



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

Audit of the Export- Import Bank's Medium- Term Early Problem Credits

September 26, 2018
OIG-AR-18-06

The Export-Import Bank of the United States (EXIM Bank) is the official export credit agency of the United States. EXIM Bank is an independent, self-sustaining executive agency and a wholly-owned U.S. Government corporation. EXIM Bank's mission is to support jobs in the United States by facilitating the export of U.S. goods and services. EXIM 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 EXIM Bank, was statutorily created in 2002 and organized in 2007. The mission of the EXIM 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.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



To: David Sena, Senior Vice President of Office of Board Authorized Finance
Walter Hill, Vice President of Credit Review and Compliance
Kevin Turner, Senior Vice President and General Counsel

From: Jennifer Fain, Acting Assistant Inspector General for Audits and Evaluations 

Subject: Audit of the Export-Import Bank's Medium-Term Early Problem Credits

Date: September 26, 2018

This report presents the results of our audit of the Export-Import Bank's ("EXIM Bank," "EXIM" or "the Bank") Medium-Term Early Problem Credits. The objectives of this audit were to determine (1) what caused the problems for EXIM Bank's medium-term guarantees that experienced early problems and (2) if the origination and claims and recovery processes for these guarantees were in accordance with EXIM Bank's policies and procedures and Federal guidelines.

The report contains six recommendations for corrective action. In response to our report, management concurred with all six recommendations. Management's comments are included as Appendix B in this report. We consider management's proposed actions to be responsive. The recommendations will be closed upon completion and verification of the proposed actions.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We appreciate the courtesies and cooperation extended to us during this audit. If you have any questions or comments regarding the audit report, please contact me at: (202) 565-3439 or jennifer.fain@exim.gov. You can obtain additional information about the Export-Import Bank Office of Inspector General and the Inspector General Act of 1978 at www.exim.gov/oig.

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EXECUTIVE SUMMARY

Audit of EXIM Bank's Medium-Term Early Problem Credits
OIG-AR-18-06

Why We Did This Audit

Medium-term guarantee transactions are less than or equal to \$10 million (excluding exposure fees) and usually have a repayment term of one to seven years. EXIM uses loan guarantees to assist U.S. exporters by protecting against the commercial and political uncertainty of exporting. Through a medium-term guarantee, EXIM provides guarantees to lenders (U.S. or foreign) that make a loan to a foreign buyer to purchase U.S. goods and services. We obtained the universe of nine authorized medium-term guarantee transactions that were not part of the Medium-Term Delegated Authority Program with claims. We selected and reviewed two transactions because they exhibited early problems between the time the transaction was approved and when the claims were filed by the guaranteed lenders.

The objectives of this audit were to determine (1) what caused the problems for EXIM Bank's medium-term guarantees that experienced early problems and (2) if the origination and claims and recovery processes for these guarantees were in accordance with EXIM Bank's policies and procedures and Federal guidelines.

What We Recommend

We have six recommendations for the Bank: (1) Review the Character, Reputational and Transaction Integrity (CRTI) procedures to determine how they may be updated to ensure all required participants are included; (2) establish procedures necessary to reduce transactional credit risk for transactions involving principal owners of closely held companies, where it's legally permissible; (3) develop policies and procedures to require the identification and validation of the borrower's source of down payment prior to the lender's cash disbursement and include all supporting documentation in the credit file; (4) develop policies and procedures to perform appropriate due diligence checks (i.e., CRTI check) on the source of down payment, if the source is not the borrower; (5) enhance EXIM's policies and procedures to require the loan officer to document the analysis of Operations Cash Flow to Debt Service ratio and how it was considered in EXIM's decision making process; and (6) finalize the revisions of the Master Guarantee Agreement (MGA) used in the Medium-Term Loan Guarantee Program.

What We Found

We found that EXIM documented the factors that led to the early problems on the two loans we sampled and generally followed its policies and procedures and Federal guidelines for the origination and claims and recovery processes. The two loans sampled were: (b) (4) and (b) (4). EXIM determined that (b) (4) stopped receiving payments from one of its primary customers, which resulted in bankruptcy and loan default, while the cause of (b) (4) default, according to EXIM's claim's report, was "insufficient cash flow." While we determined that (b) (4) bankruptcy was unforeseen at the time of loan origination, there were indications of potential cash flow issues with the (b) (4) transaction during underwriting. For this transaction, the Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) to debt service did not meet EXIM's standard of 150 percent and the Operations Cash Flow (OCF) to debt service calculation indicated insufficient cash flow. However, we were unable to determine whether the insufficient cash flow calculation was properly mitigated during origination because current EXIM procedures do not require the loan officer to document how the OCF calculation is considered in their analysis. EXIM transactions with red flag warnings, such as potential cash flow issues, should be documented to show how the Bank analyzed and mitigated these issues.

While EXIM generally followed its policies and procedures and Federal guidelines for the origination and claims and recovery processes, we identified a few improvements for EXIM's due diligence procedures. Specifically, EXIM did not conduct a Character, Reputation and Transaction Integrity (CRTI) check for all required transaction participants; does not require loan officers to obtain credit information for principal owners of closely held companies; and does not require the identification and validation of the source of the borrower's down payment for its transactions.

We also found that EXIM does not require supporting documents for its Additionality determinations and the Master Guarantee Agreement (MGA) for the Medium-Term Guarantee Program has not been updated since 2001.

