United States General Accounting Office 134124

GAO

Report to the Congress

September 1987

EXPORT CREDIT INSURANCE

Assessment of Export-Import Bank's Role

134124

040193

GAO/NSIAD-87-189

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-227697

September 30, 1987

To the President of the Senate and the
Speaker of the House of Representatives

The Export-Import Bank Act Amendments of 1986 (Public Law 99-472) requires GAO to report to the Congress on the government's role in providing export credit insurance and the delivery of those services through its agent, the Foreign Credit Insurance Association.

The Export-Import Bank is a U.S. government agency and facilitates U.S. exports by making loans, guaranteeing private loans, and providing export credit insurance. Export credit insurance protects policyholders against risks that foreign buyers may not pay for the exports. The Foreign Credit Insurance Association is a private association of insurance firms, formed in 1961, to act as an agent of the Export-Import Bank in providing insurance services.

We are sending copies of this report to the Chairman of the Export-Import Bank Board of Directors; President of the Foreign Credit Insurance Association; Director of the Office of Management and Budget; and Secretaries of State, Treasury, and Commerce.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Executive Summary

Purpose

The 1986 Export-Import Bank of the United States (Eximbank) reauthorization legislation requires GAO to report to the Congress on the (1) need for government involvement in export credit insurance, (2) need to employ an agent to deliver the insurance services, and (3) efficiency and effectiveness of continuing to use the Foreign Credit Insurance Association (FCIA) as Eximbank's agent.

The required study was prompted by congressional concerns over changes in FCIA's function, the private export credit insurance market, and the risks in export sales to less-developed countries.

Background

In 1961 the Congress authorized Eximbank's export credit insurance program to provide insurance against risks of nonpayment by foreign buyers. The program has broad objectives for assisting in the expansion of exports and providing a facility comparable to those available to foreign exporters in major competitor countries. Other objectives are also pursued in the program's execution, such as assisting small exporting firms, involving the private sector in delivery of the services, and operating the program on a self-sustaining basis.

In establishing the insurance program, the Congress intended that the government would fill a gap in the availability of private insurance and that private insurers would be involved to a maximum extent in delivering this service. FCIA, a private insurance association, was formed to act as Eximbank's agent. FCIA began operations in 1962 as an Association of 71 insurance companies. The Association was a pooling arrangement whereby participating insurance firms assumed some of the risks on the transactions underwritten and shared in profits and losses. Ultimately, it was anticipated that the private sector would directly provide the insurance.

In 1986 the program insured $3.4 billion of U.S. export sales, which was less than 2 percent of the $217 billion in U.S. exports. The program, however, supports larger shares of U.S. exports to countries in riskier markets, such as in Latin America and Africa. At the end of fiscal year 1986, the program had an estimated cumulative loss of about $360 million.

Results in Brief

The level of U.S. exports depends on such factors as exchange rates and demand for U.S. products and the availability of export credit insurance alone will not have a significant effect on increasing export sales.

The program, however, may be helpful as a defensive strategy. To ensure that U.S. exporters have a stable and reliable supply of export credit insurance and to meet some of the congressional objectives (e.g., facilitating exports to riskier markets, assuring U.S. exporters of a facility comparable to those of major foreign competitors, and supporting small exporters) GAO believes that the government would need to provide this insurance, at least in the near term.

The insurance program incurred large losses in the early 1980s and all but four FCIA member insurance firms withdrew from the Association. FCIA presently functions as a servicing agent employed by Eximbank on a cost-reimbursable basis. While Eximbank does not need to employ an agent for delivering the insurance services, FCIA's overall performance and its special expertise support a continuation of that agency relationship at the present time. FCIA has taken steps to improve its operations and the delivery of its service, but further actions are needed to reduce costs and improve program efficiency and effectiveness.

Principal Findings

Government Involvement Needed

Private insurers generally were not inclined to insure the smaller exporters and banks which accounted for much of the government's insurance in 1986. Private insurance is also subject to market forces which make it an inconsistent source of risk protection for exporters. A complete withdrawal by the government from the export credit insurance business would likely leave a gap that presently would not be filled by private insurers. There are, however, some transactions insured by the government which could be potentially insured in the private market, but GAO could not quantify the extent of this overlap.

GAO's study also noted that the extent of government involvement in export credit insurance could be restricted to acting only as an insurer of last resort. In discussing this concept, GAO observed that this approach could conflict with the current objectives that the program be both self-sustaining and internationally competitive.

FCIA Role Changes but Its Continued Use Is Beneficial

In the early 1980s, the insurance program experienced a series of major claims and all but four of the private member companies ended their participation. FCIA has continued to perform as a cost-reimbursed servicing agent but assumes no risk on the insured transactions. Eximbank, over time, could assume all or some of FCIA's functions. However, FCIA's clients are generally satisfied with the services provided and FCIA has expertise and flexibility in delivering this specialized line of insurance. Whether Eximbank could maintain or improve upon the level of service that has been attained by FCIA is unknown.

FCIA's Operational Efficiency Could Be Enhanced

The government's cost of administering the insurance program was about $15 million in fiscal year 1986. This yielded a ratio of expenses to premium income of about 69 percent, which is high in comparison to both private insurers and major foreign programs. Two factors contributing to the high expense ratio were the large decline in insurance volume in the government's program since 1980 and the characteristics of the government's policyholder base. Most of the government policyholders, for example, are small businesses, which can entail relatively high administrative costs.

FCIA has initiated actions to improve its operations, reduce costs, and make its service more responsive. While FCIA has restrained the growth in its general and administrative expenses in recent years, the program's overall expense ratio is still relatively high. Areas needing attention include personnel turnover, financial and information management, marketing costs, and some inefficiencies in Eximbank and FCIA approval processes and data processing functions.

FCIA has experienced a high level of employee turnover and problems in financial and information resources management, as noted by FCIA and its independent auditors. If uncorrected, these problems can adversely affect operating efficiency and internal controls. As part of its audit of Eximbank financial statements, GAO recommended in August, 1987 that Eximbank monitor and report on FCIA's progress in resolving internal accounting control system weaknesses. Eximbank's Treasurer-Controller acknowledged the need for corrective action and stated that he has been monitoring this situation.

FCIA's direct marketing program which cost about $1.5 million in 1986 added relatively few new policyholders and its cost-effectiveness should be compared to results obtained through brokers and other intermediaries. Also, Eximbank and FCIA should work together to streamline their agency relationship and pursue efforts to assure that the program is administered in the most efficient and effective manner. Particular attention should be paid to ways to reduce the times required for underwriting and claims approvals and ways to better integrate FCIA and Eximbank's automated data systems.

Recommendations

GAO makes no recommendations in its report.

Agency Comments

GAO discussed a draft of its report with the President of FCIA and appropriate Eximbank officials, including the Senior Vice President for Insurance and Banking, and the Treasurer-Controller. These officials considered GAO's assessment of the export credit insurance program to be fair and agreed that there was a need for FCIA and Eximbank to address FCIA's employee turnover, the cost-effectiveness of the direct marketing program, and the inefficiencies in the FCIA-Eximbank relationship.

