



**EXPORT-IMPORT BANK  
*of the* UNITED STATES**

INSPECTOR GENERAL

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Statement of

Michael T. McCarthy  
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before the

United States House of Representatives

Committee on Oversight and Government Reform  
Subcommittee on Health Care, Benefits,  
and Administrative Rules

Committee on Financial Services  
Subcommittee on Monetary Policy and Trade

April 15, 2015 at 10:00 am

Good morning, Chairman Jordan, Chairman Huizenga, Ranking Member Cartwright, Ranking Member Moore, and members of the subcommittees.

Thank you for the invitation and opportunity to testify before you about the activities of the Office of Inspector General (OIG) and the programs and operations of the Export-Import Bank (Ex-Im Bank) as it relates to Export-Import Bank oversight and the 2012 reauthorization.

I. Export-Import Bank and the Office of Inspector General

The Export-Import Bank of the United States (Ex-Im Bank) is the official export-credit agency of the United States. Ex-Im Bank is an independent, self-sustaining executive agency and a wholly-owned U.S. government corporation. Ex-Im Bank's mission is to support jobs in the United States by facilitating the export of U.S. goods and services. Ex-Im Bank provides competitive export financing and ensures a level playing field for U.S. exports in the global marketplace.

The Office of Inspector General, an independent office within Ex-Im Bank, was statutorily created in 2002 and organized in 2007. The mission of the Ex-Im Bank Office of Inspector General is to conduct and supervise audits, investigations, inspections, and evaluations related to agency programs and operations; provide leadership and coordination as well as recommend

policies that will promote economy, efficiency, and effectiveness in such programs and operations; and prevent and detect fraud, waste, abuse, and mismanagement.

In the past five years, OIG audits, inspections, and investigations have produced quantifiable cost savings to the Bank and the U.S. Treasury. Based on court-ordered forfeitures and restitution directly resulting from OIG investigations of \$288 million, the OIG has returned more than 10 times its total budget since the office was created. Including cost savings from transactions canceled based on OIG referrals of \$47 million and the reduction in medium-term claims of at least \$80 million annually from FY 2012 onward, the OIG has returned more than 25 times its budget.

## II. Major Management Challenges

Each year, the OIG publishes a summary of what the Inspector General considers to be the most serious management and performance challenges facing the agency and a brief assessment of the agency's progress in addressing those challenges. At the end of FY 2014, the OIG focused on what we consider, based on our audit, inspection, and investigative work, the three top management challenges facing Ex-Im Bank. These include managing risk, human capital management, and information technology management. Addressing these challenges would provide Ex-Im Bank with a more efficient capability to meet its mission of creating and maintaining jobs in the U.S. through export financing.

### **MANAGING RISK**

We have reported on several challenges facing the Export-Import Bank in managing the risks inherent in its core business activities in a manner that reduces the risks of loss to the Treasury, and by extension, the taxpayer. Ex-Im Bank has experienced significant asset growth during the past several years, yet its resources and policies have not kept pace with the increased risks posed by such growth. The management challenge for Ex-Im Bank is to implement policies and practices that ensure credit and non-credit risks are assessed and priced accurately and that policy considerations are also fully considered. Key areas for consideration include the design and implementation of an agency-wide risk management framework that encompasses both credit and non-credit risks; improving the quality of underwriting and the due diligence process to capture risks associated with all parties to a transaction, including long-term and reputational risks; and improving internal controls to document compliance with clear policies and practices.

- Agency-Wide Risk Management

The OIG has stated that Ex-Im Bank should proactively manage the risk of its growing portfolio in line with common practices of commercial and multilateral development banks. Specifically, we recommended that Ex-Im Bank should establish a Chief Risk Officer or create a risk management office with independent reporting requirements to the Chairman; assess risks on an agency-wide basis; conduct periodic stress testing on its entire portfolio reflecting different market, industry, and macroeconomic scenarios; and actively monitor industry, geographic and obligor exposure levels.

