merchant marine sufficient to carry a substantial portion of its waterborne foreign commerce, and capable of service as a naval and military auxiliary in time of war or national emergency.

Exception

Requests for Waivers of PR 17 may be submitted to MARAD, a branch of the U.S. Department of Transportation. Waivers can be obtained for a variety of reasons (e.g. if a U.S. vessel is unavailable or unsuitable, etc.) If a waiver is obtained, goods shipped on vessels of non-U.S. registry are eligible for financing by Ex-Im Bank.

The costs of the shipping on foreign vessels may be eligible for financing by Ex-Im Bank if such costs meet Ex-Im Bank's foreign content rules. Shipment on a Cost, Insurance and Freight or Cost and Freight basis permits the costs of the foreign freight to be treated as a component of the cost of the good and, therefore, the shipping costs may be eligible foreign content. If shipments are made on non-U.S. vessels without a waiver, the goods will not be eligible for Ex-Im Bank financing.

Appendix B – U. S. Shipping Requirements – MARAD Internet Disclosures

The Web page of the U.S. Maritime Administration dedicated to U.S.-flag ocean vessel shipping requirements appears at http://www.marad.dot.gov/ships_shipping_landing_page/cargo_preference/Cargo_Preference_Landing_Page.htm (August 11, 2009):

Cargo Preference

Welcome to the Maritime Administration's Office of Cargo Preference and Domestic Trade (Office) web site. The Office's primary focus is to promote and monitor the use of U.S.-flag vessels in the movement of cargo on international waters. The office is composed of three sections: Agricultural Cargoes, Civilian Agencies, and Military Cargoes. Information related to these three sections may be accessed by the appropriate links below. In addition, links to Government and private entities have been provided for your viewing. However, it should be noted that the Office only accounts for the accuracy of information on its web site.

To fully understand the movement of cargo, let's first define:

What is Cargo Preference?

The Cargo Preference program works to promote and facilitate a U.S. maritime transportation system that is accessible and efficient in the movement of goods and people. It oversees the administration of and compliance with U.S. cargo preference laws and regulations. Those laws require shippers to use U.S.-flag vessels to transport any government-impelled oceanborne cargoes.

What is Government-impelled cargo?

- Government-impelled cargo is cargo that is moving:
- Either as a direct result of Federal Government involvement
- Or, indirectly through financial sponsorship of a Federal program
- Or, in connection with a guarantee provided by the Federal Government

Why Do We Have Cargo Preference?

To provide a revenue base that will retain and encourage a privately owned and operated U.S.-flag merchant marine because the U.S.-flag merchant marine is a vital resource providing:

- Essential sealift capability in wartime or other national emergencies
- A cadre of skilled seafarers available in time of national emergencies
- Help to protect United States ocean commerce from total foreign domination and control

What percent of cargo is required to be carried on U.S.-flag vessels?

- Military Cargo = 100% (governed by Military Cargo Preference Act of 1904);
- Export Import Bank = 100% (governed by Public Resolution 17);
- Civilian Agencies Cargo = at least 50% (governed by Cargo Preference Act of 1954); and
- Agricultural Cargoes = at least 75% (governed by the Food Security Act of 1985)

What is the Process?

The process is framed below:

- Shipper/cargo interests identify potential cargo move
- Fully identify cargo to be shipped to extent possible
- Identify timeframe for expected move to extent possible

- Shipper must work in advance with potential U.S.-flag carriers and with the Maritime Administration, and must solicit U.S.-flag carriers as listed on the following web site: Listing of U.S.-Flag Carriers
- Evaluate U.S.-flag carrier responses as to availability and cost
- Book the cargo on a U.S.-flag vessel or contact the Maritime Administration (1- 800-9US-FLAG [987-3524]; or (202) 366-4610; Email: cargo.marad@dot.gov) for assistance.
- File required reports (bill of lading) with the Maritime Administration