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AUDIT REPORT ON EXIM BANK'S MEDIUM-TERM EARLY PROBLEM CREDITS

INTRODUCTION

This audit report presents the results of our audit of the Export Import Bank's ("EXIM Bank," "EXIM" or "the Bank") Medium-Term Early Problem Credits. The objectives of this audit were to determine (1) what caused the problems for EXIM Bank's medium-term guarantees that experienced early problems and (2) if the origination and claims and recovery processes for these guarantees were in accordance with EXIM Bank's policies and procedures and Federal guidelines. To answer these objectives, we reviewed Federal laws, regulations and guidance, as well as EXIM Bank's applicable policies, procedures and guidelines. We also interviewed EXIM Bank officials to gain an understanding of the origination and claims and recovery processes. We obtained the universe of nine authorized medium-term guarantee transactions that were not part of the Medium-Term Delegated Authority Program¹ and valued at approximately \$22,414,164, with claims totaling \$7,907,359 between January 2012 and January 2018. Finally, we judgmentally selected and reviewed two transactions totaling \$1,974,538. These transactions were selected because they exhibited early problems due to the short timeframe² between transaction approval and the claims filed by the guaranteed lenders. See Appendix A for more details on the scope and methodology.

We conducted this performance audit from June 2017 through August 2018 at EXIM Bank Headquarters in Washington, D.C. We also traveled to Miami, Florida to meet with the guaranteed lender for one of our sampled transactions. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

BACKGROUND

EXIM's main loan products are: (1) direct loans, (2) loan guarantees and (3) working capital guarantees. The scope of this audit was limited to medium-term loan guarantees.

Medium-term guarantee transactions are less than or equal to \$10 million (excluding exposure fees) and usually have a repayment term of one to seven years.³ EXIM uses loan guarantees to assist U.S. exporters by protecting against the commercial and political uncertainty of exporting. Through a medium-term

¹ The Medium-Term Delegated Authority Program enables approved lenders to underwrite and approve EXIM Bank guarantees for commercial medium-term export credits.

² Short Timeframe: (b) (4)

³ Credit Guarantee Facilities (CGFs) are classified as medium-term with repayment terms of up to five years or seven years on an exception basis. With a minimum facility size of \$10 million, CGFs have the same coverage as other EXIM Bank medium and long-term guarantees—a 100 percent unconditional guarantee to the lender of principal and interest for up to 85 percent of financing with a 15 percent cash down payment and any financed fees.

guarantee, EXIM provides guarantees to lenders (U.S. or foreign) who make a loan to a foreign buyer to purchase U.S. goods and services. EXIM charges the foreign borrower a fee to guarantee the loan in a variable amount based on the duration, amount and risk characteristics of the transaction.

EXIM provides up to an 85 percent guarantee of the U.S. contract amount to a commercial lender that, in the event of a payment default by the borrower, it will pay the outstanding principal and interest on the loan. The remaining 15 percent is obtained from the borrower as a down payment.

EXIM's Charter establishes EXIM's operations and programs and is reauthorized on a periodic basis. The Charter requires a reasonable assurance of repayment for all transactions that are backed by the full faith and credit of the U.S. Government.⁴ To comply with this requirement, EXIM must manage a wide variety of risks associated with providing export financing such as credit, political, market, concentration (industry, geographic or obligor), foreign currency and operational risks.

The different stages of a transaction include underwriting, monitoring and restructuring and claims and recovery. For this audit, we focused on underwriting and claims and recovery.

Underwriting/Origination of a Medium Term Transaction

If a lender does not have delegated authority to approve EXIM guaranteed loans, EXIM Bank staff will perform its own underwriting procedures to determine if the guaranteed loan should be approved. EXIM's underwriting process begins once a lender submits a commercially reasonable underwriting and due diligence review of the buyer/borrower. For lenders to receive EXIM's loan guarantee, EXIM requires the financial institutions to become an Approved Finance Provider (AFP)⁵ and sign a Master Guarantee Agreement (MGA) outlining the guarantee eligibility requirements.

A component of the Bank's underwriting process is to determine whether a transaction is eligible for EXIM support. The eligibility of a transaction is completed by the assigned loan officer and includes assessments of: (1) the eligibility of the export item(s);⁶ (2) whether the origin of the exported goods was the United States; and (3) whether the conditions of Additionality were met.

The Bank's Charter addresses Additionality and directs EXIM to foster the expansion of U.S. exports and to supplement and encourage—rather than compete with—private capital. Thus, as a condition of eligibility, EXIM's Charter directs that financing efforts focus on transactions considered unlikely to proceed without EXIM support. EXIM defines Additionality as the likelihood an export transaction will not go forward unless EXIM provides support. To determine Additionality EXIM assesses the availability of (1) competing financing from other Export Credit Agencies and/or (2) private sector financing on acceptable terms.

⁴ See the Charter of the Export-Import Bank of the United States Annual Report 2015 at: [http://exim.gov/sites/default/files/2015 Charter - Final as Codified - 02-29-2016.pdf](http://exim.gov/sites/default/files/2015_Charter - Final as Codified - 02-29-2016.pdf).

⁵ An Approved Finance Provider (AFP) is a financial institution that may participate in EXIM's guarantee program after approval and execution of an MGA.

⁶ Chapter 8 of EXIM's "Loan, Guarantee and Insurance Manual," entitled "Standard Credit Structure" and dated May 2017, states that export items must be for goods with payment terms of one year or more and excludes certain items such as agricultural commodities.