Ex-Im Bank has taken steps towards improving its risk management framework such as establishing the Chief Risk Officer position and an Enterprise Risk Committee and separating origination and risk management functions. Also, the Bank has conducted stress testing and monitoring of exposure levels. We recommend that management attention to these initiatives be sustained. In particular, Ex-Im Bank should assess whether the composition of the credit portfolio produces disproportionate exposure to certain regions, industry sectors, or single obligors. Finally, we recommend that management further develop and implement key risk policies covering enterprise risk, operational risk and portfolio risk mitigation. To this end, management should develop a framework of written policies and procedures for model-validation including external validation of the model's integrity, model ownership and testing.

- Underwriting and Due Diligence

Ex-Im Bank uses a decentralized underwriting process and a risk-based due diligence model. Given the lessons learned from incidences of fraud in the Medium-Term program, the increase in the number of transactions, and insufficient credit information and history from borrowers in some regions, it is vital that Ex-Im Bank enhances credit underwriting and due diligence practices in order to identify and prevent fraud.

In July 2010, Ex-Im Bank's Board of Directors issued an Individual Delegated Authority (IDA) resolution authorizing certain individual Ex-Im Bank officers to approve loans, guarantees, and insurance up to \$10 million. Prior to this delegated authority, Ex-Im Bank approved these transactions through a credit committee. The IDA decentralized underwriting and decision-making authority. However, absent strong policies and procedures, decentralized underwriting and due diligence practices may cause inconsistent criteria to be applied in different programs.

Furthermore, the lack of due diligence efforts by delegated lenders, specifically lenders with a history of defaulted transactions in certain products, is a pattern the OIG has observed. Since Ex-Im Bank guarantees that these lenders will receive payment, their incentives to conduct thorough due diligence are reduced. The Bank issued a revised Know Your Customer policy in May 2014. Effective implementation of Know Your Customer practices by lenders, and appropriate controls by Ex-Im Bank to ensure that delegated lenders adhere to these requirements, could help minimize or prevent fraudulent activity.

OIG inspection reports have also found weaknesses in Ex-Im Bank's Character Reputational Transaction Integrity (CRTI) screening process, finding that the process as structured did not identify potentially relevant information about key transaction participants and that the screening did not cover all individuals and entities participating in transactions. Ex-Im Bank has agreed with our recommendations to improve the CRTI process and has recently introduced new CRTI procedures, which OIG will review in future audits and inspections.

- Internal Controls

One of the consistent observations arising out of audits, evaluations, and investigations conducted by the OIG are weaknesses in governance and internal controls for business operations. We have reported that internal policies providing clear guidance to staff and

establishing clear roles and authorities have not been prevalent at Ex-Im Bank. The management challenge for Ex-Im Bank is to set clear policies and controls to account for the risks in Ex-Im Bank's operations and document compliance with those controls.

An FY 2013 audit of direct loans found that loan officers did not always document sufficient evidence of the borrower's need for Ex-Im Bank financing, ensure or document borrower eligibility and compliance with Ex-Im Bank credit policies and standards, and document that comprehensive due diligence reviews were completed prior to loan approval. These conditions occurred, in part, as a result of inadequate recordkeeping and reliance on institutional knowledge.

Another issue is the Bank's reliance on self-certification by transaction participants without sampling or verification by Ex-Im Bank. An FY 2014 audit of Ex-Im Bank's Content Policy found that for the majority of transactions, Ex-Im Bank primarily relies on exporter self-certification and criminal penalty warnings to ensure content requirements are met and to deter exporters from making false content representations. For example, in FY 2012, only three percent of all Ex-Im Bank transactions were subject to content requirement oversight procedures. Without proper verification efforts, there is no assurance only eligible exports are financed and that Ex-Im's mission of maintaining or increasing U.S. employment is being met. Similarly, inspections have found that Ex-Im Bank relies on self-certifications that local costs incurred in connection with U.S. exports are in compliance with law and policy. Without a process to verify at least a sample of invoices, or the right to inspect relevant records, Ex-Im Bank does not have assurance that local costs financed by Ex-Im Bank are supporting U.S. exports.

These areas need to be addressed to ensure compliance with Federal and Ex-Im Bank policies and create a better corporate governance culture. Improvement in these areas will also reduce the vulnerability of the Bank to fraud.