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Related Links
Civilian Agency Cargoes (See below)
Humanitarian Aid Cargoes
Military Cargoes
Domestic Shipping

Contacts
Customer Outreach
Tel: (800) 9US-Flag (987-3524) or (202) 366-4610
Fax: (202) 366-5522
Email: cargo.marad@dot.gov
Contact us at 1-800-9US-FLAG if help is needed in locating U.S.-flag service

Civilian Agencies

The Civilian Agencies team works with all government-impelled cargo that is (1) not covered under the Military Cargo Preference Act of 1904, essentially Department of Defense (DOD) cargo, or (2) not covered under the Agricultural Food Aid Program.
The team works with the private sector shippers, suppliers and ocean carriers, as well as applicable civilian Government Agencies to assist all parties with their compliance with the applicable Federal legislation on cargo preference.

Legislation

The Cargo Preference Act of 1954 (P.L. 83-664), as amended, applies to all government-impelled cargo moving in international ocean trade. It requires that at least 50 percent of the gross tonnage of all U.S. Government-impelled cargo be transported on privately owned, U.S.-flag commercial vessels. The "at least 50 percent" requirement is applicable to the extent such vessels are available at fair and reasonable rates, as determined by the Maritime Administration

Government-Impelled Cargo

Government-impelled cargo is defined as cargo that is moving either as a direct result of the U.S. Government's involvement or indirectly due to financial sponsorship of a Federal program or under a guarantee provided through the Federal Government.

Compliance Responsibility

It is the responsibility of each Department or Agency to ensure it and its contractors comply with the Cargo Preference Act of 1954. One of the prime methods to accomplish this is for the Agency or Department involved to have the appropriate clauses inserted in their program contracts and documentation.

Federal Acquisition Regulations (FAR)

The Cargo Preference Act of 1954 is administered by all Departments and Agencies, other than Department of Defense, under the Federal Acquisition Regulations as set forth in 48 CFR Subpart 47.5 "Ocean Transportation by U.S.-flag Vessels."

Reporting to the Maritime Administration

Regulations require that documentation on all government-impelled cargo moves must be reported to the Maritime Administration within 20 working days from date of loading on all shipments loaded from the United States and 30 working days for shipments loaded outside the United States. The reporting requirement applies whether the cargo moves on a foreign-flag or U.S.-flag vessel. A copy of the ocean carrier's bill of lading, certified onboard, with rates and charges, is considered sufficient to meet the reporting requirements.

Export Import Bank - Public Resolution (PR) 17

Certain cargoes generated by the Export Import Bank (Ex-Im Bank) are required by Public Resolution 17 of the 73rd Congress as approved on March 26, 1934, to be carried 100 percent on U.S.-flag vessels.

PR 17 is implemented by the Export Import Bank under regulations set forth in 12 CFR 402.3 "Marine Transportation and Insurance(a) Marine Transportation."

Loans
All direct loans generated under Export Import Bank financing are to be shipped exclusively on U.S.-flag vessels under PR 17 Regulations.

Guarantees
Cargo generated under Export Import Bank guarantees are to be shipped exclusively on U.S.-flag vessels provided the guarantee amount is over $10 million or if the term of the guarantee is over 7 years.

Waivers
Requests for Waivers under PR 17 may be submitted to the Maritime Administration, an agency of the U.S. Department of Transportation. Waivers can be obtained for a variety of reasons (e.g., if a U.S. vessel is unavailable or unsuitable). If a waiver is obtained, goods shipped on vessels of non-U.S. registry are eligible for financing by Ex-Im Bank.

Types of Waivers include:

Statutory - Non availability
General - Special treaty agreement for recipient nation to carry up to 50%
Compensatory - Allows for compensatory make-up shipments where there are extenuating circumstances
Conditional - Issued primarily for over-dimensional cargo and specialty project cargo, on a long-term basis but subject to review if conditions change

To obtain more detailed information on the PR 17 program and particularly on the types of waivers listed above, please visit the PR 17 section of our web page.