Contents

Appendixes

Tables

Figures

Abbreviations

GAO General Accounting Office
FCIA Foreign Credit Insurance Association

Introduction

The Export-Import Bank of the United States (Eximbank) was created in 1934 to facilitate U.S. exports. It does this by making direct loans, guaranteeing loans made by private lenders, and providing export credit insurance.

For fiscal year 1986, Eximbank's estimated program commitments (authorizations) amounted to $6.1 billion. The export credit insurance program accounted for $4.4 billion, or 72 percent of this amount.

Largely due to the debt problems in some developing countries in the early 1980s, the insurance program has incurred cumulative losses through fiscal year 1986 of about $360 million. In addition, exports insured under the program have declined about 48 percent, from $6.6 billion in 1982 to $3.4 billion in 1986. Total U.S. exports in calendar year 1986 amounted to about $217 billion.

The Export-Import Bank Act Amendments of 1986 (Public Law 99-472, Oct. 15, 1986) requires that we submit a report to the Congress on the following topics.

- Need for U.S. government involvement in export credit insurance, considering the current activities of private insurance companies in this area, private insurance industry trends over the longer term, and ways Eximbank can encourage private insurers to maximize export credit insurance activities.
- Need to employ an agent in administering government-supported insurance programs which are determined to be necessary.
- Efficiency and effectiveness of continuing to use the Foreign Credit Insurance Association (FCIA) as Eximbank's agent (including analysis of the administrative and economic costs to the government and Eximbank of maintaining FCIA).

The requirement was originated by the Senate Committee on Banking, Housing, and Urban Affairs.[1] The Committee was concerned that Eximbank should not inhibit the growth of private export credit insurance by underwriting transactions that private insurers will take on. The Committee also noted that FCIA's function had changed in recent years and that Eximbank (and FCIA) had shown little interest in underwriting sales in less-developed countries although Eximbank was created specifically to facilitate export financing that commercial enterprises were unwilling or unable to provide.

[1]See Senate Report No 99-273 (1986)

Insurance Program Authority and Goals

In 1953 the Congress authorized Eximbank to insure exporters' overseas inventories against certain political risks, such as war, revolution, and civil strife (Public Law 83-30). This program was designed to fill a gap in the availability of private sector war-risk insurance.

In 1961 Congress changed the type of insurance authorized to cover the risks of nonpayment by foreign buyers of U.S. exports and substantially increased the amount of insurance that could be written (Public Law 87-311). This legislation was part of a national effort to address the balance-of-payments deficit. The administration and the Congress wanted to increase exports of goods and services and assist U.S. exporters to meet foreign competition. In seeking this legislation, the administration stressed the need for adequate Eximbank programs, comparable to those offered by other countries to their exporters, and the need to provide adequate facilities for small and medium sized exporting firms and the financing of consumer goods.

The 1961 legislation specified that credit and political risks were to be covered under this insurance.[2] Congress authorized Eximbank to issue insurance, guarantees, co-insurance, and reinsurance to exporters, insurance companies, financial institutions, or others and to employ any of these to act as its agent in these insurance and guarantee functions. The legislation also required that fees and premiums charged for the insurance be commensurate with the risks covered, indicating that the program was intended to be self-sustaining. The legislative history shows that, like the previous war-risk insurance program, the export credit insurance program was to fill a gap in the coverage available from private insurers. The program was also expected to stimulate private insurers' involvement in this business and ultimately to result in private sector provision of the insurance.

Eximbank programs, including insurance, are subject to the broad policy guidance in Eximbank's legislation, including the goals of (1) delivering programs at rates, terms, and other conditions which are fully competitive with government supported programs available to foreign exporters in principal competitor countries and (2) aiding small exporting businesses. For all Eximbank programs there is also to be a sufficient likelihood of repayment to justify Eximbank's support in order to actively foster U.S. foreign trade and long-term commercial interests.

[2]Political risks are defined in the government insurance policies and include war, civil strife, currency inconvertibility, export license cancellation, expropriation, confiscation, or intervention by a government in the business of the buyer. Commercial credit risk insurance covers the failure of a buyer to pay a legally enforceable debt for reasons other than those defined as political risks.

There are also a number of legislative restrictions on Eximbank programs, such as those related to supporting exports (1) of defense products, (2) to Marxist-Leninist countries, (3) to South Africa, and (4) those which may adversely affect U.S. industries and employment. In keeping with the intent of Congress that the programs assist U.S. exports, Eximbank limits its insurance program support to exports of products meeting a domestic content requirement. For short-term insurance, for example, the domestic content would have to be at least 50 percent.

Profile of Eximbank Insurance Program

Exports insured under the export credit insurance program are based on shipments reported (generally monthly) by policyholders. About 98 percent of the exports insured in 1986 were short-term credit sales (usually 6 months or less) and most were through multibuyer-type policies. The multibuyer policies require exporters to insure sufficient amounts of exports under their policies to provide a reasonable spread of risks. About 83 percent of the exports insured are through policies covering both commercial and political risks.

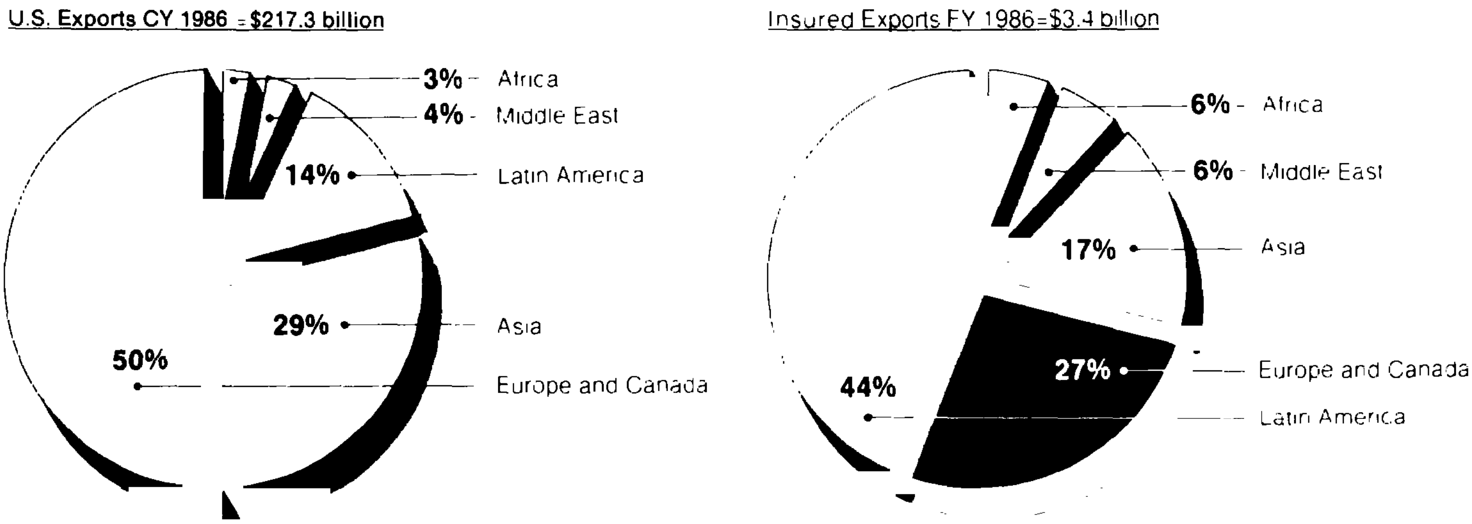
Another major characteristic of the export credit insurance program is that the risks insured are not subject to traditional actuarial analyses. In pricing the insurance, various risk perceptions (e.g., countries, types of buyers, terms of the transactions) are considered together with the goal that the program be self-sustaining in the long term. Potential losses are difficult to predict and the program can incur extensive claims during a short period. (See app. I.)