## **HUMAN CAPITAL MANAGEMENT**

The OIG has noted an imbalance between the number of Ex-Im Bank underwriters, asset managers, and compliance personnel relative to the increasing size of its asset exposure. During the past five years, Ex-Im Bank has witnessed significant asset growth from less than \$70 billion in FY 2009 to approximately \$112 billion in FY 2014. Ex-Im Bank's workforce had grown very little during this timeframe, prior to recent authorization of 59 new positions which are currently being filled.

During an FY 2013 audit of Ex-Im Bank's management of direct loans, employees expressed concerns about the impact of the growing demand for Ex-Im support on their continued ability to provide quality service. The audit found that the Credit Administration Group experienced a 100 percent increase in its workload from FY 2010 to FY 2012 without any increase to the number of employees responsible for the work. Previous reports from GAO, KPMG, LLC and CC Pace Systems also expressed concerns over the strained capacity of the Ex-Im workforce and the potential for operational risks, inadequate monitoring of credits and elongated deal cycle times. GAO reported that Ex-Im Bank had not developed benchmarks for the level of business it can properly support with the given level of resources.

In addition to the number of employees and employee workload, the Bank also faces management challenges in recruitment and retention and employee morale. To recruit and retain personnel with specialized skill sets in executing complex financial transactions, Ex-Im Bank competes not just with the private sector, but also with multilateral development agencies such as the World Bank and other federal financial agencies such as the Federal Reserve and the Securities and Exchange Commission, all of which offer a higher pay scale. According to Bank officials, uncertainty about Ex-Im Bank's long-term authorization is also hindering recruitment. Bank officials also described lack of succession planning for key positions as a concern.

In the course of our investigations and in discussions with Bank officials, OIG has received information that employee morale is low. This anecdotal information is corroborated by the results of the 2013 Federal Employee Viewpoint Survey. In that survey, the percentage of positive responses from Ex-Im Bank employees significantly trailed the federal government average in many categories. Employees are especially dissatisfied about the physical conditions of the work environment and health and safety issues, and ratings of confidence in leadership trail the federal average. In addition, OIG investigations have identified management problems in human resources functions.

During FY 2014, Ex-Im Bank added 59 positions to its staffing plan, which should address some of the challenges related to employee workload. The other human capital management issues such as morale and succession planning require sustained management attention. Management has initiated new programs to improve employee outreach and communications intended to enhance employee satisfaction.

## **INFORMATION TECHNOLOGY (IT) MANAGEMENT**

We have previously reported that Ex-Im Bank uses an ineffective, inefficient, and fragmented IT platform and infrastructure in several systems and databases. These systems and databases do not effectively and accurately interface—compromising data integrity, producing duplicative information, and creating unreliable files. These systems make data mining burdensome and time-consuming. The ineffective IT platform compromises the ability of Ex-Im Bank to provide timely service, effectively manage and track its programs, measure progress, identify transaction patterns, conduct portfolio risk analysis, and increase productivity.

A 2012 audit of Information Technology Support for Export-Import Bank's Mission found that the Bank's IT systems do not always capture and manage all necessary data for business needs and that antiquated IT applications cause workflow inefficiencies. For example, Ex-Im Bank's Application Processing Systems (APS) is critical to the bank as it is used to track the applications for long-term guarantee and direct loans. Nevertheless, it was developed decades ago and does not capture all necessary underwriting data. Further, data integrity is at risk in this system due to required manual entry of the transactions.

The audit also found that Ex-Im Bank does not have practices to effectively manage its strategic planning, IT spending, Systems Development Life Cycle and Program Change Management processes.

To address the management challenges related to information technology, we have recommended that Ex-Im Bank develop formal data management policies and procedures to ensure complete and accurate participant and transaction data is captured and reported, and develop a clear and comprehensive IT strategic plan in accordance with OMB requirements.

Since 2012, Ex-Im Bank has engaged in an IT infrastructure modernization effort focused on replacing legacy systems and improving quality and access of its data. In the 2012 reauthorization, Ex-Im Bank was authorized to spend up to \$20 million from its surplus specifically to modernize its information technology systems. Ex-Im Bank recently implemented a new comprehensive financial management system, called FMS-NG, to improve its operations. OIG recently issued an audit of the planning and implementation of the FMS-NG system, which found that there were no significant risks that would prevent the implementation of the new system. However, improvements are recommended to the planning and documentation of the implementation. Specifically, the Bank did not sufficiently plan and document the data conversion process; did not perform adequate security assessment and authorization for access controls; and did not develop a contingency plan for errors arising during implementation. We made seven recommendations for corrective action and the Bank concurred with all of them.