PR 17 Page:
(http://www.marad.dot.gov/ships_shipping_landing_page/cargo_preference/cargo_civilian_agencies/cargo_pr17_waivers/PR_17_Waivers.htm)

PR 17 Waivers

Please use the below links for PR 17 waiver procedures:

PR17 Statement of Policy (http://www.marad.dot.gov/documents/MAR730.PR17.pdf)
Appendix A: Waiver Request Procedures
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIXA.pdf)
Appendix B: Waiver Request Required Information
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIX_B.pdf)
Appendix C: Information and Communication Guide
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIXC.pdf)
Appendix D: Guideline Rate Policy
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIXD.pdf)
Appendix E: Definitions and Miscellaneous Information
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIXE.pdf)
Appendix F: Movement Reports Guide
(http://www.marad.dot.gov/documents/MAR730.PR17.APPENDIXF.pdf)

For contact information regarding the Civilian Agencies group, please visit the below link:
Civilian Agencies - Contacts

Contacts
Customer Outreach
Tel: (800) 9US-Flag (987-3524) or (202) 366-4610
Fax: (202) 366-5522
Email: cargo.marad@dot.gov
Contact us at 1-800-9US-FLAG if help is needed in locating U.S.-flag service

Appendix C – Management Response

MEMORANDUM

September 30, 2009

To: Michael W. Tankersley, Inspector General

From: John A. McAdams, Senior Vice President, Export Finance Group

CC: Alice Albright, Chief Operating Officer

Subject: Response to the Evaluation of the Readiness of Exim Bank to address the needs arising from a Financial Crisis

The response to the Evaluation will follow Section C of the report, which summarizes various Objectives and Suggestions.

Objective 1: Assess the demand for direct loans from Exim Bank by US exporters and foreign purchasers of US goods as a result of the international financial crisis.

Suggestion 1: Develop a systematic and comprehensive approach to collecting and reporting data relating to market demand and related factors impacting Exim Bank performance.

Management concurs with the recommendation and will review, in conjunction with the Strategic Planning exercise currently in process with McKinsey, Exim Bank's current systems. However, given Exim Bank's current enterprise architecture and staffing levels, it will be difficult to fully implement this recommendation.

There is clearly inherent value in having data that addresses how Exim Bank's competitive position is affected by Congressional mandates as well as established practices. If Exim Bank had empirical data that supported its position to change certain requirements, clearly Exim Bank would be in a stronger negotiating position. There has been some off-line record keeping, such as the information collected on transactions effected by MARAD, but it is limited since Exim Bank does not know if an exporter or buyer has avoided Exim Bank because of MARAD. The suggestion that the contact system used by the regional offices be the system for gathering this comprehensive data would be challenging for Exim Bank to implement since doing so would require a significant re-write of this system or an investment in a new system. In any case, such a system would require data input from all line lending groups, which are already short handed and fully employed processing applications.

The Evaluation notes that Exim Bank's data is weak with regard to knowledge of the demand for direct lending, the cause for increased demand over recent years and the lack of information on the reasons for withdrawal and denial of applications. Management agrees that more information would be advantageous but notes that Exim Bank has

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neither the systems nor the manpower to gather and maintain such information. While the direct lending program has taken on a new prominence against the backdrop of the global crisis, it has been in place for the past 75 years. Clearly, in times of economic strife, there is a heightened awareness of Exim Bank and a stronger demand for its products. While direct lending has increased significantly during the crisis, it is the result of Exim Bank filling a gap in the market (liquidity) as well as providing lower pricing based on Treasuries versus LIBOR.

Objective 2: Identify the actions taken by Exim Bank to utilize the liquidity provided by its US Treasury funding to fill gaps in response to the international financial crisis.