The program supports a small portion of total U.S. exports, but it supports larger shares of exports to some of the riskier markets, such as in Latin America and Africa. Most of the policyholders are classified on FCIA records as small businesses, but a relatively few policyholders account for most of the insured exports.

The export credit insurance program insured between 3.2 and 1.5 percent of all U.S. exports during the last 5 years. However, not all U.S. exports are eligible for or would need government insurance (e.g., cash sales). Data are not available to determine the amount of exports which would not be eligible for Eximbank's insurance.

Eximbank's insurance, although involving a small proportion of U.S. exports in 1986, covers a higher proportion of exports to certain countries. About 34 percent of the exports insured under Eximbank's program for 1982-86 went to countries in Latin America and Africa—some of the riskier markets. In fiscal year 1986, insured exports to Latin America and Africa accounted for 50 percent of the total insured under the program. The proportion of total U.S. exports to these geographic regions in 1986 was 17 percent. (See fig. 1.1.) Within these regions, the program insured, for example, about 6 percent of U.S. exports to Mexico and Brazil, over 12 percent to El Salvador, and 42 percent to Nigeria.

Figure 1.1: Distribution of U.S. Exports and Insured Exports by Geographic Region



Source Department of Commerce and FCIA

Most Exporter Policyholders Are Small Businesses, but a Few Policyholders Account for Most Insured Exports

According to its records, during fiscal year 1986 FCIA had 1,097 policyholders. Approximately 82 percent of the policyholders were exporters and 18 percent were financial institutions. Although 648, or 72 percent, of the exporter policyholders were classified as small businesses,[3] they accounted for only $770 million, or 35 percent, of the $2.2 billion of exports insured for such policyholders.

[3]FCIA uses the Small Business Administration definition for small businesses; the criteria vary by the types of businesses and are based generally on number of employees or revenues of the firms.

In 1986, 75 policyholders (about 7 percent of all policyholders) accounted for about 70 percent of the insured exports; 46 of these policyholders were exporters and 29 were financial institutions. Five policyholders (3 exporters and 2 financial institutions) insured exports of over $100 million each, accounting for about 20 percent of the insured exports.

The policies held by financial institutions supported the exports of a number of exporters. Based on data we obtained from questionnaires to policyholders, we estimate that at least 788 exporters were assisted under such policies. While the financial institutions constituted 18 percent of the policyholders, the exporters served by those policies accounted for about 34 percent of the shipments insured.

The exporters responding to our survey had 1986 total revenues ranging from $100,000 to $1.5 billion. Most firms had less than $26 million in revenues, but most of the insured exports were concentrated in firms with revenues exceeding $100 million. (See table 1.1.)

Table 1.1: Revenues of Exporters Responding to Survey[a]

Figures in percent

Revenues	Policyholders	1986 Insured Exports
$100,000 to $11 million	50	16
$12 million to $25 million	17	8
$26 million to $99 million	15	21
$100 million to $1.5 billion	18	55
	100	100

[a]based on 101 exporters providing this information

U.S. Insurance Program and Other Major Foreign Programs

Government export credit insurance programs operate within an international framework of established rules and practices, including the Organization for Economic Cooperation and Development's arrangement on guidelines for officially supported export credit and the General Agreement on Tariffs and Trade. Under this latter agreement, countries work to assure that programs do not operate with premium rates which are manifestly inadequate to cover long term operating costs and losses. In addition, international cooperation and acceptance of sound principles of providing export guarantees and insurance are objectives of the International Union of Credit and Investment Insurers (known as the

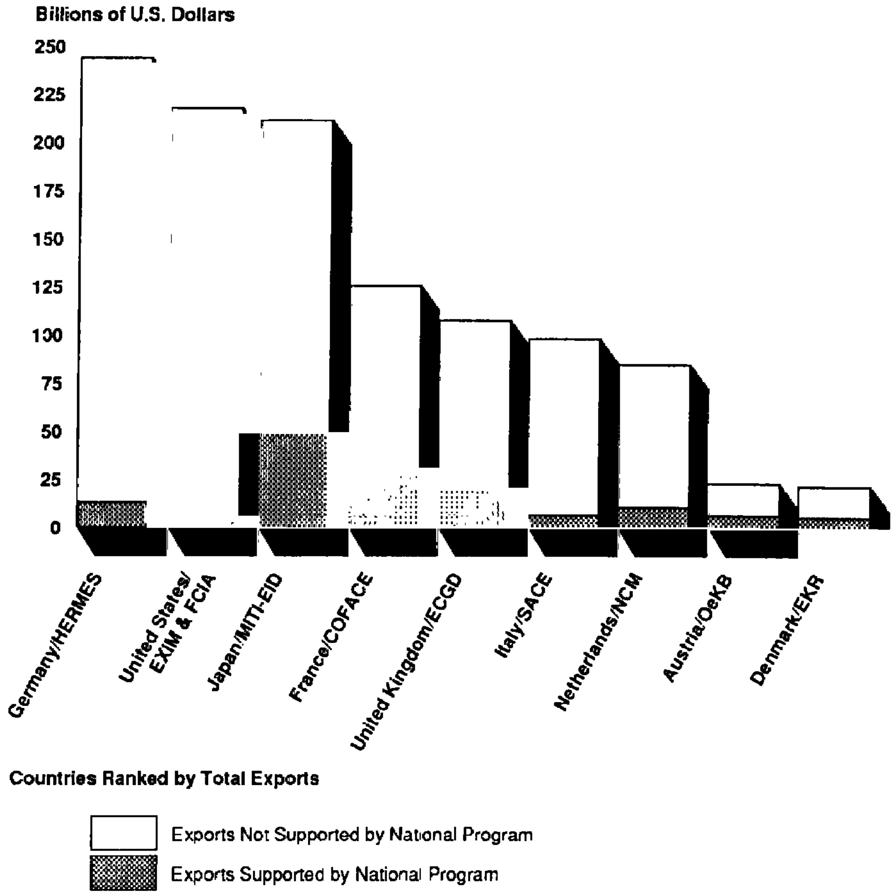
Berne Union). FCIA and Eximbank are two of the export credit agencies from 32 countries which are members of the Berne Union.

Congress requires Eximbank to report annually on the competitiveness of its programs with those of other countries. The latest reports (covering 1984 and 1985) have generally concluded that the U.S. export credit insurance program is competitive. The 1986 report (covering calendar year 1985) compared Eximbank's short-term program fees to those of Canada, France, Germany, the United Kingdom, Japan, and Italy. The U.S. program's fees were lower than those of all of these countries, except Japan. The report concluded that the United States was also highly competitive with the other countries in its willingness to assume risks, although most of these countries had become more conservative in taking risks in recent years.