In addition to the assessment of eligibility, the loan officer submits the corporate and individual names and addresses of lenders, borrowers, guarantors and other transaction participants⁷ to the EXIM Library for a Character Reputation and Transaction Integrity (CRTI) review. The CRTI review is designed to identify risks and help prevent fraud by checking loan participants' information with approximately 30 databases.⁸ For transactions that meet the minimum eligibility requirements, EXIM assigns a risk rating used to determine whether there is reasonable assurance of repayment. The ratings range from one (least risky) to 11 (most risky). These ratings are determined partly through the Interagency Country Risk Assessment System (ICRAS), a working group that includes EXIM and other federal agencies involved in providing international credit.⁹ For most private-sector transactions, EXIM officials use the private-sector ICRAS rating as a baseline and adjust that rating depending on their assessment of the obligor's creditworthiness and other factors. ICRAS ratings for private-sector transactions in a country are based on qualitative and quantitative assessments of the depth of private-sector business activity in a country, the strength of private-sector institutions, foreign exchange availability, political stability and other factors. For more complex transactions, EXIM considers additional information to develop the risk rating. EXIM generally does not authorize transactions with risk ratings over eight.

Further, risk assessment and due diligence procedures aimed at assessing the borrowers' creditworthiness and repayment ability require the loan officer to obtain and analyze the borrower's audited financial statements, credit reports¹⁰ and other relevant information, such as financial projections. To determine whether the primary source of repayment (PSOR) has the capacity to repay the loan, EXIM uses six financial performance standards, including: (1) positive operating profit in each of the last two fiscal years; (2) positive net income in each of the last two fiscal years; (3) positive cash from operations in the last fiscal year; (4) Earnings Before Interest Taxes Depreciation and Amortization (EBITDA)/debt service (including EXIM Bank debt if more than 25 percent of total debt) of at least 150 percent; (5) total liabilities (excluding EXIM debt) not to exceed 175 percent of tangible net worth; and (6) EXIM Bank exposure/tangible net worth not to exceed 40 percent. EXIM also obtains the interim financial statements to review if these statements disclose a material adverse change in financial condition.¹¹

EXIM has the option of approving loan guarantees that miss performance standards by providing risk mitigants. In addition to these six performance standards, EXIM includes a calculation of Operating Cash Flow (OCF) to Debt Service in the credit file. According to EXIM's "Loan, Guarantee and Insurance Manual," this calculation is included in the credit file at the request of senior management in order to compare EBITDA to Debt Service, but EXIM procedures do not require this calculation to be explained or used in the loan officer's analysis. Specifically, EXIM officials stated their risk analysis template also includes a calculation of OCF/Debt Service but "the relevance and or appropriateness of one or the other

⁷ In Appendix 24-A (CRTI Transaction Due Diligence Guidelines) of EXIM's "Loan, Guarantee and Insurance Manual" (May 2017), Attachment 1 (Participant Screening Criteria) provides a full list of all the other participants who should be included in a CRTI review. Examples of other participants include suppliers, agents and local cost providers.

⁸ Databases include various U.S. Government and international debarment and sanction lists maintained by organizations such as the World Bank and the Inter-American Development Bank.

⁹ ICRAS was established in 1991 to create uniformity in risk assessments among federal agencies. The ICRAS working group is chaired by the Office of Management and Budget and includes representatives from federal agencies with international credit programs as well as the U.S. Department of State, the U.S. Department of the Treasury, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System.

¹⁰ A credit report is a document created by a credit reporting agency that summarizes the financial history of a person or a business and includes payment and bankruptcy history.

¹¹ See EXIM's Medium-Term Credit Standards available at: <https://www.exim.gov/tools-for-exporters/credit-standards>.

approach is determined by the reviewing officer on a case by case basis depending on the circumstances of each credit . . .”

After the risk assessment and due diligence is performed and an overall risk rating for the transaction is assigned, the loan officer will determine the (1) exposure fee EXIM will charge the borrower for guaranteeing the transaction and (2) financing terms and conditions. Generally, the loan officer is required to structure the transaction to include a security interest (collateral) in the financed goods or other assets of the borrower.

Claims and Recovery

For the Medium-Term Guarantee Program, EXIM provides up to an 85 percent unconditional guarantee while the remaining 15 percent is paid by the borrower or financed separately. The loan guarantee could be less than 85 percent depending on the U.S. content. EXIM will pay a claim regardless of the cause of default, as long as the claim is filed timely and no amendments were made without EXIM’s consent.

EXIM’s Asset Management Division (AMD) is responsible for managing and monitoring all medium-term loan guarantee transactions, including claims and recovery. AMD’s Claims Processing Group manages the claims process, which includes processing claims based on the terms of the guarantees; notifying the guaranteed parties of the claim decisions; and paying approved claim amounts. Since EXIM’s medium-term loan guarantees are unconditional, there are only four reasons for denial, which include: (1) late claim filing, (2) accelerating the note without EXIM’s consent, (3) rescheduling the transaction without prior approval from EXIM, and (4) lender fraud. The Asset Recovery Group manages the post-claim work that includes recovering on transactions in which a claim was paid. This process begins when a guaranteed party receives a claim payment and assigns its collection rights to EXIM. The assets of the borrower and/or the guarantor are the “primary” source of the recovery process. EXIM’s recovery rate for the period 1994 through 2012 averaged around 50 percent (the total amount recovered divided by the total amount of claims paid plus recovery expenses).