Management should continue to upgrade its information technology infrastructure using the funding available for this purpose to improve data reliability and meet the business needs of Ex-Im employees and customers.

### III. Issues from the 2012 Reauthorization

The 2012 reauthorization legislation included several provisions to increase reporting and transparency for Ex-Im programs. Although the studies and reports mandated by the reauthorization bill were generally carried out by Ex-Im Bank or by the Government Accountability Office, the OIG has conducted audit and inspection work relevant to certain topics addressed in the 2012 bill.

- Due Diligence Standards for Lender Partners (Section 7)

In recent inspection reports on the PNG LNG and Punj Lloyd project financing transactions, OIG identified weaknesses in the due diligence process at Ex-Im Bank and recommended improvements to that process, including Character Reputational Transaction Integrity (CRTI) screening and Know Your Customer Policies. In May 2014, Ex-Im Bank published Know Your Customer and Due Diligence Standards for delegated lenders, and recently revised its own CRTI procedures, in response to the mandate in the 2012 reauthorization and OIG recommendations. In future transaction inspections, OIG will monitor the effectiveness of these revised policies.

- Categorization of the purpose of loans and long-term guarantees (Section 10)

The 2012 reauthorization required Ex-Im Bank to categorize the purpose of its direct loans and long-term guarantees as (1) to assume commercial or political risk that exporter or private financial institutions are unwilling or unable to undertake, (2) to overcome maturity or other

limitations in private sector export financing, (3) to meet competition from a foreign, officially sponsored, export credit competition, or (4) other.

OIG has not audited Ex-Im Bank's categorization and reporting of the purpose of loans and long-term loan guarantees required by the reauthorization. However, in FY 2014, we issued an audit report on Ex-Im Bank's management of direct loans. As part of this audit, we reviewed 6 direct loans authorized and underwritten between FY 2010 and FY 2012 (prior to the requirements of the 2012 reauthorization) to determine if Ex-Im Bank loan officers confirmed the information provided by direct loan applicants supporting the need for Ex-Im Bank financing. We found that the loan files did not include sufficient documentation to substantiate the applicants' assertions of their need for Ex-Im Bank financing. At that time, Ex-Im Bank loan officers stated that the need for Ex-Im Bank financing was done through verbal and email communication and detailed documentation was not required to be maintained.

In the report, we noted that as a result of the 2012 reauthorization, Ex-Im Bank had revised its loan manual to emphasize the importance of accurate categorization and provide guidance to assist loan officers in determining and documenting why Ex-Im support is needed. Additionally, our audit report included a recommendation to ensure detailed documentation regarding the need for Ex-Im support would be maintained. Management has implemented this recommendation by incorporating this requirement into its loan manual.

- Economic Impact Analyses (Section 12)

The 2012 reauthorization required Ex-Im Bank to publish its methodological guidelines for conducting economic impact analyses. In 2010, OIG had issued an evaluation report relating to economic impact procedures, which made several recommendations, including increasing transparency of its process for conducting its analysis. In April 2013, Ex-Im Bank published its revised procedures and methodological guidelines for economic impact analysis.

OIG is currently conducting a follow-up evaluation to assess the steps that Ex-Im Bank has taken to address the reported findings and recommendations in our 2010 report regarding economic impact analyses. We have closed out the majority of the recommendations from our 2010 report, and are currently assessing our prior recommendation to validate economic impact analyses by conducting a retrospective review of a sample of previous analyses to determine whether those assessments of economic impact turned out to be accurate. In response to recent document disclosures, the review is also assessing the transparency of the process for developing and publishing new procedures and whether any improper ex parte communications occurred.