Our analysis of the nine Berne Union members with the largest programs in 1986 showed that the U.S. program was small compared to the other programs. (See fig. 1.2.) It should be noted, however, that comparisons are difficult because of the diversity in the financial and governmental environments in which these programs operate. These major members accounted for about 80 percent of the insurance activity reported to the Berne Union in 1986, and they provide insurance and guarantees for about 9 percent of the world's trade. These members' countries account for about half the world's exports. Some trends (measured in 1982 dollars) of particular note affecting the major members' export credit insurance programs from 1980 through 1986 are as follows.

- Overall, real exports declined 12 percent. The low point was in 1983, and exports have increased somewhat since then. U.S. exports declined 26 percent.
- Exports covered by the insurance programs have declined 46 percent. FCIA had the largest decline, with 69 percent.
- Claims paid in 1986 were about 185 percent greater than in 1980. All of the programs reported cumulative deficits at the end of 1986.

Figure 1.2: 1986 Exports Insured by Selected Berne Union Members



Source: Eximbank & FCIA

Organization and Responsibilities for Administering Program

Eximbank

Overall management and administration of the export credit insurance program is assigned to Eximbank's Senior Vice President, Insurance and Banking Division, in Washington, D.C. The Eximbank Board of Directors approves all the agreements with FCIA and has responsibilities for review and concurrence or approval of certain insurance applications, claims, and other actions exceeding specified dollar thresholds.

Eximbank has 320 employees; 20 of these are in the Insurance and Banking Division and work full time on the insurance program. A portion of the time of Eximbank employees in other units is also used to support the insurance program. Eximbank estimated its administrative costs for this program in fiscal year 1986 at $3.3 million. In addition to general management of the program, it reviews and approves significant FCIA actions. Eximbank also sets premium rates, determines restrictions placed on insurance coverage in individual countries (country limitation schedules), and assists in developing and marketing new insurance products.

FCIA

FCIA is a private association of property and casualty and other insurance firms formed in 1961 to act as Eximbank's agent. It has 160 employees, is headquartered in New York City, and has regional marketing offices in five U.S cities.

FCIA operates under agreements with Eximbank which set the delegations of authority to FCIA and otherwise govern the relationship between Eximbank and FCIA. FCIA issues export credit insurance policies and performs marketing, underwriting, accounting, claims, and other services related to these policies as provided by its agreements with Eximbank.

Since FCIA opened for business in 1962, 77 insurance firms have participated. Until 1983, FCIA member companies assumed some of the commercial risks under the insurance policies and shared in profits and losses. After the program experienced heavy losses in the early 1980s, most of the participating firms withdrew from the Association. At the time of our review, four member firms remained in FCIA, but on a nonrisk participation basis.

Objectives, Scope, and Methodology

We made this review to provide the Congress with our assessment of the study topics specified by Public Law 99-472. We did not attempt to evaluate congressional objectives for the program which have been established over the years or to assess the overall success of the program in meeting public policy goals.

Our work was performed at Eximbank in Washington, D.C., FCIA headquarters in New York City, and FCIA regional offices in New York, Chicago, and Los Angeles. We also employed an industry expert to advise and assist us on technical aspects of export credit insurance.

In examining the demand for and supply of export credit insurance and the government's role in providing this service, we sent questionnaires to 167 of the 825 exporters and all 165 financial institutions insured by FCIA between April and September 1986. The response rates were 77 percent and 78 percent, respectively. We interviewed 10 insurance brokers which received about 97 percent of the brokers' commissions paid by FCIA during the April-September 1986 period. We reviewed records and interviewed officials at Eximbank and FCIA, and reviewed existing studies and analyses. Because some of the detailed information from our study should be useful to Eximbank and FCIA in managing the program, such details will be compiled in a separate report.

As part of our review of Eximbank's use of FCIA as its agent, we interviewed the four current member firms and 30 of the 73 former member firms of the Association, examined the respective program functions performed by Eximbank and FCIA, and reviewed agreements governing the agency relationship.

In examining the efficiency and effectiveness of Eximbank's continued use of FCIA, we (1) reviewed FCIA's 1984 strategic plan and subsequent operating plans, (2) reviewed audited FCIA and Eximbank financial data for the program, (3) examined Eximbank and FCIA budgeting and control procedures, (4) analyzed FCIA administrative expenses, (5) analyzed policyholder characteristics data maintained by FCIA, and (6) reviewed the assessment of internal controls prepared by FCIA's independent auditors. We obtained the views of exporters and financial institutions, brokers, FCIA member firms, and 53 ex-policyholders on the quality of FCIA service and areas which may need improvement.

We also reviewed the legislative history of the export credit insurance program and discussed the program with officials of the Departments of Treasury and Commerce. We analyzed Berne Union data showing the operations of the U.S. program in relation to those of other countries and reviewed Eximbank reports on competitiveness of the U.S. program. We interviewed officials of the New York State Insurance Department about proposed state legislation which might affect the private market for export credit insurance.

Our review was conducted between October 1986 and May 1987. It was conducted in accordance with generally accepted government auditing standards, except that we were not able to assess the reliability of all the data we obtained on the program because of time constraints and because FCIA was converting its computer system at the time of our review.

We did not obtain written comments on this report, but we did discuss a draft with Eximbank and FCIA officials and obtained and considered the views of insurance industry experts in preparing the final report.

FCIA as Agent for Eximbank in Delivering Export Credit Insurance Services

FCIA began operations in 1962 as an association of 71 property and casualty and other insurance companies. The Association was a pooling arrangement, in which participating firms assumed some of the risks on the transactions underwritten and shared profits and losses in accordance with the agreements entered into with Eximbank. In 1962, the maximum one-year risk participation for these firms ranged from $25,000 to $100,000. This private risk participation grew from an initial one-year total of $2.8 million in 1962 to a high of $15.0 million in 1980 and 1981. These risk amounts are relatively small compared with the government's total contingent risk exposure under the program during any given year. Over time, 77 private insurers, including some of the largest in the United States, participated in FCIA. At present, there are four member firms that assume no risks on the export credit insurance program. FCIA operates as an agent for Eximbank which assumes all the risks of loss on the program.

Private industry initially supported this program for various reasons. According to one former Eximbank official, private companies were motivated to join FCIA out of a desire to keep the government from entering the insurance business on its own. In our discussions with current and former FCIA members, most said that they joined FCIA for public service reasons with a secondary objective of making a profit.

Eximbank Relationship With FCIA

Under an agreement dated October 27, 1961, FCIA was appointed as Eximbank's exclusive agent for issuing and administering export credit insurance policies within prescribed guidelines. This agreement specified, among other things, the nature of risks to be assumed by FCIA and Eximbank, the authority delegated to FCIA, and the method for establishing premium rates and sharing profits and losses.

An important aspect of this agreement was the division of business between FCIA and Eximbank. FCIA was designated as insurer of commercial credit risks and Eximbank as insurer of all political risks as well as those commercial credit risks for transactions declined by FCIA but subsequently approved by Eximbank.