Transactions Reviewed

For this audit, we selected two defaulted medium-term guarantee transactions: (1) (b) (4)

(b) (4) is a manufacturer of steel structures for the (b) (4) oil and gas industry specializing in heliports and offshore platforms. (b) (4) primary customer is (b) (4), a (b) (4) state-owned oil and gas producer. Key transaction participants in addition to (b) (4) include the exporter, (b) (4) and the guaranteed lender, (b) (4) EXIM underwrote and approved a medium-term loan guarantee for \$1,213,529 to finance (b) (4)

The transaction was approved on November 25, 2013, with an initial risk rating of (b) (4). Full disbursement was made on December 27, 2013 for \$1,213,529. The first repayment was scheduled for March 25, 2014; however, the borrower missed this payment and the loan went into default. EXIM, the guaranteed lender, and the borrower continued communication until September 2015, when the borrower became current in all outstanding payments. The borrower missed another payment on March

25, 2016, and the lender subsequently filed a claim on August 16, 2016. EXIM paid the claim in the amount of \$419,317 on September 8, 2016 and EXIM recovered \$169,970 through a financial settlement with the borrower.

(b) (4) is the exclusive distributor in (b) (4) for (b) (4) medical devices under the (b) (4) brand representing advanced ultrasound equipment for point-of-care and general imaging applications, which includes the following products: (b) (4). (b) (4) primarily sells to hospitals, clinics and other healthcare entities throughout (b) (4). Key transaction participants, in addition to (b) (4), include the exporter, (b) (4), and the guaranteed lender, (b) (4). EXIM underwrote and approved a medium-term loan guarantee for \$761,009 to finance medical imaging systems and devices. The transaction was approved on (b) (4) with an initial risk rating of (b) (4). An initial disbursement was made in the amount of \$342,265 on March 23, 2016. (b) (4) was scheduled to make four semi-annual payments of \$85,566 thereafter. (b) (4) made the first payment but defaulted on the second, which was due on November 15, 2016. The lender, (b) (4) filed a claim on March 17, 2017, and EXIM paid the claim in the amount of \$270,396 on April 19, 2017. EXIM has assigned recovery efforts on this claim to Global Recovery Group, which is a company EXIM has a contract with for recovery services.

RESULTS IN BRIEF

EXIM Documented the Factors that Led to the Early Problems and Generally Followed its Policies and Procedures and Federal Guidelines for the Origination and Claims and Recovery Processes

We found that EXIM documented the factors that led to the early problems on the loans we sampled and generally followed its policies and procedures and federal guidelines for the origination and claims and recovery processes. EXIM determined that (b) (4) stopped receiving payments from one of its primary customers, which led the borrower into bankruptcy and loan default. The cause of (b) (4) default, according to EXIM's claims report, was "insufficient cash flow."

While we determined that (b) (4) bankruptcy was unforeseen at the time of loan origination, there were indications of potential cash flow issues with the (b) (4) transaction during underwriting. For this transaction, the Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) to debt service did not meet EXIM's standard of 150 percent and the Operations Cash Flow (OCF) to debt service calculation indicated insufficient cash flow. However, we were unable to determine whether the insufficient cash flow calculation was properly mitigated during origination because current EXIM procedures do not require the loan officer to document how the OCF calculation is considered in their analysis.

EXIM transactions with red flag warnings, such as potential cash flow issues, should be documented to show how the Bank analyzed and mitigated the issues. Therefore, we are recommending EXIM establish a procedure requiring the loan officer to document their analysis of the OCF to Debt Service calculation and how it was considered in EXIM's decision making process.

While EXIM generally followed its policies and procedures and federal guidelines for the origination and claims and recovery processes, we identified a few improvements for EXIM's due diligence procedures. Specifically, EXIM did not conduct a Character Reputation and Transaction Integrity (CRTI) check for all required transaction participants; does not require loan officers to obtain credit information for principal owners of closely held companies; and does not require the identification and validation of the source of the borrower's down payment for its transactions.

We also found that EXIM does not require supporting documents for its Additionality determinations and the Master Guarantee Agreement (MGA) for the Medium-Term Guarantee Program has not been updated since 2001.

To help reduce the risk of fraud, ensure a reasonable assurance of repayment, and comply with federal regulations and internal policies, it is important for EXIM to continue to update and improve their due diligence procedures and support and document all credit decisions.

We made six recommendations to address the identified areas of improvements.

FINDINGS AND RECOMMENDATIONS

Finding 1: EXIM Should Enhance its Due Diligence Procedures

We reviewed two defaulted medium-term loan guarantee transactions and found EXIM generally followed its policies and procedures for the origination and claims and recovery processes. However, (1) EXIM did not conduct a CRTI check for all of the required participants; (2) EXIM's policies and procedures did not require credit reports for principal owners of closely held companies; and (3) EXIM policy did not stipulate that the source of the down payment should be identified and validated for EXIM transactions.

EXIM Should Continue to Emphasize the Importance of CRTI Checks for All Required Participants

For both credit files reviewed, EXIM did not conduct a CRTI check for all required participants. Specifically, EXIM did not complete the CRTI checks for (b) (4) principal owner, who was also the guarantor¹² and a local cost provider, and for one of (b) (4) principal owners.

As part of EXIM's due diligence review, the loan officers perform CRTI checks on the borrowers, guarantors and other transaction participants. The purpose of this check is to identify any risks related to the trustworthiness or character of transaction participants prior to approval of the transaction. According to EXIM's "Loan Guarantee and Insurance Manual,"¹³ staff underwriting medium-term transactions should include CRTI checks for all identified exporters, suppliers, agents, local cost providers and principal owners of each entity. Additionally, the loan officer must continue to vet all transaction parties for issues that may increase the risk to the Bank, including reputational risk.