Suggestion 2: Adopt a policy for Exim Bank setting forth clear written requirements for approving material policies, new export credit products, and material changes in existing export credit products.

It has been noted in internal audits by KPMG that there is a need to update the operating manuals for nearly every product in the bank. While this deficiency is being addressed, it should be understood that the products that have been utilized during the economic crisis are not new, but rather modifications of existing products designed to respond to the current environment. When making any changes to a product, it is Exim Bank's standard operating procedure to vet these changes both externally, with lenders, brokers, and exporters, and internally, with OGC, Policy, and the Board. While a Policy Committee was established in 1999, it was not viewed by subsequent management to be effective and was, to a great extent, replaced by the Executive Working Group. Exim Bank is currently reviewing the policy approval process to be sure consistent procedures exist for modifying or creating financing products.

Suggestion 2 addresses codifying the practice that is followed in developing new products or material changes to products. While this process is well understood today, there is value in developing a consistent procedure for the development of new products and modifications to existing products which we intend to develop.

Suggestion 3: Develop a plan to guide Exim Bank's response to financial crises generally based upon evaluation of Exim Bank's response to the current financial crisis.

The role of Exim Bank is to address export financing gaps in the market and apply its products to close these gaps. The gaps may be caused by a broad range of issues, and a crisis can be considered a form of a financing gap. This current crisis resulted in a gap in liquidity on a very broad basis, but it did not cause Exim Bank to make any substantive changes to existing products. However, it did increase the rationale for Exim Bank's use of the direct loan product. This product, while being used at a much higher volume than in previous years, still represents a nominal share of Exim Bank's number of transactions and approximately 15% of Exim Bank's dollar authorizations in FY09. While some complaints from the banking community did surface, the few direct loan transactions that

Exim Bank approved were done when the banks were unwilling to participate in the financing. Exim Bank therefore did not view its direct loan authorizations as competing with the private sector.

The suggestion of developing a crisis response plan would be difficult for Exim Bank to implement since Exim Bank operates in a responsive mode. As a result, Exim Bank's products are designed to address gaps in the market, be they immediate or longer term crisis gaps, and it could be said that Exim Bank's modus operandi is in fact a response to a crisis of some nature. As is stated in the Executive Summary, the actions Exim Bank took over the past year were "responsive to the international financial crisis and consistent with Exim Bank's mission…". Exim Bank appreciates the recognition that this Evaluation has given to it having adopted its products to address the gaps caused by the economic crisis.

Objective 3: Identify conditions that might restrain Exim Bank's ability to respond to increased for direct loans and recommend actions to respond to those conditions.

Suggestion 4: Action by Exim Bank is needed to actively work with MARAD to improve the efficiency of US-flag ocean vessel shipping requirements so as to minimize any negative impact on Exim Bank support for US exports and maximize the use of US-flag ocean vessels during the international financial crisis.

Management supports this recommendation and notes that it has been, and will continue to be, identifying and discussing such constraints.

Regardless of global macroeconomic conditions, the various constraints identified in the Evaluation of foreign content, MARAD, and economic impact result in Exim Bank's being at a competitive disadvantage. As was noted, Exim Bank has had discussions with MARAD and with Labor with regard to various forms of flexibility being applied to these constraints. These discussions will continue.

The summary of the MARAD requirements was well done in the Evaluation and will provide Exim Bank with additional information that will be helpful in its upcoming discussions with MARAD management.

In summary, Exim Bank believes that it was as well prepared as could be expected to respond to the international financial crisis. It is agreed that there is room to improve Exim Bank's data gathering and Exim Bank will review what options are available with regard to data gathering, recognizing that Exim Bank has staffing and financial constraints. Consistent with the suggestion to maintain a dialogue with MARAD, Exim Bank is in the process of scheduling a meeting with MARAD. In addition, Exim Bank is in dialogue with Labor through its Advisory Committee members to evaluate the merit of Exim Bank's foreign content guidelines.