In compensation for its services, Eximbank agreed to pay FCIA 25 percent of the net premiums received for transactions insured directly by Eximbank. FCIA also shared in net underwriting profits, under a formula that was negotiated from time to time. FCIA's reinsurance agreement with Eximbank limited FCIA's exposure per buyer, per country, and in the aggregate. FCIA, in turn, agreed to pay Eximbank 20 percent of the net premiums received from comprehensive policies written for FCIA's account.[1] The relationship, however, changed in 1983 when most of the participating firms withdrew from FCIA.

FCIA Membership and Risk Participation

FCIA is governed by a Board of Directors and operates under a constitution and bylaws. Its Board is chaired by a senior Eximbank official and includes other Eximbank officials, FCIA's President, and representatives of FCIA member companies. The Board is responsible for electing senior officers of the Association and adopting the annual expense budget. Member companies are also represented on the Board's Audit, Budget, and Compensation Committees.

Each member's risk participation share was determined annually as a percentage of the total private risk participation in the Association. Membership participation peaked in 1980 and 1981, with 51 companies subscribing for a total of $15.0 million of one-year risk participation. Member participation then declined to $14.9 million in 1982 and to $14.1 million in 1983, the last year of private industry risk participation in FCIA. In total, $11.3 million in Association earnings were distributed to member companies through 1980, but these distributions were later recalled from the members as FCIA incurred losses.

Eximbank Assumption of Control and Buyout of FCIA Member Interests

In 1982, FCIA experienced a large increase in claims due to debt problems in developing countries and reported an estimated $34 million net loss as its share of the net loss for the year (net loss of about $44 million less about $10 million ceded to Eximbank). In early 1983, with losses continuing to increase, FCIA member companies informed Eximbank that they wanted to significantly reduce their risk participation for 1984. Eximbank rejected the members' proposed $2 million level of participation as too small, and the members then advised that they were withdrawing from the Association effective September 30, 1983. Subsequently, an agreement was reached to continue the Association on a non-risk participation basis in order to preserve FCIA as a separate entity for operating the export credit insurance program. Eximbank agreed to reinsure 100 percent of FCIA's transactions, cover all expenses in excess of revenues, and hold members harmless from any liabilities resulting from FCIA operations after September 1983.

[1] Comprehensive policies cover both political and commercial credit risks.

As part of this restructuring, FCIA adopted a new constitution and bylaws, giving Eximbank the primary role in FCIA management and policymaking. The present constitution provides for Eximbank to chair FCIA's Board of Directors and to control all Board committees. FCIA and Eximbank also entered into new agreements bringing rate setting, claims, and major underwriting decisions under Eximbank's control.

Eximbank, in turn, made a final settlement with FCIA's member companies covering all prior years' business. The member companies returned all prior earnings distributions and made additional cash contributions in settlement of their obligations. Given indemnification against future losses, 10 member companies elected to stay in the Association as non-risk bearing members. That number has since declined to the 4 present member companies who told us that they continued participation as a public service.

Present Status of FCIA and Plans for Reinvolving Private Risk Participation

Although FCIA continues to be a private association, Eximbank has sole financial responsibility for its operations. The member companies no longer have any financial interest in FCIA or its underwriting and recovery operations. Presently, all premiums received by FCIA are for the account of Eximbank, which has sole right to any FCIA income irrespective of its source. If the Association is terminated, members are required to assign to Eximbank all rights, title, and interest in FCIA assets.

Eximbank and FCIA recognize that private sector participation was an important guiding principle behind this program and accordingly have sought ways to reinvolve private sector risk participation. In 1983, FCIA conferred with several reinsurance[2] brokers but found that its overall pool of business was not attractive enough to interest reinsurers at a reasonable cost. As part of its efforts to reattract risk participation, FCIA initiated a project to separate its business into two pools—a national interest pool and a potentially profitable pool.

In 1986, FCIA established criteria for allocating accounts to the two risk pools based upon a number of factors, including premiums earned, loss experience, country risks, and administrative costs. Certain types of policies, including all policies for financial institutions and medium-term, single buyer policies, were excluded from the potentially profitable pool

[2]Reinsurance is insurance obtained by insurance firms Reinsurance spreads the risks among many insurance firms, thus reducing the risk of major loss to any one firm. Reinsurance brokers help to arrange for this reinsurance.

because of their poor loss experience. Small business policies were also excluded due to their relatively small premiums and high administrative costs. Of the remaining approximately 600 policies as of October 1986, FCIA had classified 234, having a total estimated annual premium of $6.3 million, as potentially profitable.

FCIA officials said they have not yet developed a methodology for allocating costs to each risk pool. They believe that it would not be advisable to approach potential member companies or reinsurers to seek risk participation until they have more data on the potentially profitable business.

Based on past events and our discussions with FCIA member firms, it is doubtful, in the near term, that FCIA can attract significant private sector risk participation through membership in the Association. Eighty five percent of the present and former member companies we interviewed told us that, under present conditions, they would be unlikely to renew participation in FCIA. Half of these companies said they would consider renewing risk participation in FCIA but only under certain circumstances, principally the reasonable expectation of making a profit and greater member control over FCIA decisionmaking. The remainder said that they would not consider renewing participation under any conditions.

In April 1987, FCIA's President told us that the Association is positioning itself for an eventual reinvolvement of the private sector by obtaining reinsurance from the private sector or reattracting members to the Association. Because of the presently limited availability of private reinsurance, however, he saw no reason to attempt to obtain reinsurance at this time.

Overlaps and Complexity of Program Management

Several overlaps in program management result from Eximbank's need to control FCIA operations which place the government at risk. For example, Eximbank maintains accounting control over FCIA's cash position, allowing FCIA enough cash on hand to cover operating expenses but requiring that all excess cash be remitted and that claims be paid through an Eximbank account. A system of delegated authority and approval requirements for underwriting decisions has also been developed, as shown in table 2.1.

Table 2.1: FCIA Underwriting Delegations and Approval Authority

Potential exposure	Approval authority
Buyer exposures of up to $1 million, multibuyer nonbank policies up to $1 million on new issues and $5 million on renewals	FCIA underwriting department
Buyer exposures from $1 million to $2 million, multibuyer policies from $5 million to $10 million	FCIA risk committee
Buyer exposures from $2 million to $3.5 million, multibuyer policies from $10 million to $20 million	FCIA plenary committee with Eximbank concurrence
Buyer exposures over $3.5 million, multibuyer policies over $20 million	Eximbank Board of Directors or Loan Committee

