Report on the PNG LNG Project Financing
(Redacted for Public Release)

June 18, 2014
OIG-INS-14-01
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.

This inspection was conducted in accordance with the 2012 Quality Standards for Inspection and Evaluation as defined by The Council of Inspectors General on Integrity and Efficiency. This report does not constitute a Government audit and therefore, it was not conducted following the Generally Accepted Government Auditing Standards ("GAGAS").
Attached please find the final inspection report on the PNG LNG project AP084099XX – Papua New Guinea. The report outlines three recommendations for corrective action. Management’s response is included as an appendix to the final report. We consider management’s proposed actions to be responsive. The recommendations will be closed upon completion and verification of the proposed actions.

We appreciate the courtesies and cooperation extended to us during the inspection.

cc: Fred Hochberg, Chairman and President  
    C.J. Hall, EVP and Chief Risk Officer  
    Osvaldo Gratacos, Inspector General  
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    James Cruse, SVP-Policy and Planning  
    Jessica Farmer, VP-Project and Corporate Monitoring  
    Elizabeth M. Touomou, VP (Acting) Structured and Project Finance Division  
    James Mahoney, Jr., VP-Engineering & Environment  
    Inci Tonguch-Murray, Business Compliance Officer

Attachment: Inspection Report PNG LNG, OIG-INS-14-01, June 2014
**Why We Did This Inspection**

Ex-Im Bank has steadily increased its volume of financings in support of U.S. jobs and exports with total FYE 2013 exposure amounting to $113.8 billion of which $40.8 billion is long term, structured and project financing.

Project financings are inherently more complex and dynamic compared to corporate financings, introducing the need for a higher level of due diligence, risk identification, risk mitigation, monitoring, and policy governance.

Although PNG LNG may not necessarily be representative of all Ex-Im Bank project financings, it can provide guidance with respect to suggested improvements in Ex-Im Bank policies, practices and procedures, consistent with industry best practices, OMB and GAO.

**What We Recommend**

1. Improve Ex-Im Bank’s CRTI process by (a) using an enhanced risk based approach to determine the level of due diligence and a plan based on the vulnerable areas of CRTI; (b) broadening the data bases and search procedures; and (c) regularly updating CRTI/KYC screening and analysis.

2. Enhance the oversight of local cost financing to ensure compliance with Ex-Im Bank Policies. Recommended measures include reserving the right to inspect the borrower’s books and records, consideration of additional reporting requirements, and written policy clarification with respect to financing local services.

3. As part of the initial project due diligence, evaluate foreign exchange risk separately with respect to construction cost.

4. Evaluate the adequacy of staffing for loan monitoring in view of workloads and the complexity of transactions, taking into consideration industry best practices in order to assure a prudent, proactive approach to asset management and credit risk.

**What We Found**

The PNG LNG Project is a vertically-integrated Liquefied Natural Gas (“LNG”) project in Papua New Guinea (PNG). Project Sponsors include ExxonMobil and several global energy companies. Total project costs are estimated at (b) (4) which includes a cost overrun compared to the original budget. Ex-Im Bank provides $3 billion in loan facilities with $576.9 million disbursed for the financing of local goods and services originating in Papua New Guinea.

OIG’s inspection focused primarily on Ex-Im Bank’s performance and adherence to internal policies and procedures. The scope of our work involved a thorough analysis of project documents, financial projections, and industry best practices, as well as interviews with Ex-Im Bank staff and outside consultants.

In the aggregate, our inspection found that the PNG LNG transaction was well structured and properly documented with Ex-Im Bank confident of full repayment. However, with the benefit of hindsight, certain internal practices and procedures can be improved to ensure compliance with Ex-Im Bank’s polices and to better protect Ex-Im Bank from potential risks. For example, we observed that the overall level of character, reputational and integrity due diligence conducted for this transaction could have been more comprehensive to protect Ex-Im Bank from potential fraud and reputational risks. It did not fully vet the directors of the project owners, nor other relevant persons and entities connected with the project.

In addition, the OIG was unable to validate the origin of $576.9 million of local costs financed by Ex-Im Bank. Of this amount, 70 percent was billed in non-local currencies. Although Ex-Im Bank relied on the certifications of the Borrower, Ex-Im Bank’s credit documentation did not require sufficient information nor did it provide the right to inspect the records of the Borrower to confirm compliance with Ex-Im Bank’s Local Cost Policy.

OIG also found that although Ex-Im Bank took several proactive measures to address potential cost overruns, it did not sufficiently analyze the foreign exchange risk during construction. The unhedged exposure contributed $2.1 billion to the (b) (4) cost overrun. Finally, the OIG notes that the current level of staffing assigned to monitor complex structured transactions may not be sufficient to ensure a proactive approach and effective coverage.

For additional information, contact the Office of the Inspector General at (202) 565-3908 or visit www.exim.gov/oig.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Glossary of Terms</td>
<td>3</td>
</tr>
<tr>
<td>Project Description</td>
<td>5</td>
</tr>
<tr>
<td>Inspection Scope and Points of Inquiry</td>
<td>12</td>
</tr>
<tr>
<td>Principal Findings and Recommendations</td>
<td>13</td>
</tr>
<tr>
<td>Conclusions</td>
<td>34</td>
</tr>
<tr>
<td>Appendix A: Management Responses</td>
<td>39</td>
</tr>
<tr>
<td>Appendix B: Local Cost Policy of Ex-Im Bank</td>
<td>44</td>
</tr>
<tr>
<td>Appendix C: Local Cost Invoice Descriptions</td>
<td>45</td>
</tr>
<tr>
<td>Appendix D: Inspection Rights of Export Credit Agencies</td>
<td>46</td>
</tr>
<tr>
<td>Appendix E: CRTI Transaction Due Diligence Guidelines</td>
<td>47</td>
</tr>
<tr>
<td>Appendix F: PNG LNG Transaction Time Line</td>
<td>49</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>52</td>
</tr>
</tbody>
</table>
LIST OF FIGURES AND TABLES

Table 1: LNG Off-Takers (Long Term Buyers) 8
Table 2: Sources and Uses of Funds (Before and After the Project Cost Overrun) 10
Table 3: Annual Number of Ex-Im Bank CRTI Search Requests 17
Table 4: CRTI Screening Results for PNG LNG Transaction 19
Table 5: EX-IM Bank Loan Disbursements for PNG Local Goods and Services 24
Table 6: Right of Inspection 26
Table 7: Base Case Ratios Before and After Cost Overrun in 2013 32

Figure 1: PNG LNG Project – Ownership & Project Structure (as of 12/2013) 7
Figure 2: LNG Price Forecast 9
Figure 3: PNG LNG Assigned BCL Risk Ratings 20
Figure 4: Exchange Rate Fluctuations 30
# Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMD</td>
<td>The Asset Management Division of Ex-Im Bank</td>
</tr>
<tr>
<td>Board</td>
<td>Ex-Im Bank Board of Directors</td>
</tr>
<tr>
<td>Board Memorandum</td>
<td>Memorandum submitted to the Ex-Im Bank Board of Directors as part of the process for approving transaction applications</td>
</tr>
<tr>
<td>Borrower</td>
<td>Papua New Guinea Liquefied Natural Gas Global LDC (Project borrower and obligor to the Ex-Im Bank Credit Agreement)</td>
</tr>
<tr>
<td>Common Terms Agreement (CTA)</td>
<td>An agreement between the obligors and the senior credit parties setting forth the terms and conditions of the credit that are common to all the senior credit parties</td>
</tr>
<tr>
<td>Company</td>
<td>ExxonMobil PNG Limited, a subsidiary of ExxonMobil and operator of the PNG LNG Project</td>
</tr>
<tr>
<td>Contractor</td>
<td>A supplier of engineering, procurement and construction (EPC) goods and services to ExxonMobil PNG Limited, the operator of the PNG LNG Project</td>
</tr>
<tr>
<td>CRTI</td>
<td>An Ex-Im Bank term meaning Character, Reputational and Transaction Integrity</td>
</tr>
<tr>
<td>CRTI Process</td>
<td>An Ex-Im Bank CRTI due diligence analysis of companies and individuals to identify potential fraud, corruption and integrity risks associated with companies and individuals</td>
</tr>
<tr>
<td>Credit Agreement</td>
<td>The Direct Loan Credit Agreement between the Borrower and Ex-Im Bank dated December 15, 2009</td>
</tr>
<tr>
<td>CTA</td>
<td>PNG LNG Project Common Terms Agreement</td>
</tr>
<tr>
<td>ECA</td>
<td>Export Credit Agency</td>
</tr>
<tr>
<td>EPC</td>
<td>Engineering, Procurement and Construction, often used in conjunction with “EPC Contract” or “Contractor”</td>
</tr>
<tr>
<td>Ex-Im Bank</td>
<td>The Export Import Bank of the United States</td>
</tr>
<tr>
<td>Esso Highlands, Ltd.</td>
<td>Former name of ExxonMobil PNG Limited</td>
</tr>
<tr>
<td>ExxonMobil</td>
<td>Exxon Mobil Corporation</td>
</tr>
<tr>
<td>GAO</td>
<td>The U.S. Government Accountability Office, the audit, evaluation, and investigative arm of the United States Congress</td>
</tr>
<tr>
<td>TERM</td>
<td>DESCRIPTION</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>IE</td>
<td>Independent Engineer</td>
</tr>
<tr>
<td>Kina or PGK</td>
<td>The local currency of Papua New Guinea</td>
</tr>
<tr>
<td>KYC (Know Your Customer)</td>
<td>KYC is a term used in conjunction with transaction due diligence with respect to integrity, corruption and bribery risk in accordance with a set of Ex-Im Bank policy guidelines dated January 10, 2008</td>
</tr>
<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
</tr>
<tr>
<td>Local Cost Financing</td>
<td>Ex-Im Bank financing for goods and services that originate and/or are manufactured in the Project’s host country</td>
</tr>
<tr>
<td>mtpa</td>
<td>Millions of tonnes annually (used in describing LNG processing capacity of the PNG LNG Project)</td>
</tr>
<tr>
<td>PNG</td>
<td>Papua New Guinea</td>
</tr>
<tr>
<td>OIG</td>
<td>Office of the Inspector General, Ex-Im Bank</td>
</tr>
<tr>
<td>Offtake Agreements</td>
<td>Agreements to sell the Project’s output of LNG, also referred to as SPAs, or Sales Purchase Agreements</td>
</tr>
<tr>
<td>OMB</td>
<td>The Office of Management and Budget of the U.S. Government</td>
</tr>
<tr>
<td>Operator/Company</td>
<td>ExxonMobil PNG Limited, an ExxonMobil subsidiary, the operator of the Project</td>
</tr>
<tr>
<td>Papua New Guinea (PNG)</td>
<td>A developing country of 7.2 million people, occupying the eastern half of the island of New Guinea including the island of Bougainville, Papua New Guinea is located 100 miles north of Australia, having a GDP of USD 15.7 billion in 2012</td>
</tr>
<tr>
<td>Participant</td>
<td>An owner of the Borrower, Papua New Guinea Liquefied Natural Gas Global LDC (Project borrower and obligor to the Ex-Im Bank Credit Agreement)</td>
</tr>
<tr>
<td>PNG LNG Project (Project)</td>
<td>The Papua New Guinea Liquefied Natural Gas Project in Papua New Guinea, the Lead Sponsor of which is ExxonMobil</td>
</tr>
<tr>
<td>Sponsor</td>
<td>An owner of the Project entities that have the rights and ownership interests in the PNG LNG Project. The Sponsors are Exxon Mobil ; Oil Search Limited; Santos Limited; Nippon Oil and JPP Company; and the State of PNG and MRDC (a PNG government owned corporation)</td>
</tr>
<tr>
<td>Supplemental Debt</td>
<td>Additional senior debt(b) (4)</td>
</tr>
<tr>
<td>World-Check</td>
<td>World-Check is based in London and maintains a database of Politically Exposed Persons (PEPs), heightened risk individuals &amp; organizations for the purpose of identifying &amp; managing financial, regulatory and reputational risks</td>
</tr>
</tbody>
</table>
PROJECT DESCRIPTION