¹² The guarantor is the person or entity that agrees to repay the credit if the borrower or lessee does not.

¹³ See Chapter 24 "Credit Review and Compliance" (May 2017).

Without performing the CRTI due diligence check for all required participants, EXIM may be susceptible to unidentified risks related to the trustworthiness or character of transaction participants.

EXIM Should Improve its Due Diligence Process for Principal Owners of Closely Held Companies

During our review of EXIM's "Loan, Guarantee and Insurance Manual,"¹⁴ we found the loan officer is required to obtain credit reports for the primary source of repayment (PSOR), which would be the borrower and the guarantor if the guarantor is the PSOR. The manual does not require credit information for principal owners of closely held companies, which is defined as a business with a principal owner who has 20 percent or more ownership.

(b) (4) is a closely held company with two principal owners who own 100 percent of the company, with one owner serving as the guarantor but not the PSOR. During our review, we found one owner was issued a Social Security number in 1988 by the state of California, the principal owners had a residence in Florida since 2004 and both had filed for personal bankruptcy in Florida in March 2012. We also noted that the bankruptcy was filed less than two years prior to submitting a loan guarantee application to EXIM. None of this information related to the owners' U.S. residency, U.S. property ownership and U.S. Social Security number was in EXIM's credit file. Therefore, a CRTI check could not be performed using the owner's Florida address to identify any possible trustworthiness or character-related issues. However, because EXIM's manual does not require the loan officer to obtain credit information for principal owners or non-PSOR guarantors, EXIM risks not detecting pertinent information that could impact credit decisions.

EXIM Should Develop Policies and Procedures to Identify and Validate the Source of Down Payment

EXIM provides up to an 85 percent unconditional guarantee with the remaining 15 percent obtained from the borrower as a down payment. According to EXIM's Handbook for Down Payment,¹⁵ EXIM does not stipulate the form of the 15 percent down payment nor does EXIM require support for the down payment. Instead, the buyer and seller of the goods and/or services determine whether the buyer will make the down payment in cash or through financing. Therefore, identifying and validating the source of the down payment is not required by EXIM.

EXIM officials stated that EXIM relies on the exporter to confirm the receipt of the down payment because the exporter would not ship until they received the payment. However, EXIM's guarantee programs have been susceptible to fraud schemes by foreign borrowers, U.S. based exporters and other transaction participants as found by the Office of Inspector General's (OIG) Office of Investigations (OI). The OIG-OI has prosecuted at least five cases where exporters provided false certification for the receipt of the 15

¹⁴ See Chapter 6 "Standard Medium-Term Preliminary Commitments, Final Commandments and Insurance Application" (April 2017).

¹⁵ Regarding "Cash Payment" (September 2017), the handbook states: "EXIM does not stipulate the form of the down payment, nor does EXIM provide any support for the down payment; that is, whether the buyer makes the down payment in cash or finances the 15 percent down payment is determined by the buyer and seller of the goods and/or services."

percent down payment.¹⁶ Therefore, EXIM’s reliance on the exporter’s confirmation is not sufficient. In addition, OIG-OI has identified and communicated risks associated with borrower’s down payment as a red flag¹⁷ to EXIM. As such, EXIM should enhance its policy to identify and validate the down payment via methods such as reviewing bank statements and wire transfers. Further, by not identifying and validating the down payment, EXIM cannot ensure that only 85 percent of the contract value is being financed.

Additionally, per EXIM’s “Loan Guarantee and Insurance Manual, a CRTI check is required for all transaction participants. If EXIM Bank does not know the source of the down payment, it will not be aware of all the participants who are involved in the transaction. As a result, EXIM is unable to perform its proper due diligence to determine if the funds were provided by a prohibited entity or fraudulent source. Lastly, if the funds are borrowed, this would be pertinent information that should be considered during the transaction’s origination process. Therefore, it is important for EXIM to identify and validate the source of the down payment made by the borrower prior to disbursement of funds.

RECOMMENDATIONS, MANAGEMENT COMMENTS AND OIG RESPONSE

To improve EXIM’s Medium-Term Loan Guarantees Program, we recommend that the Senior Vice President of the Office of Board Authorized Finance and the Vice President of Credit Review and Compliance:

1. Review the CRTI procedures to determine how they may be updated to ensure all required participants are included.

Management Comments

Management agrees with this recommendation. EXIM Bank will review the CRTI procedures to determine how they may be updated to ensure all required participants are included.

OIG Response

Management’s proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

2. Establish procedures necessary to reduce transactional credit risk for transactions involving principal owners of closely held companies, where it’s legally permissible.

Management Comments

¹⁶ EXIM OIG-OI Cases: (b) (6), (b) (7)(C) 09-0011-C Garcia, Ismael (et al.); 09-0021-C Poma Tools & Industrial Supplies, Inc.; 10-003-C Mimbella, Mario (et al.); and 12-0015-C Global Export Machinery (et al.).

¹⁷ EXIM OIG’s red flags on Guaranteed Loans and Insurance Transactions, entitled “Commercial Invoices,” states that commercial invoices are inflated to generate cash back for the borrower, cover the lack of any required down payment received by the exporter or create a disparity between lesser valued goods shipped and cash for all parties.

Management agrees with this recommendation. EXIM Bank will establish procedures to reduce transactional credit risk for those transactions involving principal owners of closely held companies, where legally permissible.

OIG Response

Management's proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

3. Develop policies and procedures to require the identification and validation of the borrower's source of down payment prior to the lender's cash disbursement and that all supporting documentation is included in the credit file.