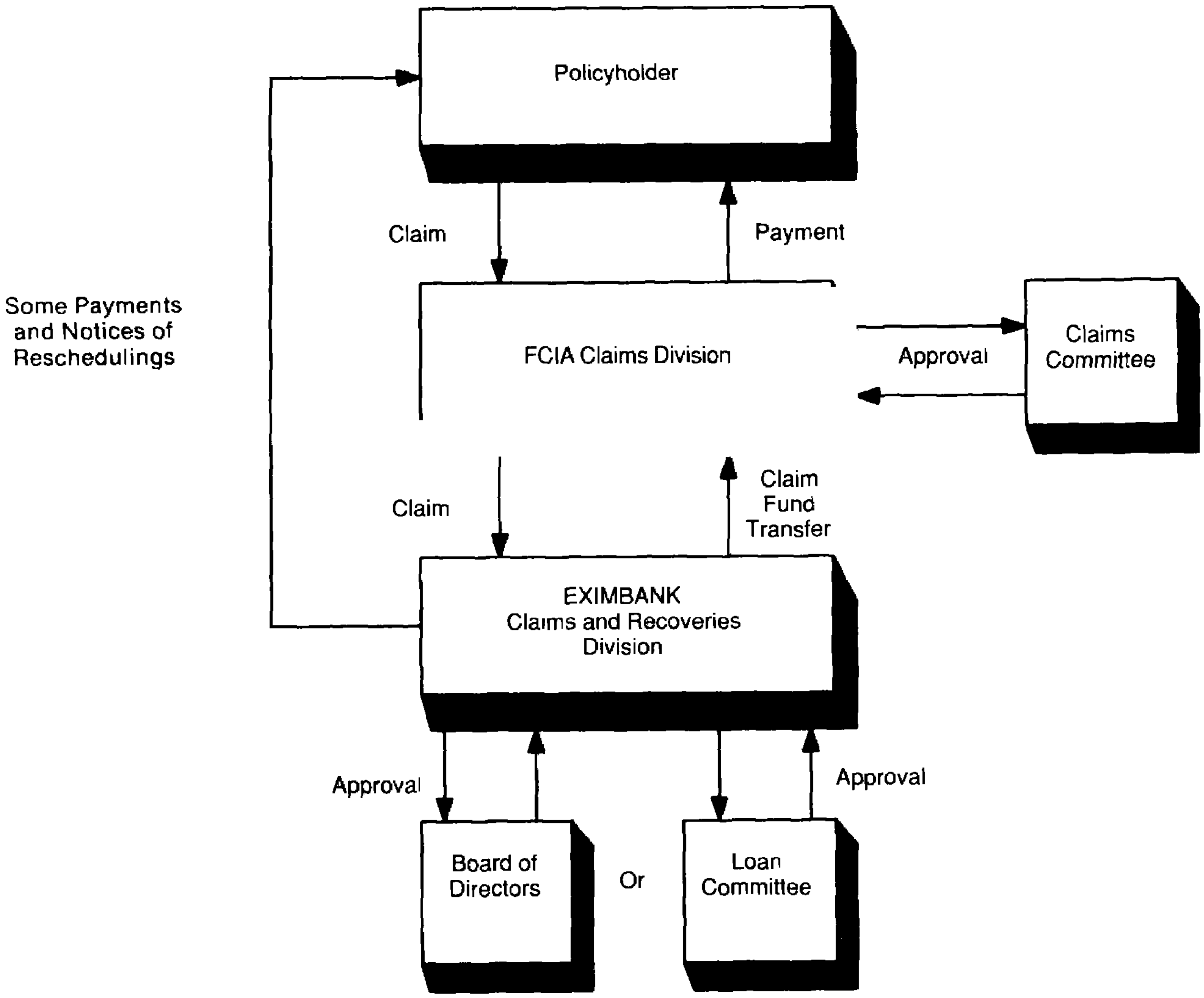
Source FCIA

FCIA risk and plenary committees meet three times each week as necessary to review and approve underwriting decisions. If an Eximbank representative is not present at a plenary committee meeting, FCIA sends its recommendations to Eximbank by overnight mail and Eximbank telexes its concurrence or nonconcurrence to FCIA. FCIA also reviews and makes recommendations on major proposed actions that require approval of Eximbank's Board of Directors. According to an FCIA official, such Eximbank approvals normally take from 2 to 3 weeks.

FCIA's approval authority may be further restricted by Eximbank's table of restricted countries and limitation schedules, which establishes the maximum amounts of coverage and specifies required terms of payment for selected countries. Certain products and buyers also fall outside the normal delegations of authority. For example, insurance for sales of (1) natural gas and petroleum products, (2) aircraft to government entities, and (3) any product to foreign military or police authorities must receive prior Eximbank approval.

Eximbank maintains a separate claims and recoveries department, which processes for approval all political claims and commercial claims over $750 thousand (commercial claims under $750 thousand are approved by FCIA). Eximbank also approves political claims payments and concurs with the payment of commercial claims authorized by FCIA. When there is nonconcurrence, claims are sent to Eximbank for further consideration. Claims processed by Eximbank are authorized for payment by the Loan Committee, or the Board of Directors when the amount exceeds $2 million. Eximbank is also responsible for making recoveries relating to political claims, whereas FCIA generally handles all commercial recovery efforts. In some cases, these recovery functions can also overlap. Figure 2.1 illustrates the coordination required on claims payments.

Figure 2.1: Claims Payment Process



FCIA and Eximbank accounting and financial management systems also overlap. FCIA maintains separate accounting records for FCIA and Eximbank business. However, because of differences in Eximbank and

FCIA financial management systems, FCIA is required to manually extract some financial data from its books and records for monthly reports to Eximbank, and Eximbank manually enters this data into its automated information system. FCIA also sends data to Eximbank on insured shipments and insurance authorizations for entry into Eximbank's data system. At the time of our review, FCIA and Eximbank were considering ways to better integrate their automated data systems.

FCIA Provides Certain Advantages

FCIA has served as Eximbank's agent for 25 years, and there are a number of advantages to this exclusive agency arrangement. FCIA has an established identity in the marketplace and has demonstrated its ability to serve the exporting community in a professional manner. It has developed a knowledge of its customers and their markets and an international underwriting expertise that would, at least for the short term, be difficult to replace. Having developed a knowledge of trade finance, international banking, insurance documentation requirements, claims administration and other legal aspects of the business, FCIA's staff is familiar with the needs of exporters and financial institutions that finance export sales.

FCIA has private industry participation on its Board of Directors, so it brings private sector influence to the delivery of Eximbank's insurance program. Its private association status has also provided flexibility in both managing its work force and responding to changing forces in the marketplace. This flexibility is important, especially in an environment where claims and recoveries and underwriting activities can vary significantly in a short time period.

During our review, we noted that several officials of private export credit insurance firms were former FCIA employees. FCIA has thus been instrumental in providing some of the experience in this specialized line of insurance that now exists in the private market.

Activities of Private Export Credit Insurers

Export credit insurance is a small and non-traditional line of insurance offered by few private insurance underwriters in the United States and Europe. Data concerning this insurance are not systematically compiled or made public. We obtained a general perspective on the size and activities of the export credit insurance industry through discussions with underwriters and brokers and through reviewing data provided by the underwriters, industry experts' estimates, and other studies.

We found no evidence that the industry would assume all of the risks presently insured by the government through FCIA. Some of these risks would be potentially insurable in the private market, but the magnitude of this privately insurable segment is not known. One private U.S. based insurer offers an insurance program that is generally comparable to that of FCIA, but terms and conditions of coverage and the countries open for coverage can differ from that available from FCIA.

Major Providers of Export Credit Insurance

The private export credit insurance market consists of insurance brokers who assist in placing most of this insurance; insurance firms' underwriting managers, who issue and service policies; and insurance firms (including reinsurance firms) that assume risks on the policies.

Figure 3.1 shows the participants involved in the delivery of export credit insurance in the United States through the Lloyds of London market, other private underwriters, or FCIA.