Introduction

The PNG LNG Project (the “Project”) is a vertically-integrated Liquefied Natural Gas ("LNG") project in Papua New Guinea, consisting of gas fields in the highlands, an onshore and offshore pipeline of over 400 miles, a gas liquefaction plant on the coast, marine export facilities and in-country infrastructure to include roads and bridges. Construction started in 2010 and is scheduled for completion in 2015. The current estimated Project cost is (b) (4).

When completed, the Project will be capable of producing up to 6.9 million metric tonnes1 per annum (“mtpa”) of LNG and will generate annual revenue of approximately (b) (4) , which equates to (b) of the 2012 GDP of Papua New Guinea. Exxon Mobil Corporation (ExxonMobil) is the lead sponsor and a principal owner of the Project with a 32.9% interest. ExxonMobil PNG, Ltd., an ExxonMobil subsidiary, is the operator (the “Operator”) of the Project pursuant to an ownership agreement between the four other Project owners. The engineering, procurement and construction (“EPC”) firms building the Project are global firms from Australia, Italy, France and Japan.

In December of 2009, Ex-Im Bank extended a $3 billion, 17.5 year financing to the Project, consisting of an US $2.2 billion direct loan and an $800 million guaranteed bank loan.

Project Finance

Project finance is the long-term financing of infrastructure and industrial projects based upon the projected cash flows of the project rather than the balance sheets of its sponsors. The project’s legal and economic structures are defined by an interlocking, interdependent series of related contracts to include but not limited to construction, ownership, operation, maintenance, fuel supply, management, loan, revenue (“off-take”), and transportation.

A project financing structure typically involves a number of equity investors, known as ‘sponsors’, as well as a syndicate of lenders such as banks and export credit agencies that provide loans for the construction of the project. Project finance loans are typically with limited or non-recourse during construction. During the construction period, in some projects, there may be recourse to a completion guarantee. Once the project is in commercial operation and construction is completed, the loans are typically re-paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors. The project lenders are given a lien on all of these assets and are able to assume control of a project if the project company has difficulties complying with the loan terms.

Generally, a special purpose entity for each project is established, thereby shielding the other assets owned by a project sponsor from the detrimental effects of a project failure. As a special purpose entity, the project company has no assets other than the project.

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1 Tonne is a metric system unit of mass equal to 1,000 kilograms (2,204.6 pounds). Production based on current 2013 financial projections.
Risk identification and allocation are key components of project finance. A project may be subject to a number of contractual, market, technical, environmental, economic and political risks, particularly in developing countries and emerging markets.

A financial model is an important tool to assess, identify, and evaluate the economic feasibility, risks and returns of a project. The financial models are used by lenders and rating agencies alike to determine creditworthiness and risk. A key metric is the debt service coverage ratio, the ratio of project cash flow to debt service (principal and interest). Although no one metric is conclusive, the debt service coverage ratio is critical and used by Moody’s, Standard and Poor’s and Fitch in determining ratings. In addition, the project may default if the ratio is less than one if additional funds in the debt service reserve account are not available and/or if there is no further equity infusion.

In summary, project financings are more complicated than alternative, traditional financing methods. As such, project financings require a high level of due diligence, structuring and proactive monitoring to minimize risk and assure repayment. The financial model is an important tool in determining credit worthiness and risk.

**Project Background**

On December 3, 2009, Ex-Im Bank’s Board approved $3.0 billion in credit facilities, consisting of a $2.2 billion direct loan and an $800 million guaranteed loan. Proceeds were used to finance over $2.4 billion in export of U.S. goods and services, including capitalized interest during construction, and $578.9 million for local goods and services originated and manufactured in Papua New Guinea.

**Project Structure, Shareholders and Sponsors**

The Project is a joint venture, the direct and several owners of which are referred to as “Participants” and the ultimate parent entities being “Sponsors.”

ExxonMobil PNG Ltd, a subsidiary of ExxonMobil, is the Operator and responsible for coordinating all aspects of the Project.
Figure 1: PNG LNG Project – Ownership & Project Structure (as of 12/2013)
(Confidential and Proprietary Information)
Financial Closing and Disbursements

Financial closing for the Ex-Im Bank credit facilities occurred on December 15, 2009, and the first disbursement occurred on March 30, 2010. Total usage as of December 31, 2013, under the Ex-Im Bank facilities was $2.1 billion, of which $576.9 million was disbursed for local goods and services in Papua New Guinea.

Project Revenue

Table 1: LNG Off-Takers (Long Term Buyers)

<table>
<thead>
<tr>
<th>Company</th>
<th>(b) (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Osaka Gas Co. Ltd. (a major Japanese gas utility)</td>
<td>(b) (4)</td>
</tr>
<tr>
<td>UNIPEC (China International United Petroleum &amp; Chemicals Co., Ltd.)</td>
<td>(b) (4)</td>
</tr>
<tr>
<td>CPC Corporation (a state owned gas and oil company in Taiwan)</td>
<td>(b) (4)</td>
</tr>
<tr>
<td>TEPCO (The Tokyo Electric Power Company)</td>
<td>(b) (4)</td>
</tr>
<tr>
<td>Total</td>
<td>(b) (4)</td>
</tr>
</tbody>
</table>

Source: PNG LNG Project documentation

Global Demand and Supply for LNG

Both global demand and supply for LNG are increasing at a high rate. Standard & Poor’s Ratings Services expects natural gas consumption to grow over the longer term, particularly in Asia, the region of PNG LNG’s off-takers. For example, Japan currently imports some 30% of global LNG production given its recent shutdowns of nuclear reactors and its longer shift in energy policy. With tight LNG supplies and the forecast for demand outpacing new liquefaction capacity until at least 2014, Standard & Poor’s anticipates a positive

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2 Reuters: Japan’s 2013 LNG imports hit record high on nuclear woes (Jan 27, 2014); For more information, see http://www.reuters.com/article/2014/01/27/energy-japan-mof-idUSL3N0L103N20140127
Outlook for LNG producers in the near term. Moreover, LNG Producers are likely to maintain favorable pricing for the next few years, both in long-term contracts and spot pricing.

Currently, there are factors that may increase supply levels such as new LNG capacity in Australia (seven projects underway), the Middle East, Africa, the U.S., and the development of vast unconventional gas reserves elsewhere in the world, particularly shale gas. These conditions may affect future LNG prices or force changes to current long-term, oil-indexed offtake contractual conventions. In addition, the spot market currently represents 25% of global LNG traded volumes. Should this proportion grow materially, prices could come under pressure. This view is shared by the Economist Intelligence Unit as shown in the following forecast of LNG prices in Figure 2 below.

**Figure 2: LNG Price Forecast**

(US$/million Btu, Japan)

Source: Economist Intelligence Unit, January 16, 2014

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4 The price forecast represents the interaction of demand and supply. It is the price that clears the market.
Project Cost Overruns and Factors Contributing to the Overrun

In November of 2012, ExxonMobil announced that the PNG LNG Project would incur a major cost overrun. In early December of 2012, Ex-Im Bank staff from AMD and the Engineering and Environmental Division conducted a seven day site visit to the PNG LNG project facilities and attended meetings with Exxon Mobil and the lenders, where ExxonMobil provided a description of the cost overruns.