Management Comments

Management agrees with this recommendation. EXIM will develop policies and procedures that require identification and validation of the borrower's source of down payment prior to the lender's cash disbursement and all supporting documentation is included in the credit file.

OIG Response

Management's proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

4. Develop policies and procedures to perform appropriate due diligence checks (i.e., CRTI check) on the source of down payment if the source is not the borrower.

Management Comments

Management agrees with this recommendation. EXIM Bank will develop policies and procedures to perform appropriate due diligence checks (i.e., CRTI check) on the source of the down payment if the source is not the borrower as appropriate.

OIG Response

Management's proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

Finding 2: EXIM Should Enhance its Policies and Procedures to Require Documentation for Operations Cash Flow to Debt Service Analysis and the Additionality Determination

EXIM should enhance its procedures for the Medium-Term Guarantee Program to require (1) documentation of EXIM's consideration and conclusion on the analysis of a transaction's OCF to debt service calculation and (2) supporting documents for Additionality determinations.

Operations Cash Flow to Debt Service Analysis Should be Documented

Under the Medium-Term Guarantee Program, EXIM has six performance standards¹⁸ to assist with determining whether the PSOR has the capacity to repay the loan. One of these standards is whether the borrower's EBITDA is at least 150 percent of the debt service (EBITDA/Debt Service ratio). EXIM also performs a calculation for OCF to debt service ratio but it is not a performance standard to determine the borrower's repayment ability. Per EXIM's "Loan, Guarantee and Insurance Manual," this ratio is "being included at the request of senior management in order to compare EBITDA to OCF. It is not to be explained or used for analysis." However, EXIM's management stated that EXIM determines the relevance and the appropriateness of EBITDA to debt service or OCF to debt service approach on a case by case basis depending on the circumstances of each credit.

During our review of the (b) (4) transaction file, we found that the decision memorandum listed the following: (1) OCF to debt service ratio of 80 percent and (2) EBITDA to debt service ratio of 148 percent. The OCF to debt service ratio showed that (b) (4) had insufficient cash flow to cover their debt service while the EBITDA showed that the borrower had the ability to service 48 percent above its debt. EXIM's requirement is for the borrower to have the ability to service 50 percent above its debt. In the decision memorandum, EXIM stated there were no direct mitigants for the missed two percent because the amount of the equipment being financed on a two-year term was included in the debt service ratio. The borrower was purchasing this equipment for resale and the equipment would be sold to customers with terms of up to two years.

Additionally, during our interview, the loan officer stated EXIM expected the borrower's earnings to increase in future years based on the borrower's high profit margin. Furthermore, the loan officer believed the borrower would be able to use the financed equipment to generate additional income.

Nevertheless, the borrower's future earning analysis was not included in the credit file and the (b) (4) transaction ultimately defaulted due to insufficient cash flow. The OCF to debt service ratio showed the borrower did not have the ability to repay its debt. However, we were unable to determine how EXIM considered this information in their decision because this ratio is not required to be explained or used for analysis. Given the circumstances of this loan, EXIM should document in the decision memorandum how this ratio impacts the credit decision for all of its transactions.

EXIM Does Not Require Documentation to Support Additionality Determination

We found there was no documentation in the two credit files we reviewed to support EXIM's required Additionality determination.

¹⁸ EXIM's "Credit Underwriting Manual," Chapter III, "Credit Standards and Guidelines" and section C "Medium Term Credit Standards" (December 2000).

EXIM's Charter states, "It is the policy of the United States to foster expansion of exports . . . It is also the policy of the United States that the Bank in exercise of its functions supplement and encourage, and not compete with, private capital . . ." Therefore, before authorizing each transaction, EXIM staff must determine the probability that the export in question would likely not go forward without the Bank's financial support. This probability is referred to as the transaction's "Additionality." However, EXIM's Medium-Term Guarantee Program policies and procedures on Additionality do not require EXIM to obtain documentation to support the Additionality determination.

Specifically, in the (b) (4) credit file, the lender's credit memorandum stated that "there is limited availability of private financing available from either external or domestic sources" and the loan officer's decision memorandum stated "Limited private financing" in support of the Additionality determination. In the (b) (4) credit file, the lender credit memorandum stated that the "company seeks to utilize the competitively priced medium-term EXIM Bank financing option in order to maximize its equipment purchases under better terms. In addition to diversifying its funding sources, the EXIM financing is not expected to encumber all of the borrower's assets, as opposed to other local financing options available in (b) (4)." Further, the loan officer's decision memorandum stated, "Limited private financing." Since it is not required by EXIM policies and procedures, the credit files did not include supporting documentation, such as any third party verification (i.e., denial letters or noncompetitive loan terms and agreements for private lenders), detail analysis performed by the guaranteed lender or EXIM or any other supporting documents to support the Additionality determination noted on the lenders' credit memorandums and EXIM's decision memos. Without the supporting documents to support the Bank's Additionality determination, the Bank risks violating its Charter by approving transactions that may be ineligible for EXIM's support.

The OIG's Office of Inspections and Evaluations is currently completing an evaluation on Additionality. As a result, we are not making any recommendations specific to Additionality in this report.

RECOMMENDATIONS, MANAGEMENT COMMENTS AND OIG RESPONSE

To improve EXIM's Medium-Term Loan Guarantees Program, we recommend that the Senior Vice President of the Office of Board Authorized Finance:

5. Enhance EXIM's policies and procedures to require the loan officer to document the analysis of Operations Cash Flow to Debt Service ratio and how it was considered in EXIM's decision making process.