- Domestic Content Policy (Section 15)

The 2012 reauthorization required Ex-Im Bank to conduct a review of its domestic content policy for medium- and long-term transactions. In 2013, OIG completed an audit of Ex-Im Bank's domestic content policy. The audit found that only long-term transactions are subject to procedures that could identify content-related discrepancies. For all other transactions, Ex-Im Bank largely relied on exporter self-certifications and criminal penalty warnings to ensure content requirements are met and to deter exporters from making false statements. The audit

recommended that Ex-Im Bank verify exporter self-certifications of domestic content for a representative sample of transactions each year. Ex-Im Bank plans to implement verification procedures by September 30, 2015. The report also made recommendations for Ex-Im Bank to obtain a resolution from the Board of Directors regarding a requirement to provide an annual report on content trends and to establish mechanisms to obtain specific, measurable, and reliable data to analyze the impact of any content-related procedural changes. Both of these recommendations had implementation target dates of March 31, 2015, but are still outstanding.

- Periodic Audits of Bank Transactions (Section 17)

The 2012 reauthorization required GAO to audit loan and guarantee transactions to determine compliance with underwriting guidelines, lending policies, due diligence procedures, and content guidelines. As part of its risk-based auditing plan, OIG also completed compliance audits of Ex-Im direct loan and short-term multi-buyer insurance programs.

Our audit of Ex-Im Bank's management of direct loans included a review of 6 direct loans totaling \$7.3 billion that were authorized and underwritten between FY 2010 and FY 2012. The audit found that loan officers did not always document sufficient evidence of the borrower's need for Ex-Im Bank financing, ensure or document borrower eligibility and compliance with Ex-Im Bank credit policies and standards, and document that comprehensive due diligence reviews were completed prior to loan approval. These conditions occurred, in part, as a result of inadequate recordkeeping and reliance on institutional knowledge. The audit also found that Ex-Im Bank had not formally adopted key OMB and Department of Treasury policy documents. The Bank has fully implemented two of the recommendations from this audit related to documenting the need for Ex-Im Bank support and formally adopting OMB and Treasury policies. The remaining two recommendations - to develop a quality control review program to prevent, detect and correct noncompliance and to evaluate Ex-Im Bank's recordkeeping practices and implement a plan to address deficiencies - are still open and should be implemented by September 30, 2015.

Our audit of Ex-Im Bank's short-term multi-buyer insurance program included a review of 23 transactions totaling approximately \$25 million in credit limits. We found that Ex-Im Bank's internal control environment and activities for the program were generally designed, operated, and updated to provide reasonable assurance of compliance with applicable laws and regulations. However, we identified five transactions, totaling over \$5 million in credit limits, were approved even though the required credit standards were not met or the required CRTI check was not performed prior to approval. We also found that underwriters were not consistently documenting their credit decisions. The Bank agreed to implement our recommendations to improve the underwriting and CRTI process by September 30, 2015.

- Iran Sanctions (Section 18)

In 2014, OIG initiated an audit of Ex-Im Bank's compliance with Iran sanctions. The initial phase of the audit found no transactions with persons on the sanctions list, and that the OIG had an outstanding recommendation from a previous inspection report to enhance the Bank's CRTI process which would help ensure compliance with Iran sanctions requirements. As a result, the

audit was terminated to reallocate resources to higher-risk areas. The Bank has also implemented the inspection recommendation and enhanced its CRTI process.

#### IV. Fraud and Integrity Investigations

Since 2009, OIG investigative efforts have resulted in a number of law enforcement actions against parties who have attempted to defraud the Bank, including 80 criminal indictments and criminal informations; 47 convictions; \$288 million in judgments from fines, criminal forfeiture, restitution, cost savings, and civil judgments; and 600 referrals of investigative intelligence to OGC for enhanced due diligence.

The most common fraud schemes that we have encountered involve outside parties obtaining loans or guarantees through false representations and submission of false documents. Accordingly, we have provided training to Bank staff and to delegated lending institutions in recognizing indicators of fraudulent documentation. Frauds are often detected after loans default and claims are received. The OIG, in collaboration with the Bank's Office of General Counsel and Asset Management Division, reviews defaults and claims for indicators of fraud. The OIG also conducts proactive investigative work, such as data analysis and review of law enforcement databases, to identify potential fraud in Bank transactions.

Last summer, it was reported that four Ex-Im Bank employees had been removed or suspended based on OIG investigations. At that time, we stated that OIG had three open investigations involving four Ex-Im employees, but could not provide further information about active ongoing investigations. Since that time, we have closed two cases of employee misconduct and reported the results of these cases back to these committees in October 2014 and February 2015.