Table 2: Sources and Uses of Funds (Before and After the Project Cost Overrun)

(Confidential & Proprietary Information)

(b) (4)
Other Project Risks

Apart from construction cost overruns, the PNG LNG transaction faces additional risks:

- **Crude Oil Prices:** (b) (4)

- **Contract Stability:**

- **Interest Rate Volatility:** (b) (4)

- **Strength of Sponsors:** (b) (4)

- **Country Risk:** The PNG government recently nationalized the Rio Tinto mine and is considering legislation for greater state control of the extractive industries sector, (b) (4)

- **Character and Reputational Risks:** Transparency International currently ranks PNG as 144 on a scale of 177 in its Corruption Perceptions index with 177 being the most corrupt, indicating a high risk of corruption. 6 In addition, the PNG government faces serious governance-related issues regarding continuing disputes over land rights and the distribution of funds under the PNG LNG Benefits Sharing Agreement. 7

6 Transparency International, Data and Research (02-04-2014); For more information, see http://www.transparency.org/country#PNG

Inspection Scope and Points of Inquiry

OIG’s inspection seeks to assess the level of due diligence, Ex-Im policy compliance, risk assessment, risk mitigation and portfolio monitoring performed by Ex-Im Bank given its $3 billion commitment, the 17.5 year term of the transaction, the complexity of the PNG LNG project financing, and the non-recourse nature of repayment once construction is completed.

A combination of quantitative and qualitative techniques was employed by the OIG’s Office of Inspection and Evaluation (OIE) as part of its review. These included (1) a review of the Project’s legal documents, internal Ex-Im Bank reports and correspondence related to the transaction; (2) interviews of Ex-Im Bank staff including representatives from Structured Finance, Asset Management Division, Engineering and Environmental Division, Credit Policy, and Office of the General Counsel; (3) analysis of the PNG LNG financial statements, financial projections, disbursement requests, invoices and payment history; and (4) a review of public and open source documents, press releases and network analysis. Finally, several points of inquiry directed our focus and helped guide our Inspection:

POINT OF INQUIRY 1: Did Ex-Im Bank perform the CRTI/KYC Transaction Due Diligence in accordance with its current policies and procedures? Are current policies and procedures sufficiently comprehensive to protect Ex-Im Bank from potential waste, fraud, abuse and reputational risk issues?

POINT OF INQUIRY 2: Are Ex-Im Bank’s practices with respect to Local Cost loan disbursements of $576.9 million in Papua New Guinea being implemented and managed in accordance with Ex-Im Bank Policy and Ex-Im Bank’s statutory mission “to increase U.S. employment through the export of goods and services”?

POINT OF INQUIRY 3: Did Ex-Im Bank conduct sufficient credit due diligence and monitoring of the key project risks, parties involved, exposures, and red flags in accordance with Ex-Im Bank policies and project finance best practices? Were the relevant risks identified, evaluated, and mitigated accordingly?

The OIG conducted this inspection during FY 2013/2014 in accordance with the 2012 Quality Standards for Inspection and Evaluation as defined by The Council of Inspectors General on Integrity and Efficiency (CIGIE). Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.
PRINCIPAL FINDINGS AND RECOMMENDATIONS

In writing this report, OIG recognizes that our findings and recommendations primarily relate to the PNG LNG project financing, and may not necessarily be generalized to the broader universe of Ex-Im Bank transactions. Our approach is to review transactions from a lessons learned perspective and to help identify potential systemic improvements in Ex-Im Bank’s policies and procedures. The report is guided by the three Points of Inquiry listed above. For each point, OIG provides applicable criteria based on Ex-Im Bank’s policies and procedures, market best practices, peer entities, as well as rating agent criteria. The report continues with OIG’s findings and attendant recommendations to management.

We note that the Project is in compliance with Ex-Im Bank’s credit agreements. The Project is more than 90% complete. In April of 2014 ExxonMobil reported that the Project started producing LNG from its first liquefaction facility ahead of schedule. ExxonMobil plans to complete construction of its second liquefaction facility in 2015. OIG found the Project to be generally well structured and well documented with a strong lead sponsor, ExxonMobil.

Point of Inquiry 1: Did Ex-Im Bank perform the CRTI/KYC Transaction Due Diligence in accordance with its current policies and procedures? Are current policies and procedures sufficiently comprehensive to protect Ex-Im Bank from potential waste, fraud, abuse and reputational risk issues?

Applicable Standards

OIG reviewed various Applicable Standards and focused on the following: (1) Ex-Im Bank’s CRTI policies as outlined in Ex-Im Bank’s Loan Guarantee and Insurance Manual, 2009-2013 (“Loan Manual”), Chapter 24, Credit Review and Compliance Division; (2) “Transaction Due Diligence Best Practices8,” Export-Import Bank of the U.S., January 10, 2008; (3) Ex-Im Bank’s CRTI Training Presentation, June 2013; (4) The US Foreign Corrupt Practices Act of 1977 (“FCPA”); 9 (5) the OECD Convention on Combating Bribery;10 and (6) best practices as observed by other multilateral financial agencies.

U.S. and OECD Anti-Corruption Frameworks

Anti-corruption diligence is an important component of transactional due diligence.11 Regulators have

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8 The CRTI / KYC Transaction Due Diligence is a process to identify potential debarment, fraud, corruption, bribery, and integrity risks associated with companies and individuals.

9 For more information see http://www.justice.gov/criminal/fraud/fcpa/

10 For more information see http://www.oecd.org/corruption/oecdantibriberyconvention.htm

endorsed a risk-based approach, focusing on those countries, entities and names that potentially represent higher levels of perceived risk.

The US Foreign Corrupt Practices Act of 1977 ("FCPA") was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. The OECD Anti-Bribery Convention establishes legally-binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective. Under both FCPA and OECD, the bribery of foreign officials is prohibited, either directly or through third parties. The U.S. Department of Justice is charged with the criminal enforcement of the FCPA’s provisions.

In addition, the US Department of Justice and Department of Commerce have jointly provided guidance on corrupt third party payments: “To avoid being held liable for corrupt third party payments, US companies are encouraged to exercise due diligence and take all necessary precautions to ensure that they have formed a business relationship with reputable and qualified partners and representatives.” Failure to adequately assess clients, agents and business partners, and to know how they operate, can expose organizations to reputational risk, as well as monetary losses and criminal liability.

**Ex-Im Bank CRTI/KYC Transaction Due Diligence**

Ex-Im Bank’s policies related to fraud and corruption prevention are outlined in several core documents including Ex-Im Bank’s “Transaction Due Diligence Best Practices” and Character Reputational & Transaction Integrity ("CRTI") procedures as outlined in Chapter 24 of its Loan Manual. The potential for fraud and corruption is recognized as a key concern as it may result in significant monetary loss to the transaction participants and undermine Ex-Im Bank’s institutional integrity and reputation.

Ex-Im Bank policy prescribes a two-step approach to CRTI due diligence. Step one provides that all relevant parties to the transaction are to be vetted, including the foreign buyer, borrower, project sponsors, off-takers, end-users, guarantors, and principal owners of each of these entities. Step two assesses CRTI risk indicators to determine if the transaction represents standard or elevated CRTI risk. As outlined in Appendix E, step two CRTI due diligence involves a number of additional possible due diligence measures. Finally, Ex-Im Bank cooperates with law enforcement authorities, foreign and

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12 Under certain circumstances, it is considered unlawful to make a payment to an intermediary “knowing “that all or part of the payment will be used as a bribe to a foreign official. “The US Congressional Record accompanying the statues states which indicate “conscious disregards” and “wilful blindness” may also constitute “knowledge.” For more information, see FCPA web site (http://www.justice.gov/criminal/fraud/fcpa/), OECD web site (http://www.oecd.org/corruption/)

13 International Association of Oil & Gas Producers ("OGP"), “Guidelines on Reputational Due Diligence”, 2004; For more information, see http://www.ogp.org.uk/publications/management-committee/guidelines-on-reputational-due-diligence/

14 Transaction Due Diligence Best Practices, Ex-Im Bank, January 10, 2008; For more information, see http://www.exim.gov/generalbankpolicies/upload/Due-Diligence-Guidelines-1.pdf

15 Chapter 24, Loan Guarantee and Insurance Manual, January 2013; For more information, see http://eximnet.bankhq.exim.gov/manuals/credit/indexcm.html
domestic, including the OIG, and will refer to such authorities on fraud or corruption allegations that Ex-Im Bank deems appropriate.

**CRTI Due Diligence Best Practices**

OIG conducted interviews with several multilateral agencies including the Inter-American Development Bank (IADB), the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC). OIG has confirmed that these institutions employ a broad and in-depth CRTI process at transaction inception. The results are used to guide further, on-going due diligence efforts, credit structuring, documentation, and asset monitoring. In addition, transactions typically require the sign off from an independent “Office of Integrity” that certifies satisfactory completion of the due diligence efforts.

Depending on the nature of the perceived risks, these institutions will employ an array of standard checks and enhanced due diligence techniques:

- The use of a large number of databases including (although not limited to) World-Check.
- Comprehensive web-screening for Politically Exposed Persons (PEPs) and other reputational and integrity issues.
- The use of vertical and affiliated-entity relationship analysis of a transaction participant to “pierce the ownership veil” of transaction parties including individuals, sponsors, EPC contractors, major vendors, local cost providers etc. The objective is to identify non-transparent ownership and relational CRTI risks.
- Interviews with local agents and/or embassy staff in the host country.
- Cross checks and exchange of information with other government agencies, multilaterals, etc.

In addition to CRTI due diligence, several multilateral agencies have an independent accountability mechanism to address potential sociological and environmental impacts to the local community. These mechanisms include:

- Addressing complaints by affected people; seeking to resolve problems with bank staff.
- Reviewing compliance where complainant may seek an independent review of the Bank’s project.
- Providing advice to management on policies and procedures.

**Finding 1:** CRTI procedures for PNG LNG transaction were not sufficiently implemented, developed, and systematically applied to adequately protect Ex-Im Bank from potential fraud, reputational and integrity risks.
The Directors and Key Officers of Relevant Transaction Parties Were Not Vetted

OIG observed that the CRTI screening request of July 2009 included the project sponsors, owners, and certain participants, but did not include the names of any individuals, such as directors and key officers of project participants. All of this information was available to Ex-Im Bank prior to the first disbursement in March of 2010. The next CRTI analysis took place in 2011 and covered the EPC contractors and proposed local, in-country suppliers, but not the names of directors or signatories to the PNG LNG documentation. OIG has confirmed that these names were not vetted by Ex-Im Bank.