From our discussions with government and industry participants and our review of prior studies, we identified eight domestic underwriters of export credit insurance. Two of these underwriters were managers for Lloyds of London syndicates; two ceased writing export credit insurance; and three entered this market during our review. Only AIU offered an insurance program generally comparable to that of the FCIA. As shown in table 3.1, all eight underwriters had entered this market since 1975.

Figure 3.1: Export Credit Insurance Industry Participants

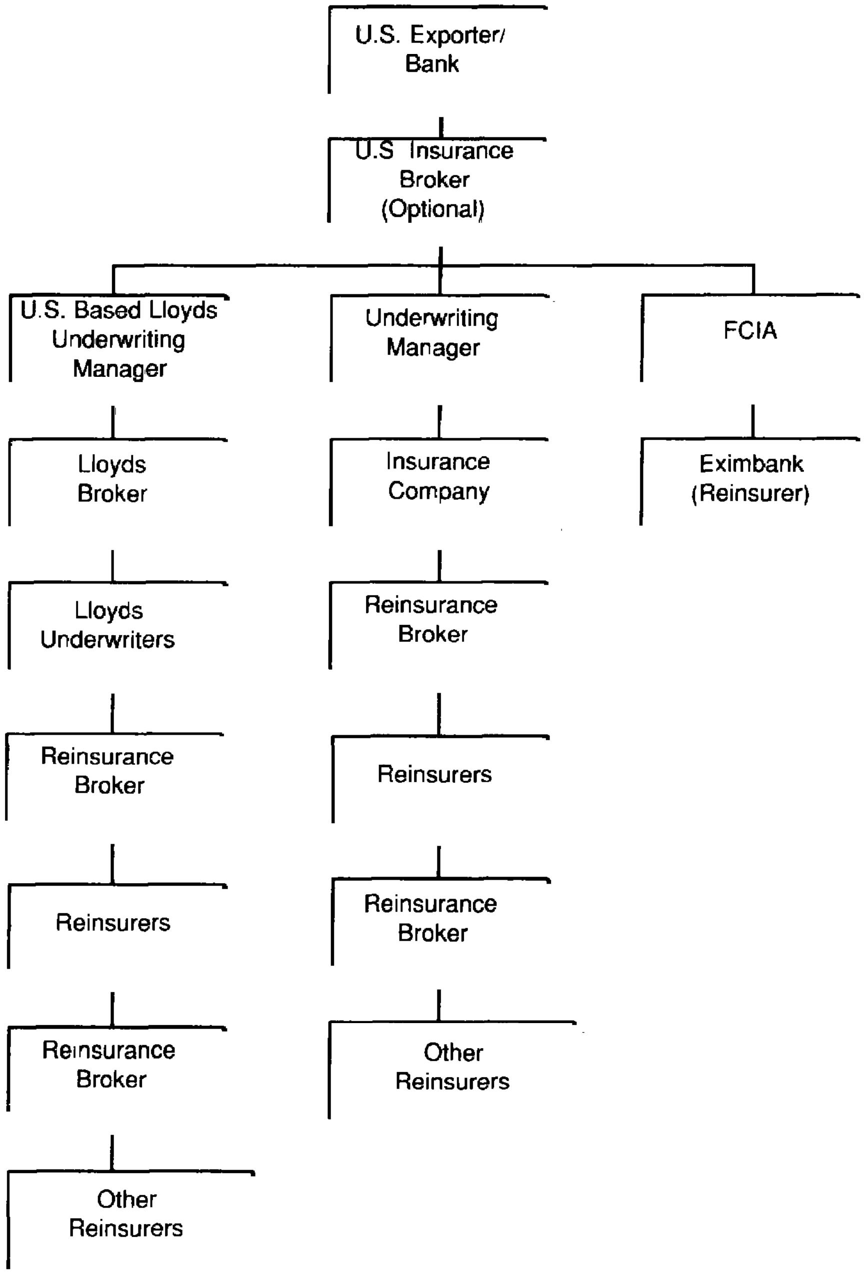


Table 3.1: U.S. Underwriters of Export Credit Insurance

Underwriter	Entered market	Comments
American International Underwriters (AIU), a division of AIG, on behalf of various AIG insurance firms	1975	Offers commercial and political risk coverage for both sovereign and private buyers.
Universal Investment Consultants Ltd , on behalf of Crum and Forster Insurance organization	1983	Offers political risk coverage for sovereign buyers.
American Credit Indemnity Co.	1986	Offers commercial risk coverage for sales to private buyers in Western Europe.
Citicorp International Trade Indemnity, Inc.	1987	Planned to begin operations in May 1987 and to offer political risk coverage for private buyers and political and commercial risk coverage for public buyers.
Trade Credit Underwriters, Inc. on behalf of Aetna Casualty and Surety Company	1985	Offered political and commercial risk coverage. Terminated business in October 1986 due primarily to lack of reinsurance.
CIGNA Worldwide, Inc.	1981	Offered both political and commercial risk coverage. Terminated program in December 1986.
Professional Indemnity Agency, on behalf of Lloyds syndicates	1987	Began operations at the time of our review and offered political risk coverage for both private and public buyers.
Global Special Risks, Inc , on behalf of Lloyds syndicates	1987	Began offering political risk coverage in January 1987 for sovereign buyers and private buyers with government backing.

Several European-based private insurers offer export credit insurance. The Lloyds of London market (underwriting through various syndicates) provides political risk insurance. It also is a major source of political risk reinsurance for firms that are primary insurers of export credit transactions.

Private Insurance Coverage and Underwriting Approach

A variety of insurance coverages are available in the private insurance market. All eight of the private firms we contacted offered or had offered some coverage for some types of transactions insured by FCIA. Five of them currently offer or planned to offer political risk protection for export transactions involving public buyers. However, only two of the domestic underwriters we identified currently offer commercial credit risk protection for export transactions involving private buyers, and one of these restricts its insurance to cover exports to Western Europe.

Private underwriters offer political risk coverage for investments in assets as well as trade transactions. The investment-related insurance covers confiscation, expropriation, and nationalization risks and would be similar to that provided by the government through its Overseas Private Investment Corporation. Because private insurers can provide a variety of insurance coverage, they can write policies to cover investment and trade-related transactions and domestic and foreign-sourced products.

FCIA's export credit insurance can cover both the commercial credit and political risks of an exporter's transactions with public or private buyers. Only one private domestic firm currently offers this coverage on both a whole or limited turnover basis and an individual transaction basis.[1]

The private underwriters we contacted have relatively few employees underwriting and servicing trade credit insurance compared with FCIA. The insureds are expected to retain more of the risk and to have the capability to evaluate and monitor their buyers' creditworthiness and collect the trade debts. Private underwriters generally prefer to insure the larger and more experienced exporting firms because they would more likely have these needed capabilities. High minimum premiums are used to screen out smaller exporters that generate low premiums and entail relatively higher administrative costs to the insurers; one insurer, for example, has established a usual minimum premium of $50,000 per year.

Private insurers also require longer waiting periods before claims can be filed than does FCIA. The longer waiting periods and greater risk retention are techniques used by private insurers to encourage insureds to actively pursue collections before filing a claim.

Three private underwriters told us that they were somewhat selective in the products they insured. One for example, preferred to insure non-luxury products, such as food, pharmaceuticals, and essential industry inputs, that would have a greater likelihood of being paid in the event of country debt problems.