Management Comments

Management agrees with this recommendation. EXIM Bank will enhance EXIM's policies and procedures to require the loan officer to document the analysis of Operations Cash Flow to Debt Service ratio and how it was considered in EXIM's decision making process.

OIG Response

Management's proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

Finding 3: EXIM Should Update its Master Guarantee Agreement for the Medium-Term Guarantee Program

We found that the current MGA for the Medium-Term Guarantee Program used by EXIM to outline the guarantee eligibility requirements, the undertakings of the lender, claims procedures and other miscellaneous items has not been updated since 2001. According to EXIM's "Loan, Guarantee and Insurance Manual,"¹⁹ any financial institution that works with EXIM Bank must become an Approved Finance Provider (AFP) and, with respect to most guaranteed loans, must have signed the appropriate MGA. According to Bank officials, the MGA had not been updated because the terms did not have significant programmatic changes that required the MGA to be updated.

EXIM uses a standardized MGA template for all guarantee lenders participating in the Medium-Term Guarantee Program. The MGA is a general agreement between the Bank and an AFP that contains the general terms and conditions of the Bank's comprehensive²⁰ or political risk guarantee. During our audit, we interviewed EXIM personnel from the Office of General Counsel (OGC) and were informed that revisions to the standardized MGA were started in 2016 but not completed. OGC has not established a completion date for the revisions; however, it was stated that it is ongoing. Given the extensive period since the last MGA revision, EXIM should continue its efforts to update the MGA template for the Medium-Term Guarantee Program to ensure the general terms and conditions on loans conform to current best practices.

RECOMMENDATIONS, MANAGEMENT COMMENTS AND OIG RESPONSE

To improve EXIM's Medium-Term Loan Guarantees Program, we recommend that the Senior Vice President of the Office of General Counsel:

6. Finalize the revisions of the Master Guarantee Agreement used in the Medium-Term Loan Guarantee Program.

Management Comments

Management agreed with this recommendation. EXIM Bank will finalize the revisions of the Master Guarantee Agreement used in the Medium-Term Loan Guarantee Program.

OIG Response

¹⁹ EXIM's "Loan Guarantee and Insurance Manual," Chapter 10 "Approved Finance Providers," dated June 2017.

²⁰ A comprehensive risk guarantee covers all default risks.

Management's proposed actions are responsive to the recommendation. Therefore, the recommendation is considered resolved and will be closed upon completion and verification of the proposed actions.

CONCLUSION

We found the cause for the early problems of (b) (4) was the loss of payments from a primary customer, which led to bankruptcy and loan default. The cause of default for the (b) (4) transaction was "insufficient cash flow." We determined that (b) (4) bankruptcy was unforeseen during the origination process; however, there were indications of potential cash flow issues with the (b) (4) transaction, as the borrower's OCF to debt service indicated insufficient cash flow. However, we were unable to determine whether the insufficient cash flow calculation was properly mitigated for (b) (4) because EXIM's current procedures do not require the loan officer to document how the insufficient cash flow calculation was considered in their analysis.

Overall, for these two transactions, we determined EXIM generally followed its policies and procedures and federal guidelines for the origination and claims and recovery processes. However, we identified a few improvements for EXIM's due diligence procedures, credit file documentation and the MGA. Specifically, EXIM did not conduct a CRTI check for all required transaction participants; does not require credit information for principal owners of closely held companies; and does not require the identification and validation of the source of the down payment for its transactions. Additionally, credit files did not have supporting documents for Additionality determination because EXIM's Medium-Term Guarantee Program policies and procedures on Additionality do not require EXIM to obtain documentation to support the Additionality determination. Lastly, EXIM's MGA for the Medium-Term Guarantee Program has not been updated since 2001.

In an effort to assist EXIM with strengthening its Medium-Term Guarantee Program, we made six recommendations that address the areas for improvement.

Management's comments are included in their entirety in Appendix B.

APPENDICES

APPENDIX A: SCOPE AND METHODOLOGY

We performed this audit from June 2017 through August 2018 at EXIM Bank Headquarters in Washington, D.C., in accordance with generally accepted government auditing standards. We also traveled to Florida to meet with the guaranteed lender for one of our sampled transactions. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our objectives were to determine (1) what caused the problems for EXIM Bank's medium-term guarantees that experienced early problems and (2) if the origination and claims and recovery processes for these guarantees were in accordance with EXIM Bank's policies and procedures and Federal guidelines. We reviewed Federal laws, regulations and guidance as well as EXIM Bank's applicable policies, procedures and guidelines. We also interviewed EXIM Bank officials to gain an understanding of the origination, claims and recovery processes. Specifically, we interviewed EXIM Bank management officials within the Office of Chief Financial Officer, Engineering and Environment Division, Claims Processing Group, Asset Recovery Group, Global Infrastructure Division and external lenders for our two sampled transactions. We also developed an evaluation tool for the review of early problem credits, based on EXIM Bank's policies, procedures and guidelines and other applicable criteria. We judgmentally selected and reviewed two transactions of the nine credits with claims for medium-term guarantees authorized from January 2012 and onward, as of January 2018. We consider the two samples selected to be early problem credits because of the relatively short timeframe between deal approval and a claim or other indications of a repayment issue.

Review of Internal Controls

We reviewed and evaluated the internal controls associated with EXIM Bank's origination, claims, and recovery process. We found that improvements can be made to reduce the probability of early default. Our recommendations, if implemented, should correct the weaknesses we identified.

APPENDIX B: MANAGEMENT COMMENTS



Reducing Risk. Unleashing Opportunity.