OIG notes that the loan monitoring policy of Ex-Im Bank does not require CRTI analysis and screening on a periodic basis after initial due diligence. For example, Ex-Im Bank’s AMD Operating Manual: Functions, Resources, Goal and Objectives, Employee Standards does not reference CRTI due diligence and responsibilities, although loan monitoring policy does include the requirement for CRTI screening of new transaction parties which AMD becomes aware of through transaction documentation amendment, waiver and consent requests. Yet, CRTI events, circumstances and participants change throughout the life of a transaction, particularly in a transaction such as PNG LNG that spans 17.5 years, exposing Ex-Im Bank to reputational risk over a long period of time.

Current CRTI Screening May Not Place Sufficient Emphasis on Individuals

Although individuals and not organizations often present the highest level of character and reputational risk, OIG could not find any record of individual names submitted for screening in connection with the PNG LNG Transaction from 2009 through the date of this report. Separately, OIG note that the number of company searches significantly outweighs the number of personal names searched for CRTI Screening, suggesting that additional emphasis could be placed on screening individuals for CRTI purposes.

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16 OIG noted that Ex-Im Bank had the names of all the contractors and key participants as well as the right to receive the names, nationalities, dates of birth and residential addresses of each owner’s directors that were directly involved with the PNG LNG transaction, but these names were not vetted at the time; Common Terms Agreement, Section 5.1, Schedule S: Know Your Customer Requirements, December 15, 2009

### Table 3: Annual Number of Ex-Im Bank CRTI Search Requests

<table>
<thead>
<tr>
<th>Group</th>
<th>Total Requests</th>
<th>Company Names Searched</th>
<th>Personal Names Searched</th>
<th>Total Searches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Business</td>
<td>1,315</td>
<td>15,903</td>
<td>1,874</td>
<td>17,777</td>
</tr>
<tr>
<td>Export Finance</td>
<td>1,143</td>
<td>7,664</td>
<td>2,206</td>
<td>9,870</td>
</tr>
<tr>
<td>CFO</td>
<td>100</td>
<td>346</td>
<td>190</td>
<td>536</td>
</tr>
<tr>
<td>Board</td>
<td>12</td>
<td>166</td>
<td>32</td>
<td>198</td>
</tr>
<tr>
<td>Credit Management Group</td>
<td>14</td>
<td>118</td>
<td>7</td>
<td>125</td>
</tr>
<tr>
<td>General Counsel</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,586</strong></td>
<td><strong>24,199</strong></td>
<td><strong>4,311</strong></td>
<td><strong>28,510</strong></td>
</tr>
</tbody>
</table>

Source: Ex-Im Bank’s Character, Reputation and Transaction Integrity (CRTI) Training June, 2013

**Incomplete CRTI Due Diligence Despite the High Level of Industry Sector Risk and Country Risk**

(b) (5)

Transparency International ranked Papua New Guinea as 2.1 on a scale of 1-10 with 1 as the most corrupt category and 10 the least corrupt category\(^{19}\), indicating a high risk of corruption. Finally, rating agencies such as Moody’s, S&P as well international periodicals such as the Economist also indicated PNG as a country of high risk of corruption. (b) (5), (b) (7)(E)

\(^{19}\) The TI Index scores 180 countries and territories on a scale from 1 (highly corrupt) to 10 (no corruption); For more information, see [http://archive.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table](http://archive.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table)
Current CRTI Screening Fails to Identify Known Risks of Corruption and Significant Governance Issues

OIG conducted a preliminary test to assess the effectiveness of the standard CRTI process currently utilized by Ex-Im Bank. As part of its review, OIG submitted for CRTI analysis the names of two Project contractors that had been charged with FCPA violations in the past as well as the principals of the leading Project shareholders. The objective of the procedure was to compare the results obtained from the standard CRTI check with the results obtained by OIG, using in depth screening of publicly available data sources.

As summarized in Table 4 below, CRTI screening requests to the Ex-Im Library resulted in no findings, or “No Match,” for either the Project contractors or the principals submitted in 2013. In contrast, OIG’s open sourced internet search revealed several significant risk factors that were publicly known at the time, including (b) (6).

In addition, OIG identified a number of publicly available articles citing ongoing violent disputes between MRDC and local farmers, and broader governance issues related to widespread allegations of corruption related to the alleged mismanagement of landowner’s investments.22

PNG’s Oil & Gas Act of 1998 requires that the fiscal benefits from its oil and gas projects be widely distributed to affected peoples through the allocation of Benefits Sharing Agreements (“BSAs”) as a condition to granting licenses. In the case of PNG-LNG, the BSAs were to be executed or issued before financial closing.24 However, according to a report published in December 2009 by Jubilee Australia, an

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24 Conditions Precedent: 5.1(e)(vi) each BSA, each of which shall be in full force and effect.
Australian NGO, in-fighting and disputes among members of the group meant that many Project-affected areas struggled to sign before the deadline. “Just days before the deadline was reached, the Government threatened to unilaterally impose its own terms on Project-affected areas that would not negotiate and sign. This threat was effective in bringing most of the struggling groups to agreement.”

A subsequent report by Human Rights Watch in 2012 stated, “Disputes between local landowners and LNG contractors have been common since the project was sanctioned in 2009, and unresolved disputes over compensation for landowners, outstanding business development grants, and inadequate benefits for employees continue to generate protests and occasional violence. In August [2011] local villagers attacked two employees at the LNG site in Komo, a proposed airfield, forcing Exxon Mobile to temporarily halt operations.” In addition, although enhanced due diligence was done on two PNG LNG contractors and documented in the project file, the CRTI screening process performed by Ex-Im Bank’s Library did not result in any negative findings for these entities.

**Table 4: CRTI Screening Results for PNG LNG Transaction**

<table>
<thead>
<tr>
<th>CRTI screening requests submitted by OIG</th>
<th>Open Source Web Search Performed by OIG</th>
<th>Library CRTI Screening Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) (4), (b) (6)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Column Library Search from Library results as requested by OIG in 2013

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Applying the appropriate CRTI due diligence in accordance with the perceived level of risk is critical to a successful CRTI procedures. However, the CRTI procedures of Ex-Im Bank do not require the risk assessment process to be conducted prior to the CRTI screening of participants. The CRTI screening process is performed first at the inception of the transaction. Due diligence of CRTI risk is then evaluated throughout the underwriting process. Accordingly, it is not clear whether an upfront risk assessment plan is established that properly directs the subsequent CRTI screening process and due diligence.

In accordance with the CRTI procedures, Ex-Im Bank staff evaluates each transaction according to the appropriate CRTI risk indicators. If it is determined that the transaction represents Standard 27 CRTI risk, the staff has responsibility for evaluating and mitigating the risks as may be necessary. If the

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27 CRTI risk indicator(s) exists but are appropriately mitigated. Loan Manual, Ch. 24.
transaction is determined to represent Elevated\textsuperscript{28} CRTI risk, Bank staff notifies the Office of General Counsel (OGC) and the Credit Review and Compliance Division (CRC) to evaluate, execute and document further actions as appropriate.\textsuperscript{29} However, Ex-Im Bank’s policy manuals do not provide written criteria to guide the action to be taken. Finally, in the case of PNG LNG, there was no evidence that an enhanced CRTI Risk Indicator Check List was ever filed pursuant Chapter 24 of the Loan Manual.

**RECOMMENDATION 1**

To strengthen the effectiveness and transparency of the CRTI/KYC due diligence, OIG recommends that Ex-Im Bank review and evaluate its current CRTI policies and procedures, giving consideration to the following:

- Enhance efficiency and effectiveness of the CRTI/KYC due diligence by implementing a risk-based assessment to determine the appropriate level of due diligence required for each transaction. On the basis of these results, develop an appropriate systematic plan to screen, mitigate and monitor CRTI risk, particularly in the critical pre-approval stage of a transaction.

- Conduct enhanced, upfront internet web screening to include local in-country sources and media for Politically Exposed Persons (PEPs) and other potential reputational/integrity issues.

- Employ vertical and affiliated relationship analysis to “pierce the ownership veil” to identify non-transparent and relational CRTI risks including owners, sponsors, EPC contractors, etc.

- Expand the external databases and sources being used for CRTI screening beyond the 20 watch lists of World-Check currently being used.

- Implement CRTI screening on all relevant transactional parties on a regular, periodic basis during asset monitoring subsequent to initial due diligence.

- Develop a dialogue with multilateral financial institutions such as IFC to learn more about CRTI and KYC best practices.

While enhancing the Ex-Im Bank’s CRTI procedures cannot guarantee that improper conduct will not occur, appropriate due diligence research will help reduce the potential misuse of financing involving fraud and corruption that could result in monetary loss to the transaction participants as well as loss of creditability in Ex-Im Bank’s programs and reputation.

\textsuperscript{28} CRTI risk indicator(s) exists but are not appropriately mitigated. Loan Manual, Ch. 24.

\textsuperscript{29} The elevated CRTI risk potential action steps for staff are listed in Appendix 4 in CRTI Procedures.
**Management Response**

Management is currently reviewing and evaluating its current KYC/CRTI process, and expects to have this completed by the end of this calendar year. Management agrees to take the OIG recommendations into consideration. Due to budgetary and staffing constraints, the Bank will need to conduct a cost-benefit analysis to determine the level of participant review which is both practical and feasible. The Bank has already added another database to the CRTI screening process and will continue to evaluate other potential databases for inclusion. The Bank notes that local in-country sources and media are often politically motivated, therefore not the most accurate and reliable sources of information.