In one case, the OIG investigated allegations that an Ex-Im Bank employee was hired despite a felony conviction and provided improper assistance to his former employer bidding on a contract. The investigation substantiated that the employee had a felony conviction and participated in the procurement process for the contract. The investigation also found that the employee maintained outside part-time employment with another company, made unsuccessful efforts to obtain contracts for the part-time employer, and misused government IT resources. OIG referred the investigative findings to Ex-Im Bank, and Ex-Im Bank management removed the employee from federal employment and replaced managers responsible for hiring and supervising the employee. The Bank reviewed procurement actions but concluded that the actions of the employee did not require those procurements to be modified or re-competed.

In another case, OIG received an allegation that certain contractor employees were improperly paid during the October 2013 government shutdown. The allegations were substantiated. Witnesses provided testimonial and documentary evidence establishing that a contractor, contractor employees, and an Ex-Im Bank contracting official engaged in a scheme to overstate the hours worked in the second half of October 2013 in order to compensate contractor employees for hours not worked or billed during the shutdown period. The scheme resulted in the payment of approximately \$19,356 for hours not actually worked. After OIG shared the investigative findings with OGC and Ex-Im Bank management, the employee resigned before

disciplinary action was initiated. Ex-Im Bank terminated the contract and is recovering the \$19,356 in improper payments.

Another case involving two former Ex-Im employees remains open. At the time of the submission of this testimony, we cannot provide additional information. We expect further updates on this matter will be available in the near future.

V. Conclusion

As Congress reviews the results of the 2012 reauthorization of Ex-Im Bank, this testimony highlighted some of the challenges and weaknesses facing Ex-Im Bank for consideration in the current reauthorization process. The OIG will continue to perform its independent oversight role as well as strengthen its efforts in preventing and detecting fraud, waste, and abuse.

Chairman Huizenga, Chairman Jordan, Ranking Member Moore, Ranking Member Cartwright, and members of the subcommittees, thank you once again for the opportunity to testify before you today. I would be pleased to respond to any questions you may have.

## Witness Bios

**Michael T. McCarthy** is the Deputy Inspector General of the Export-Import Bank of the United States and currently leads the Office of Inspector General. He provides overall direction to the teams of auditors, investigators, and inspectors responsible for improving the programs and operations of Ex-Im Bank and preventing and detecting fraud, waste, and abuse.

Mr. McCarthy is a career public servant who has worked in all three branches of government. Before joining Ex-Im Bank, he was a senior executive at the U.S. Department of the Treasury and the Administrative Conference of the United States, and previously served at the U.S. Department of Justice. For the U.S. House of Representatives, Mike served as deputy staff director and general counsel to the Committee on Oversight and Government Reform and as staff director of that panel's Subcommittee on Government Management. He was law clerk to U.S. District Judge Leonie Brinkema (E.D. Va.). Mr. McCarthy graduated with honors from Harvard Law School and received a B.A. from Georgetown University, where he was a Big East All-Academic swimmer. Mike and his wife, Carrie Wilks, have three daughters.

**Mark Thorum** serves as Assistant Inspector General for Inspections and Evaluations, Office of Inspector General (OIG) Export-Import Bank of the United States. In this capacity, he manages the inspection and evaluation functions within the OIG. These functions assess the efficiency and effectiveness of Ex-Im Bank programs, operations and financings; review and evaluate policies, and regulations; and develop recommendations for improving program performance and mitigating risk.

Mr. Thorum has more than 25 years of experience with credit structuring, financial markets and risk management advisory with domestic and international banks. In his last position, he worked as Senior Consultant and Head of Capital Structuring Advisory with the Financial Markets Advisory department of an international bank. He has successfully executed complex financial and risk advisory assignments and structured debt financings in the US, Europe and Asia. Mr. Thorum is a Ph.D. candidate at the Virginia Polytechnic Institute and State University School of Public and International Affairs. He holds a M.A from the John Hopkins University; School of Advanced International Studies, and a D.E.A. from the Institute of Political Studies, Paris, France. Mr. Thorum is conversant in several languages including English, French, Spanish and Dutch. Mark and his wife, Caterina, have three sons.