September 12, 2018

Jennifer Fain
Acting Assistant Inspector General for Audits and Evaluations
Office of the Inspector General
Export-Import Bank of the United States
811 Vermont Avenue, NW
Washington, DC 20571

Dear Ms. Fain,

Thank you for providing the Export-Import Bank of the United States (“EXIM Bank” or “the Bank”) management with the Office of the Inspector General’s (“OIG”) audit report on “EXIM Bank’s Medium-Term Early Problem Credits,” dated August 29, 2018 (the “Early Problems report”). Management continues to support the OIG’s work which complements the Bank’s efforts to continually improve its processes. EXIM Bank is proud of the strong and cooperative relationship it has with the OIG.

EXIM Bank appreciates the OIG’s determination that for both defaulted medium-term guarantees sampled for this audit EXIM “generally followed its policies and procedures and Federal guidelines for the origination and claims and recovery processes” and that EXIM “documented the factors that led to the early problems.”

Additionally, EXIM values the OIG’s acknowledgment that the bankruptcy causing default in one of the two transactions reviewed by the OIG was “unforeseen at the time of loan origination.” Furthermore, the Bank appreciates OIG noting EXIM’s successful recovery efforts. EXIM continues its robust recovery efforts and has already recovered approximately 41% of the amount for one of the sampled transactions.

The Bank continuously strives to improve its policies and practices and agrees to all six OIG recommendations in this report as they relate to the Medium-Term Guarantee program. EXIM notes, however, that while EXIM will implement all OIG recommendations, it will have to do so after careful cost-benefit analysis and weighing competing concerns and mandates.



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Recommendation 1: that the Senior Vice President of the Office of Board Authorized Finance and the Vice President of Credit Review and Compliance review the CRTI procedures to determine how they may be updated to ensure all required participants are included.

Management response: Management agrees with this recommendation. EXIM Bank will review the CRTI procedures to determine how they may be updated to ensure all required participants are included. EXIM notes that it continuously improves, updates and provides training to the Bank staff on its CRTI process, and the last training session held in May 2018. The Bank has an established policy and clear CRTI Participant Screening Criteria, to include “All identified Exporter(s), Supplier(s), Agent(s), Local Cost providers, Foreign Buyer, Borrower and/or End-User, Guarantors of the EXIM Bank transactions, and if applicable, Principal owners of each of the above entities.” The criteria further clarify that “for closely-held companies, principal owners are defined as 20% or more of ownership. For widely-held companies, if there is a controlling interest and knowledge of which is readily available, the controlling shareholder(s) should be the subject of the due diligence checks.”

Recommendation 2: that the Senior Vice President of the Office of Board Authorized Finance and the Vice President of Credit Review and Compliance establish procedures necessary to reduce transactional credit risk for transactions involving principal owners of closely held companies, where it's legally permissible.

Management response: Management agrees with this recommendation. EXIM Bank will establish procedures necessary to reduce transactional credit risk for transactions involving principal owners of closely held companies, where it's legally permissible.

Recommendation 3: that the Senior Vice President of the Office of Board Authorized Finance and the Vice President of Credit Review and Compliance develop policies and procedures to require the identification and validation of the borrower's source of down payment prior to the lender's cash disbursement and that all supporting documentation is included in the credit file.

Management response: Management agrees with this recommendation. EXIM will develop policies and procedures to require the identification and validation of the borrower's source of down payment prior to the lender's cash disbursement and that all supporting documentation is included in the credit file. As noted above, EXIM Bank will conduct careful cost benefit analysis and weighing competing concerns and mandates.

Recommendation 4: that the Senior Vice President of the Office of Board Authorized Finance and the Vice President of Credit Review and Compliance develop policies and procedures to perform appropriate due diligence checks (i.e., CRTI check) on the source of down payment if the source is not the borrower.

Management response: Management agrees with this recommendation. EXIM Bank will develop policies and procedures to perform appropriate due diligence checks (i.e., CRTI check) on the source of down payment if the source is not the borrower as appropriate.



Reducing Risk. Unleashing Opportunity.

Recommendation 5: that the Senior Vice President of the Office of Board Authorized Finance enhance EXIM's policies and procedures to require the loan officer to document the analysis of Operations Cash Flow to Debt Service ratio and how it was considered in EXIM's decision making process.

Management response: Management agrees with this recommendation. EXIM Bank will enhance EXIM's policies and procedures to require the loan officer to document the analysis of Operations Cash Flow to Debt Service ratio and how it was considered in EXIM's decision making process.

Recommendation 6: that the Senior Vice President of the Office of General Counsel finalize the revisions of the Master Guarantee Agreement used in the Medium-Term Loan Guarantee Program.

Management response: Management agrees with this recommendation. EXIM Bank will finalize the revisions of the Master Guarantee Agreement used in the Medium-Term Loan Guarantee Program.

We thank the OIG for your efforts to ensure the Bank's policies and procedures continue to improve, as well as the work you do with us to protect EXIM funds from fraud, waste, and abuse. We look forward to strengthening our working relationship and continuing to work closely with the Office of the Inspector General.

Sincerely,

Jeffrey Goettman
Executive Vice President & Chief Operating Officer
Export-Import Bank of the United States

ACKNOWLEDGEMENTS

This report was prepared by the Office of Audits, Office of Inspector General for the Export-Import Bank of the United States. Several individuals contributed to this report including: Erica Wardley, Courtney Potter, Karin Beam, Neha Diwan and Arinee Tackoor.

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