**Evaluation of Management’s Response**

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

**Point of Inquiry 2: Are Ex-Im Bank’s practices with respect to Local Cost loan disbursements of $576.9 million in Papua New Guinea being implemented and managed in accordance with Ex-Im Bank Policy and Ex-Im Bank’s statutory mission “to increase U.S. employment through the export of goods and services”?**

**Applicable Standards**

OIG reviewed various relevant Applicable Standards and focused on the following: (1) Ex-Im Bank’s Local Cost Policy as stated on its website[^30] and in its Loan, Guarantee and Insurance Manual, 2009 - 2013 (“Loan Manual”); (2) Ex-Im Bank’s Policy Handbook, 2009; (2) Executive Order 13520 - Reducing Improper Payments and Eliminating Waste in Federal Programs, November 23, 2009;[^31] (3) Ex-Im Bank’s Charter[^32] and (4) OECD guidelines as provided in the 2009 “Arrangement on Officially Supported Export Credits.”[^33]

In addition, OIG reviewed various Applicable Standards related to the reimbursement of Local Costs as outlined in Ex-Im Bank’s “Operations and Data Quality Division Manual,” March 2009 as well as the Utilization Procedures included in Annex B to the PNG LNG Credit Agreement. Complementing these resources, OIG interviewed Ex-Im Bank staff representing Engineering, Operations, Asset Management, Policy, and the Office of General Counsel.

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[^33]: Available at [http://www.oecd.org/tad/xcred/theexportcreditsarrangementtext.htm](http://www.oecd.org/tad/xcred/theexportcreditsarrangementtext.htm)
**OECD Local Cost Guidelines**

Organisation for Economic Co-operation & Development (OECD) defines the Local Cost as “expenditure for goods and services in the buyer's country that are necessary either for executing the exporter's contract or completing the project of which the exporter's contract forms a part.”

In accordance with the OECD guidelines, the OECD Participants may provide official support for local costs, provided that:

- Local cost support shall not exceed 30% of the export contract value.
- Local cost support shall not be provided on terms more favorable/less restrictive than those agreed for the related exports.
- Whenever local cost support exceeds 15% of the export contract value, such support shall be subject to prior notification, pursuant to Article 48, specifying the nature of the local costs being supported.

**Ex-Im Bank Local Cost Policy**

Ex-Im Bank policy permits the financing of up to 30% of the value of U.S exports for locally originated and/or manufactured goods and services in the host country. This support is in addition to the maximum support of 85 percent of the U.S. Contract Price. The local cost represents locally-originated and manufactured goods and services in support of long-term and medium-term U.S. export transactions. The Policy reflects the premise that some amount of local labor and raw materials are necessary to efficiently build or assemble the end product of the U.S. export.

In comparison to OECD guidelines, Ex-Im Bank’s Local Cost policy adds additional eligibility requirements for Local Cost financing. It requires that the expenditure for goods and services supplied from the buyer's country is:

- Beneficial to the project
- Certified by the Borrower
- Detailed in the Acquisition List
- Originated in the host country

Ex-Im Bank also requires the Borrower certify that the local cost support was not used to cover products that could reasonably be purchased in the U.S.

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34 See Appendix B, Local Cost Policy, Ex-Im Bank’s website; For more information, see [http://www.exim.gov/generalbankpolicies/localcost/](http://www.exim.gov/generalbankpolicies/localcost/)

Loan Disbursements for Local Costs

The following table shows the loan amounts disbursed for local goods and services by Ex-Im Bank, the invoicing entities, the billing currencies, and the total loans. Of the total loan amount approved ($578.9 million), Ex-Im Bank funded $576.9 million, of which seventy percent (70%), or $403.8 million, was invoiced in (b) (4) and the remainder (30%) in Kina, the local currency of Papua New Guinea. The invoicing entities were affiliates of international, foreign construction (EPC) contractors, registered to do business in Papua New Guinea, as shown in Table 5.

Table 5: EX-IM Bank Loan Disbursements for PNG Local Goods and Services

(Confidential & Proprietary Information)
Finding 2A: OIG was not able to validate compliance with Ex-Im Bank’s Local Cost Policy due to insufficient information provided to Ex-Im Bank Pursuant to its Credit Agreement\textsuperscript{36}

**Insufficient Information to Validate Origin**

In discussions with Ex-Im Bank staff, OIG learned that Ex-Im Bank largely relies on the certifications of the Borrower to validate local cost compliances required in its Credit Agreement in lieu of requiring detailed information. OIG understands that this is the general procedure to reduce paperwork, promote efficiency in processing and to make best use of limited internal resources.

In accordance with Ex-Im Bank’s Credit Agreement, the Borrower provided Ex-Im Bank with an initial Acquisition List on March 1, 2010, for Local Goods and Services and subsequent versions as the lists were modified. The lists showed the names and addresses of the local suppliers, a broad description of the goods and services and estimated cost. The lists were approved by Ex-Im Bank’s Engineering and Environment Division.

These suppliers (referred to as “Contractors”) in turn reportedly entered into subcontracts with local entities to provide all or part of the local goods and services. The Borrower also provided Ex-Im Bank with another, separate list of potential, local cost subcontractors dated December 22, 2010, that was also reviewed and approved by Ex-Im Bank. However, invoices submitted to Ex-Im Bank for reimbursement did not identify the origin of the goods and services and their associated cost.

Although in compliance with the Credit Agreement, the descriptions on the invoices submitted by the Contractors for reimbursement were generic without reference to origin and lacked details to confirm local sourcing. Examples of the descriptions are: (b) (4)

Moreover, OIG noted that the entities submitting the invoices were affiliates of international EPC construction companies (contractors), with local addresses, and doing business in PNG as local companies registered in Papua New Guinea. Additionally, $403.8 million, or 70% of the invoices, were billed in a currency other than the currency of Papua New Guinea.

Finding 2B: Ex-Im Bank does not have the right to inspect and audit the books and records to validate the origin of local goods and services financed by Ex-Im Bank.

The Credit Agreement and Common Terms Agreement permit Ex-Im Bank the right to “reasonably request” information. The Common Terms Agreement also gives Ex-Im Bank the right to inspect the project site with limitations and receive copies of the project’s books and records in the Event of

\textsuperscript{36} In conducting this inquiry, OIG attempted to validate that the local goods and services were financed in compliance with its policy as in effect in 2009, specifically whether these goods and services were of local origin.
Default. Absent an Event of Default, Ex-Im Bank does not have the right to inspect and audit the relevant books and records to validate compliance with Local Cost Policy.

In reviewing the credit agreements of the other ECAs, OIG learned that (b) (4)

Ex-Im Bank states that other ECAs may not have the same level of pre-disbursement due diligence as Ex-Im Bank and may as a result request the right to audit and spot check the borrower’s record after their loans have been disbursed. The following table shows the inspection and audit rights of Ex-Im Bank and the other ECAs in the PNG LNG financing.38

**Table 6: Right of Inspection**
*(Confidential & Proprietary Information)*

<table>
<thead>
<tr>
<th>ECA Lender</th>
<th>US-Exim</th>
<th>EPF (Australia)</th>
<th>SACE S.P.A. (Italy)</th>
<th>JBIC (Japan)</th>
<th>NEXI (Japan)</th>
<th>C-Exim (China)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facility</td>
<td>$3,000,000,000</td>
<td>$350,000,000</td>
<td>$900,000,000</td>
<td>$1,800,000,000</td>
<td>$950,000,000</td>
<td>$1,300,000,000</td>
</tr>
</tbody>
</table>

**Finding 2C: Local cost eligibility criteria may not be applied consistently to goods and services**

In discussions with the Policy and Planning Group of Ex-Im Bank, OIG was advised that Ex-Im Bank’s Local Cost Policy requires that both the goods and services originate and be incurred in the host country to be eligible for local cost financing.39 However, OIG was also advised that although goods need to be of local origin, services do not necessarily have to be. Services provided by individuals from outside of the host country, but employed by a locally registered firm, could also be eligible for

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38 See Appendix D, Inspection Rights of ECAs (Export Credit Agencies)

39 See Appendix B, Local Cost Policy, Ex-Im Bank’s website; For more information, see [http://www.exim.gov/generalbankpolicies/localcost/](http://www.exim.gov/generalbankpolicies/localcost/)
financing. 40.

With respect to PNG LNG, Policy and Planning stated that if a locally registered entity (such as (b) ) had entered into a local services contract, the services under the contract (b) (4) ) could be eligible for Ex-Im Local Cost support, since the services were contracted with a locally registered business entity and not directly with the providers. 41 **This practice appears to imply a two tier approach for eligibility, one for local goods and another for local services.** 42

**RECOMMENDATION 2**

To strengthen compliance with Ex-Im Bank Policies and to enhance transparency in the financing of local cost goods and services, the OIG makes the following recommendations to Ex-Im Bank:

- Reserve the right of inspection and audit of the borrower’s books and records in Ex-Im Bank’s credit agreements, particularly for project financings. This right should be provided on an ongoing basis and not be restricted to the occurrence of an Event of Default.
- Require borrowers to maintain a set of verifiable records subject to audit and consider extending this inspection right to the records of construction contractors as applicable.
- Consider additional requirements to provide greater transparency and to facilitate validation of compliance, such as requiring the Borrower to provide, when requested, more descriptive information and details regarding local cost disbursements.
- Review and evaluate Local Cost Policy with respect to the origin of local services to explicitly state its criteria and requirements for funding such services in keeping with transparency, consistency, the statutory mandate to create U.S. jobs and defined business strategy.

**Management Response**

The Bank agrees to review and evaluate the current local cost policy. The Bank notes that Ex-Im conducts a higher level of pre-disbursement due diligence to protect the taxpayers than other ECAs which may rely on potential post-disbursement document reviews. Any changes to the Bank’s credit agreements will need to be evaluated by the Bank’s business and legal divisions. The Bank will also evaluate the recommendations regarding the required local cost information for transactions and determine what mechanism would be

40 Email from Policy and Planning August 28, 2013
41 Meeting with Policy and Planning, December 17, 2013
42 See Appendix B, Local Cost Policy, Ex-Im Bank’s website; For more information, see http://www.exim.gov/generalbankpolicies/localcost/
practical and feasible, as well as legally sound, to validate the information the Bank currently receives through the local cost certification process.

In addition, section 2(i) of the Bank’s 2012 Charter requires the Bank to "set due diligence standards for its lender partners and participants " and "require all delegated lenders to implement 'Know your customer practices.'" The Bank has taken into consideration prior Government Accountability Office (GAO) and OIG recommendations in developing the Bank’s current policy on "Know Your Customer Requirements and Due Diligence Standards" (posted 5/22/14) which contains "Cooperation Requirements and Reservation of Rights.”

As part of the cooperation requirement s, all participants in Ex-Im Bank transactions (defined as a lender in direct privity with Ex-Im Bank, a borrower, a guarantor, a buyer, an exporter, an Ex-Im bank approved broker, an assignee or Enhanced assignee, or an agent, broker, finder or representative for any of the foregoing) are "expected to cooperate with all request s of Ex-Im Bank for documents and information related to any transaction involving Ex-Im Bank which, in Ex-Im Bank's sole discretion, are necessary to review any participant's due diligence process, underwriting, know your customer practices, documentation, funding and operation of any and all Ex-Im Bank transactions, both before and after approval and consummation of a transaction." The reservation of rights provides additional mechanisms for the Bank to review and make determinations based on "know your customer" and due diligence practices.

**Evaluation of Management’s Response**

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

**Point of Inquiry 3: Did Ex-Im Bank conduct sufficient due diligence and monitoring of the key project risks, parties involved, exposures, and red flags in accordance with Ex-Im Bank policies and project finance best practices? Were the relevant risks identified, evaluated, and mitigated accordingly?**

**Applicable Standards**

In conducting this inquiry, the OIG reviewed various Applicable Standards and focused on the following: (1) Ex-Im Bank’s analysis and due diligence of the risk factors as outlined in *Ex-Im Bank’s Loan, Guarantee and Insurance Manual, 2009-2013* (“Loan Manual”), Chapter 14.5 Risk Factors; Chapter 22, Post-Operative Monitoring; (2) *Asset Management Division Operating Manual*, March 009 (“Monitoring Manual”); (3) guidance found in the rating criteria used by the principal credit rating agencies: Standard & Poor’s, Moody’s and Fitch Ratings43; and (4) industry best practices.

Ex-Im Bank Credit Policy - Project Financing

Reflecting the complex, non-recourse nature of a project financing, Ex-Im Bank’s Loan Manual calls for a comprehensive analysis of all aspects of the project financing. Among the many risk factors that are commonly addressed are construction, market, country, transportation, sponsor, fuel and operation. Also carefully evaluated are the project’s plan of operations, financial projections and scenario, legal structure, and the background of the sponsor(s) and project management team. As outlined in Ex-Im Bank’s Loan Manual, Chapter 14.5.1 Risk Factors, a thorough review of all the major contracts and underlying project documents are required to include the Engineering Procurement and Construction (EPC) contracts.

Ex-Im Bank Monitoring Policy

The Monitoring Manual44 of Ex-Im Bank states that the mission of its Asset Management Division (AMD) is to proactively monitor portfolios so as to provide an early warning mechanism of potential loss situations. The Manual in particular states that the monitoring of project finance transactions during the construction period requires additional oversight.45 Additionally, the Manual requires the AMD officer to “review construction progress reports submitted by obligors whose projects are still in construction as well as engineering reports submitted by the IE (independent engineer). Ex-Im Bank follows a risk-based approach to monitoring credits where staff actively and continuously reviews transactions to help to ensure early identification of cost overrun risks.”46 The Monitoring Manual requires a similar level of professional, proactive monitoring during the commercial operation of a project. The Monitoring Manual requires the preparation of reports semi-annually on all actively monitored obligors and quarterly reports on all defaulted and/or impaired credits.

Monitoring of the PNG LNG transaction, particularly during its construction, is time intensive. It involves site/client visits and the evaluation of updated financial projections as well as a constant flow of documents to include construction reports, future operational reports, financial statements, budgets, disbursement requests, amendments, waivers, country reports, environmental and social reports and others. Given that the repayment risk is non-recourse and solely dependent on cash flows after construction involving multiple risks and multiple parties, the transaction requires a high level of due diligence by a professional staff that is adequately resourced and trained in accordance with the Monitoring Manual.

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44 Asset Management Division Operating Manual, March 2009, pp 3, 15 and 24; For more information, see AMS (Asset Management System)

45 Asset Management Division Operating Manual, March 2009, p. 29: “Monitoring project finance transactions during the construction period requires additional oversight on the part of the AMRG (AMD) officer. The asset under construction is generally the only source of cash flow that will be used to repay the loan.”

46 “Portfolio Experience with Projects in the Construction Phase,” Ex-Im Bank, 10-24-2013
Finding 3A: Although Ex-Im Bank took a number of proactive, carefully-considered steps to mitigate construction cost overruns through (b) (4), the foreign exchange ("FX") risk during construction was not separately addressed and sufficiently evaluated. In retrospect, FX exposure accounted for $2.1 billion of a (b) (4) project cost overrun.

Ex-Im Bank management advised OIG that Ex-Im Bank viewed foreign exchange volatility to be one of several construction risks that in aggregate would be mitigated by the proactive measures taken above. The eventual foreign exchange losses of $2.1 billion were due to a mismatch of currencies in the construction contracts, namely the Australian Dollar and the Kina (currency of Papua New Guinea) versus the US dollar (Project’s functional currency). Both the Australian Dollar and Kina appreciated materially during the construction period from 2010 to 2013 as shown in Figure 4.

![Figure 4: Exchange Rate Fluctuations](source: Oanda Corporation as of July 31, 2013)

The construction contracts were subject to comment, review and questions by Ex-Im Bank as a condition precedent to lending, and as such, the foreign exchange risk during construction could have been identified, measured, evaluated and mitigated by the Sponsors through hedging or other means.

The OIG also found that the financial model did not include the foreign exchange exposure as a risk variable in estimating construction costs.

Finding 3B: Monitoring of Foreign Exchange Losses and Financial Projections was not sufficiently proactive
48 OIG noted that the Loan Officer monitoring the PNG LNG transaction has 15 active loans involving both large corporate and project financings. In contrast, KPMG noted in its 2013 report to Ex-Im Bank’s Audit Committee that the normal work load is 7 to 10 structured financings per loan officer. This finding was based on a peer group survey of 19 financial institutions. In another 2013 report to Ex-Im Bank management, CC Pace stated that “Ex-Im Bank’s credit volume increased three-fold in the past five years, during which time Ex-Im Bank has maintained an essentially steady staffing level and has received very limited investment funding to replace or renew aging technology. This has resulted in significant strains to an overworked staff.”
Revised Financial Projections indicate a reduction in Key Financial Ratios

As indicated in Table 7, the FX losses and cost overruns resulted in a decline in two key financial ratios compared with the original 2009 forecast. Although the decline in projected financial performance may not threaten the Project’s “reasonable assurance of repayment,” the impact on the Project’s credit profile is not immaterial from a credit perspective.49

**Table 7: Base Case Ratios Before and After Cost Overrun in 2013**

*(Confidential & Proprietary Information)*
RECOMMENDATION 3

- In addition to completion guarantees, Ex-Im Bank should evaluate foreign exchange exposure during construction as a separate risk factor when mitigating construction cost overruns and depending on the potential magnitude of the foreign exchange risk, consider requiring the borrower to mitigate the exposure through hedging or other means as a condition of lending. Additionally, if deemed material, foreign exchange volatility should be included in the financial model as a relevant variable subject to stress testing and sensitivity analysis.

- To assure a proactive management of credit risks and a timely evaluation of key documents to include financial projections, OIG recommends that Ex-Im Bank (1) review its staffing levels in its Asset Management Division to be in line with workloads, industry best practices, and ongoing requirements and (2) consider assigning additional personnel, resources and training as necessary.

Management Response

As part of the Bank’s risk management framework, Ex-Im Bank staff, as well as technical and financial advisors, conducted extensive due diligence regarding the construction period risk, including foreign exchange risk, for this Project. The Bank appreciates OIG finding that Bank staff "took a number of proactive, carefully-considered steps to mitigate construction cost overruns through completion guarantees." A completion guarantee was determined to be an effective means to mitigate several types of risk. In the PNG LNG project, staff relied on three structures to mitigate the cost overrun risk: (i) the negotiated Supplemental Debt cap, (ii) the completion guarantees and (iii) the Coordinated Development and Operating Agreement (CDOA) among project sponsors to protect the lenders from cost overruns. The Bank, in accordance with the OIG recommendation agrees to evaluate the foreign exchange exposure during construction as a separate risk factor, and include foreign exchange volatility in the financial model as deemed necessary.

Regarding the second part of this recommendation, the Bank continually reviews staffing levels in all areas, and must work within budgetary and work space constraints for staffing issues. Since FY 2012, the Bank has increased, by 45%, the monitoring staff for the Long Term Monitoring Group. The Bank’s Audit Committee is conducting a review with outside consultants to benchmark our staffing levels against peer institutions. Also, the FY 2014 appropriations from the U.S. Congress provided for additional administrative funds enabling management to allocate new staff resources in line with workloads, industry best practices, and ongoing requirements.

Evaluation of Management’s Response

Management’s proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.
CONCLUSIONS

The PNG LNG Project is a vertically-integrated Liquefied Natural Gas ("LNG") project in Papua New Guinea (PNG). Project Sponsors include ExxonMobil and several global energy companies. Total project costs are estimated at $(b) (4)$ which includes a $(b) (4)$ construction cost overrun compared to the original budget. Ex-Im Bank provides $3 billion in loan facilities with $576.9 million disbursed for the financing of local goods and services originating in Papua New Guinea.

OIG’s inspection found that the PNG LNG transaction is a well-structured and supported by strong and experienced sponsors. However, with the benefit of hindsight, OIG believes that certain Ex-Im Bank practices can be strengthened to ensure compliance with Ex-Im Bank’s polices and to better protect Ex-Im Bank from potential waste, fraud and abuse as well as character and reputational risks. For example, the OIG found no evidence that Ex-Im Bank identified the country Papua of New Guinea and the industry sector of Oil & Gas as high risk elements falling short of capturing critical information on key individuals and companies within the transaction.

In addition, 70% of Ex-Im Bank’s local cost disbursements were invoiced in currencies other than the currency of PNG. Based on current Ex-Im Bank requirements, OIG could not validate the origin of the local goods and services and Ex-Im Bank does not have the right of inspection and audit unlike several other ECAs.

The following provides a summary of the inspection’s Point of Inquiry, Findings, and Recommendations:

**Point of Inquiry 1:** Did Ex-Im Bank perform the CRTI/KYC Transaction Due Diligence in accordance with its current policies and procedures? Are current policies and procedures sufficiently comprehensive to protect Ex-Im Bank from potential waste, fraud, abuse and reputational risk issues?

**Finding 1:** CRTI procedures for PNG LNG transaction were not sufficiently implemented, developed, and systematically applied to adequately protect Ex-Im Bank from potential fraud, reputational and integrity risks.

**Recommendation 1:** To strengthen the effectiveness and transparency of the CRTI/KYC due diligence, OIG recommends that Ex-Im Bank review and evaluate its current CRTI policies and procedures, giving consideration among others to the following:

- Enhance efficiency and effectiveness of the CRTI/KYC due diligence by implementing a risk-based assessment to determine the appropriate level of due diligence required for each transaction. On the basis of these results, develop an appropriate systematic plan to screen, mitigate and monitor CRTI risk, particularly in the critical pre-approval stage of a transaction.
- Conduct enhanced, upfront internet web screening to include local in-country sources and media for Politically Exposed Persons (PEPs) and other potential reputational/integrity issues.
Employ vertical and affiliated relationship analysis to “pierce the ownership veil” to identify non-transparent and relational CRTI risks including owners, sponsors, EPC contractors, etc.

Expand the external databases and sources being used for CRTI screening beyond the 20 watch lists of World-Check currently being used.

Implement CRTI screening on all relevant transactional parties on a regular, periodic basis during asset monitoring subsequent to initial due diligence.

Develop a dialogue with multilateral financial institutions such as IFC to learn more about CRTI and KYC best practices.

While enhancing the Ex-Im Bank’s CRTI procedures cannot guarantee that improper conduct will not occur, appropriate due diligence research will help reduce the potential misuse of financing involving fraud and corruption that could result in monetary loss to the transaction participants as well as loss of credibility in Ex-Im Bank’s programs and reputation. Additionally, in certain circumstances, proof of having conducted appropriate due diligence research might be required in a court of law.

Management Response

Management is currently reviewing and evaluating its current KYC/CRTI process, and expects to have this completed by the end of this calendar year. Management agrees to take the OIG recommendations into consideration. Due to budgetary and staffing constraints, the Bank will need to conduct a cost-benefit analysis to determine the level of participant review which is both practical and feasible. The Bank has already added another database to the CRTI screening process and will continue to evaluate other potential databases for inclusion. The Bank notes that local in-country sources and media are often politically motivated, therefore not the most accurate and reliable sources of information.

Evaluation of Management’s Response

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

Point of Inquiry 2: Are Ex-Im Bank’s practices with respect to Local Cost loan disbursements of $576.9 million in Papua New Guinea being implemented and managed in accordance with Ex-Im Bank Policy and Ex-Im Bank’s statutory mission “to increase U.S. employment through the export of goods and services”?

Finding 2A: OIG was not able to validate compliance with Ex-Im Bank’s Local Cost Policies due to insufficient information provided to Ex-Im Bank Pursuant to its Credit Agreement.

Finding 2B: Ex-Im Bank does not have the right to inspect and audit the books and records to validate the origin of local goods and services financed by Ex-Im Bank.

Finding 2C: Local cost eligibility criteria may not be applied consistently to goods and services.
Recommendation 2: To strengthen compliance with Ex-Im Bank Policies and to enhance transparency in the financing of local cost goods and services, the OIG makes the following recommendations to Ex-Im Bank:

- Reserve the right of inspection and audit of the borrower’s books and records in Ex-Im Bank’s credit agreements, particularly for project financings. This right should be provided on an ongoing basis and not be restricted to the occurrence of an Event of Default.

- Require borrowers to maintain a set of verifiable records subject to audit and consider extending this inspection right to the records of construction contractors as applicable.

- Consider additional requirements to provide greater transparency and to facilitate validation of compliance, such as requiring the Borrower to provide, when requested, more descriptive information and details regarding local cost disbursements.

- Review and evaluate Local Cost Policy with respect to the origin of local services to explicitly state its criteria and requirements for funding such services in keeping with transparency, consistency, Ex-Im Bank’s statutory mandate to create U.S. jobs, and defined business strategy.

Management Response

The Bank agrees to review and evaluate the current local cost policy. The Bank notes that Ex-Im conducts a higher level of pre-disbursement due diligence to protect the taxpayers than other ECAs which may rely on potential post-disbursement document reviews. Any changes to the Bank’s credit agreements will need to be evaluated by the Bank’s business and legal divisions. The Bank will also evaluate the recommendations regarding the required local cost information for transactions and determine what mechanism would be practical and feasible, as well as legally sound, to validate the information the Bank currently receives through the local cost certification process.

In addition, section 2(i) of the Bank’s 2012 Charter requires the Bank to "set due diligence standards for its lender partners and participants " and "require all delegated lenders to implement 'Know your customer practices.'" The Bank has taken into consideration prior Government Accountability Office (GAO) and OIG recommendations in developing the Bank’s current policy on "Know Your Customer Requirements and Due Diligence Standards" (posted 5/22/14) which contains "Cooperation Requirements and Reservation of Rights." As part of the cooperation requirement s, all participants in Ex-Im Bank transactions (defined as a lender in direct privity with Ex-Im Bank, a borrower , a guarantor, a buyer, an exporter, an Ex-Im bank approved broker, an assignee or Enhanced assignee, or an agent, broker , finder or representative for any of the foregoing) are "expected to cooperate with all request s of Ex-Im Bank for documents and information related to any transaction involving Ex-Im Bank which, in Ex-Im Bank's sole discretion, are necessary to review any participant’s due diligence process, underwriting, know your customer practices, documentation, funding and operation of any and all Ex-Im Bank transactions, both before and after approval and consummation of a transaction." The reservation of rights provides additional mechanisms for the Bank to review and make determinations based on "know your customer" and due diligence practices.
Evaluation of Management’s Response

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

Point of Inquiry 3: Did Ex-Im Bank conduct sufficient due diligence and monitoring of the key project risks, parties involved, exposures, and red flags in accordance with Ex-Im Bank policies and project finance best practices? Were the relevant risks identified, evaluated, and mitigated accordingly?

Finding 3A: Although Ex-Im Bank took a number of proactive, carefully-considered steps to mitigate construction cost overruns through (b) (4), the foreign exchange (“FX”) risk during construction was not separately addressed and sufficiently evaluated. In retrospect, FX exposure accounted for $2.1 billion in a project cost overrun and (b) (4).

Finding 3B: Monitoring of Foreign Exchange Losses and Financial Projections was not sufficiently proactive.

Recommendation 3:

- In addition to completion guarantees, Ex-Im Bank should evaluate foreign exchange exposure during construction as a separate risk factor in mitigating construction cost overruns, and depending on the potential magnitude of the foreign exchange risk, consider requiring the borrower to mitigate the exposure through hedging or other means as a condition of lending. Additionally, if deemed material, foreign exchange volatility should be included in the financial model as a relevant variable subject to stress testing and sensitivity analysis.

- To assure a proactive management of credit risks and a timely evaluation of key documents to include financial projections, OIG recommends that Ex-Im Bank (1) review its staffing levels in its Asset Management Division to be in line with workloads, industry best practices, and ongoing requirements and (2) and consider assigning additional personnel, resources and training as necessary.

Management Response

As part of the Bank’s risk management framework, Ex-Im Bank staff, as well as technical and financial advisors, conducted extensive due diligence regarding the construction period risk, including foreign exchange risk, for this Project. The Bank appreciates OIG finding that Bank staff "took a number of proactive, carefully-considered steps to mitigate construction cost overruns through completion guarantees." A completion guarantee was determined to be an effective means to mitigate several types of risk. In the PNG LNG project, staff relied on three structures to mitigate the cost overrun risk: (i) the negotiated Supplemental Debt cap, (ii) the completion guarantees and (iii) the Coordinated Development
and Operating Agreement (CDOA) among project sponsors to protect the lenders from cost overruns. The Bank, in accordance with the OIG recommendation agrees to evaluate the foreign exchange exposure during construction as a separate risk factor, and include foreign exchange volatility in the financial model as deemed necessary.

Regarding the second part of this recommendation, the Bank continually reviews staffing levels in all areas, and must work within budgetary and work space constraints for staffing issues. Since FY 2012, the Bank has increased, by 45%, the monitoring staff for the Long Term Monitoring Group. The Bank's Audit Committee is conducting a review with outside consultants to benchmark our staffing levels against peer institutions. Also, the FY 2014 appropriations from the U.S. Congress provided for additional administrative funds enabling management to allocate new staff resources in line with workloads, industry best practices, and ongoing requirements.

**Evaluation of Management’s Response**

Management’s proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon completion and verification of the proposed actions.
APPENDIX A: MANAGEMENT RESPONSES

The letter from the Ex-Im Bank of June 5, 2014 responding to the draft report is reproduced in full on the following pages:
June 5, 2014

Osvaldo Gratacós
Inspector General
Office of the Inspector General
Export-Import Bank of the United States
811 Vermont Avenue NW
Washington, DC 20571

Dear Inspector General Gratacós,

Thank you for providing the Export-Import Bank of the United States (“Ex-Im Bank” or “the Bank”) Management with the Office of the Inspector General’s (OIG) “Report on PNG LNG Project” (OIG-INS-14-01, May 21, 2014). Management continues to support the OIG’s work and inspections which complement the Bank’s efforts to continually improve its practices and procedures. Ex-Im Bank is proud of its strong and cooperative relationship with the OIG.

The Bank appreciates the OIG recognizing that this transaction, in the aggregate, was “well-structured and properly documented.” This Project continues to perform and the Bank remains confident of full repayment. This report on the Bank’s Papua New Guinea (PNG) Liquefied Natural Gas (LNG) transaction makes three recommendations regarding the Bank’s Character, Reputational and Transaction Integrity (CRTI) process, local cost policy, and foreign exchange risk analysis.

Recommendation 1: To strengthen the effectiveness and transparency of the CRTI/KYC due diligence, OIG recommends that Ex-Im Bank review and evaluate its current CRTI policies and procedures, giving consideration to the following:

- Enhance efficiency and effectiveness of the CRTI/KYC due diligence by implementing a risk-based assessment to determine the appropriate level of due diligence required for each transaction. On the basis of these results, develop an appropriate systematic plan to screen, mitigate and monitor CRTI risk, particularly in the critical pre-approval stage of a transaction.
- Conduct enhanced, upfront internet web screening to include local in-country sources and media for Politically Exposed Persons (PEPs) and other potential reputational/integrity issues.

- Employ vertical and affiliated relationship analysis to “pierce the ownership veil” to identify nontransparent and relational CRTI risks including owners, sponsors, EPC contractors, etc.

- Expand the external databases and sources being used for CRTI screening beyond the 20 watch lists of World-Check currently being used.

- Implement CRTI screening on all relevant transactional parties on a regular, periodic basis during asset monitoring subsequent to initial due diligence.

- Develop a dialogue with multilateral financial institutions such as IFC to learn more about CRTI and KYC best practices.

Management response: Management is currently reviewing and evaluating its current KYC/CRTI process, and expects to have this completed by the end of this calendar year. Management agrees to take the OIG recommendations into consideration. Due to budgetary and staffing constraints, the Bank will need to conduct a cost-benefit analysis to determine the level of participant review which is both practical and feasible. The Bank has already added another database to the CRTI screening process and will continue to evaluate other potential databases for inclusion. The Bank notes that local in-country sources and media are often politically motivated, therefore not the most accurate and reliable sources of information.

Recommendation 2: To strengthen compliance with Ex-Im Bank Policies and to enhance transparency in the financing of local cost goods and services, the OIG makes the following recommendations to Ex-Im Bank:

- Reserve the right of inspection and audit of the borrower’s books and records in Ex-Im Bank’s credit agreements, particularly for project financings. This right should be provided on an ongoing basis and not be restricted to the occurrence of an Event of Default.

- Require borrowers to maintain a set of verifiable records subject to audit and consider extending this inspection right to the records of construction contractors as applicable.

- Consider additional requirements to provide greater transparency and to facilitate validation of compliance, such as requiring the Borrower to provide, when requested, more descriptive information and details regarding local cost disbursements.
- Review and evaluate Local Cost Policy with respect to the origin of local services to explicitly state its criteria and requirements for funding such services in keeping with transparency, consistency, the statutory mandate to create U.S. jobs and defined business strategy.

Management response: The Bank agrees to review and evaluate the current local cost policy. The Bank notes that Ex-Im conducts a higher level of pre-disbursement due diligence to protect the taxpayers than other ECAs which may rely on potential post-disbursement document reviews. Any changes to the Bank’s credit agreements will need to be evaluated by the Bank’s business and legal divisions. The Bank will also evaluate the recommendations regarding the required local cost information for transactions and determine what mechanism would be practical and feasible, as well as legally sound, to validate the information the Bank currently receives through the local cost certification process.

In addition, section 2(i) of the Bank’s 2012 Charter requires the Bank to “set due diligence standards for its lender partners and participants” and “require all delegated lenders to implement ‘Know your customer practices.”’ The Bank has taken into consideration prior Government Accountability Office (GAO) and OIG recommendations in developing the Bank’s current policy on “Know Your Customer Requirements and Due Diligence Standards” (posted 5/22/14) which contains “Cooperation Requirements and Reservation of Rights.” As part of the cooperation requirements, all participants in Ex-Im Bank transactions (defined as a lender in direct privity with Ex-Im Bank, a borrower, a guarantor, a buyer, an exporter, an Ex-Im bank approved broker, an assignee or Enhanced assignee, or an agent, broker, finder or representative for any of the foregoing) are “expected to cooperate with all requests of Ex-Im Bank for documents and information related to any transaction involving Ex-Im Bank which, in Ex-Im Bank’s sole discretion, are necessary to review any participant’s due diligence process, underwriting, know your customer practices, documentation, funding and operation of any and all Ex-Im Bank transactions, both before and after approval and consummation of a transaction.” The reservation of rights provides additional mechanisms for the Bank to review and make determinations based on “know your customer” and due diligence practices.

Recommendation 3:

- In addition to completion guarantees, Ex-Im Bank should evaluate foreign exchange exposure during construction as a separate risk factor when mitigating construction cost overruns and depending on the potential magnitude of the foreign exchange risk, consider requiring the borrower to mitigate the exposure through hedging or other means as a condition of lending. Additionally, if deemed material, foreign exchange volatility should be included in the financial model as a relevant variable subject to stress testing and sensitivity analysis.
To assure a proactive management of credit risks and a timely evaluation of key documents to include financial projections, OIG recommends that Ex-Im Bank (1) review its staffing levels in its Asset Management Division to be in line with workloads, industry best practices, and ongoing requirements and (2) and consider assigning additional personnel, resources and training as necessary.

Management response: As part of the Bank’s risk management framework, Ex-Im Bank staff, as well as technical and financial advisors, conducted extensive due diligence regarding the construction period risk, including foreign exchange risk, for this Project. The Bank appreciates OIG finding that Bank staff “took a number of proactive, carefully-considered steps to mitigate construction cost overruns through completion guarantees.” A completion guarantee was determined to be an effective means to mitigate several types of risk. In the PNG LNG project, staff relied on three structures to mitigate the cost overrun risk: (i) the negotiated Supplemental Debt cap, (ii) the completion guarantees and (iii) the Coordinated Development and Operating Agreement (CDOA) among project sponsors to protect the lenders from cost overruns. The Bank, in accordance with the OIG recommendation agrees to evaluate the foreign exchange exposure during construction as a separate risk factor, and include foreign exchange volatility in the financial model as deemed necessary.

Regarding the second part of this recommendation, the Bank continually reviews staffing levels in all areas, and must work within budgetary and work space constraints for staffing issues. Since FY 2012, the Bank has increased, by 45%, the monitoring staff for the Long Term Monitoring Group. The Bank’s Audit Committee is conducting a review with outside consultants to benchmark our staffing levels against peer institutions. Also, the FY 2014 appropriations from the U.S. Congress provided for additional administrative funds enabling management to allocate new staff resources in line with workloads, industry best practices, and ongoing requirements.

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 Ex-Im funds from fraud, waste, and abuse. We look forward to continuing to work closely with the Office of the Inspector General.

Sincerely,

Charles J. Hall
Executive Vice President and Chief Risk Officer
Export-Import Bank of the United States
APPENDIX B: LOCAL COST POLICY OF EX-IM BANK

As posted on Bank’s website: (http://www.exim.gov/generalbankpolicies/localcost/)

Local cost

When Ex-Im Bank provides medium- or long-term guarantee, loan, or insurance support for U.S. exports for foreign projects, it may also provide local cost support. Local costs are those project-related costs for goods and services incurred in the buyer's country.

Ex-Im Bank can support up to 30% of the value of the U.S exports for locally originated and/or manufactured goods and services subject to the following availability and eligibility guidelines.

Availability

Long-Term Transactions: Ex-Im Bank may provide local cost support for all long-term transactions.

Medium-Term Transactions: Ex-Im Bank may provide local cost support if the U.S. exporter can prove either: (i) the availability of official export credit support for the local cost; or (ii) private market financing of local costs is difficult to obtain for the transaction.

Ex-Im Bank offers “automatic” local cost support for all environmental exports, medical exports, and project finance transactions (including medium-term transactions).

All transactions that receive local cost support must meet the eligibility criteria defined below.

Eligibility

If Ex-Im Bank provides local cost support for long-term or medium-term limited recourse project finance transactions, then the local costs must be:

- Beneficial to the project;
- Certified by the Borrower;
- Detailed in the Acquisition List; and
- Originated/manufactured in the host country. Services must be provided by individuals and/or business entities that are residents of the host country.

Note: Ex-Im Bank will require the Borrower to certify that the local cost support was not used to cover products that could reasonably be purchased in the U.S.

If Ex-Im Bank provides local cost support for medium-term transactions, then the local costs must be:

Related to the U.S. exporter's scope of work;

Certified by the U.S. exporter in the Exporter's Certificate; and

Originated/manufactured in the host country. Services must be provided by individuals and/or business entities that are residents of the host country.

Note: The decision to extend local cost support is subject to budgetary and other discretionary considerations as determined by Ex-Im Bank's management.
APPENDIX C: LOCAL COST INVOICE DESCRIPTIONS

(b) (4)
APPENDIX D: INSPECTION RIGHTS OF EXPORT CREDIT AGENCIES

(b) (4)
APPENDIX E: CRTI TRANSACTION DUE DILIGENCE GUIDELINES

(b) (5)
APPENDIX E: CRTI TRANSACTION DUE DILIGENCE GUIDELINES (Cont.)

(b) (5)
APPENDIX F: PNG LNG TRANSACTION TIME LINE

(b) (4)
(b) (4)
Acknowledgements

This report was prepared by the Inspection and Evaluation Group; Office of Inspector General for the Export-Import Bank of the United States. Several individuals contributed to this report including Mark S. Thorum; Assistant Inspector General for Inspections and Evaluations; Donald B. Reid, Senior Inspector; Vania Georgieva, Inspector; and Daniel Wong, Inspector.