[1]Whole turnover and limited turnover policies cover all or a meaningful part of the export transactions of the insured. Transaction-by-transaction (single sale) policies cover a particular transaction

Areas of Competition Between FCIA and Private Insurers

Competition between FCIA and the private underwriters could occur on two levels; (1) technical (i.e., premium rates and policy terms and conditions) and (2) program (i.e., overall insurance coverage provided). As noted earlier, only one private domestic insurer offered a program that was comparable to that of FCIA.

Based on our interviews with and data gathered from eight private insurers of export credit transactions and from our discussions with 10 insurance brokers, we noted that there are some areas of competition for business between FCIA and private insurers. Four private insurers believed that the competition had inhibited, or they expect it to inhibit, the growth of their business and four believed that there was little or no competition. All the insurers thought that there was a role for both the government and private insurers in providing export credit insurance.

Two of the insurance firms told us that FCIA had an advantage over private firms, particularly in offering lower premiums. Other factors favoring FCIA's insurance included government provision of up to 100 percent political risk coverage, insurance of interest on the trade debts, and other underwriting practices, such as short waiting periods for filing claims.

Private underwriters cited several areas where there was little or no competition with FCIA, including insuring of foreign-sourced transactions, small and inexperienced exporters, defense products, and financial institutions. The smaller and inexperienced exporters generally are not attractive to private insurers because of the relatively high administrative costs associated with this business. Banks also are not generally sought by private insurers because of their perceptions that those debts entailed large risks and that banks are prime candidates to be involved in debt rescheduling.

FCIA Policyholders and Insurance Broker Views on FCIA and Private Insurance

Forty percent of the exporters and 78 percent of the financial institutions responding to our questionnaires were aware of private insurance offerings. The respondents noted that FCIA's advantages over private insurance involved its backing by the government, its reliability, its availability for small policies, and its lower cost. Table 3.2 shows the most frequently cited areas that policyholders rated as of moderate or greater importance in selecting FCIA as their insurer.

Table 3.2: FCIA Advantages Over Private Insurance

Figures in percent

	Cited as Important by	
Area	Exporters[a]	Financial Institutions[b]
Confidence in backing by U S government	76	87
FCIA provides 95 to 100% political risk coverage	67	81
FCIA considered more reliable	58	61
FCIA willing to cover smaller policies	53	51
FCIA premium rates more favorable	58	53

[a]Based on 45 exporters aware of private insurance

[b]Based on 94 financial institutions aware of private insurance

Insurance brokers we interviewed cited the following advantages and disadvantages of private insurance.

Table 3.3: Advantages and Disadvantages of Private Insurance

Advantages	Disadvantages
More flexible in pricing and other terms and in tailoring policies to meet the clients' needs	Costs more.
More countries open for coverage.	Insureds retain more risks.
No foreign content limitation and fewer other restrictions	Waiting periods for filing claims are longer
Fewer administrative requirements.	Capacity of the private insurers is uncertain.

Seven of the 10 insurance brokers we interviewed believed that the area for probable competition between private insurers and FCIA was relatively small. The area where FCIA and private insurers compete is for the larger exporters. They saw, for example, little or no competition for smaller exporting firms and banks. In some cases the exporters will purchase both FCIA and private insurance because of restrictions on types of transactions which can be insured by FCIA (e.g., foreign content, defense products, and country restrictions).

Market Development, Trends, and Future Prospects

The Lloyds of London market traditionally has been a primary source for private trade-related political risk insurance. Since 1975, several U.S. firms have entered the market and some have withdrawn. A 1982 Eximbank study noted that four major domestic firms were then offering political risk insurance and that one of them also offered coverage for commercial credit risks. The study observed that the industry was in its infancy and that the capacity of the firms and the coverage offered were limited.

The study estimated that the private capacity for export credit insurance was about $1 billion, compared with about $6 billion insured by FCIA at that time. Private insurers from whom we obtained data provided various estimates of current insurance written. Those estimates, however, could not be directly compared to the $3.4 billion insured by FCIA in 1986. For example, they included insurance for exports from other countries and excluded some risks which are covered in combination trade and investment-related insurance policies. Because of these and other data limitations, we were not able to make a meaningful estimate of the insurance written by private insurers or of the value of exports insured.

An indicator of the capacity of the private insurance market to provide export credit insurance is the availability of reinsurance for the primary insurers. Insurers obtain reinsurance for a large portion of their potential liability under the policies written. The terms and conditions of the reinsurance are also important determinants of the nature and extent of coverage which can be offered by the primary insurers. For example, the reinsurance agreements in some cases may exclude coverage of credit sales with repayment terms over 3 years, sales to certain countries, and certain types of risks.

Reinsurance agreements also limit the amount of risk which can be assumed, on a per risk basis, per country basis, and in the aggregate. One private underwriter we contacted said that because of per country exposure limits, it could not write insurance for the last year in some countries. Given the small number of private export credit underwriters at present, the per country (particularly developing countries which pose substantial political risks) and aggregate risk limits could, we believe, pose a basic restraint on the ability of the private market to assume the risks presently insured by the FCIA.

Eximbank's 1982 study of the private market observed that reinsurance was not a constraint at that time on the growth of the private export credit insurance market. Private underwriters told us that reinsurance availability now was much more constrained. One insurer's per risk limits for some insurance coverages, for example, are down by as much as 85 percent since 1984. One private underwriter that started operations in early 1985 ceased operations in 1986 primarily because it was unable to obtain reinsurance. Private underwriters, from whom we obtained information and studies of the market, principally attributed this contraction in reinsurance availability to the unfavorable conditions in the property and casualty insurance industry.

Private export credit insurance is subject to the cyclical swings in the property and casualty insurance industry as are major lines of insurance. Given the small and non-traditional status of export credit insurance, we believe this class of insurance may be even more vulnerable to these swings than major lines of insurance.

These cycles affect the profitability of the industry and, consequently, the capacity of the industry to undertake risks. Some industry analysts consider the latest cycle to be much more severe than usual. The period from 1978 to 1984 has been characterized as being a soft market for property and casualty firms involving intensive price competition, large underwriting losses, and high interest rates. Underwriting capacity was generally abundant and insurers (including reinsurers) were actively seeking new sources of income and ways of maintaining market shares and clients.

In addition to large annual underwriting losses between 1979 and 1985, the industry also reported net operating losses in 1984 and 1985. With insurance industry capital more constrained, the capacity of the industry to assume risks was likewise constrained. Export credit insurance was affected through reduced limits of liability offered by the providers of these lines and, in some cases, elimination of the lines altogether. Nevertheless, some new underwriters have entered the market in recent years.

The private market for export credit insurance has certain characteristics and problems which may have limited its maturity to date or may affect its future development. Potential problems in attracting and retaining private sector participation in export credit insurance include the non-traditional nature of this insurance, the high visibility surrounding recent international debt problems, and the difficulty in predicting future claims losses.

In addition, there is some uncertainty over the impact of proposed New York State legislation which would require that financial guarantees be underwritten by monoline insurance firms rather than the traditional multiline insurance firms. Should export credit insurance coverage be deemed to be financial guarantees under this proposed legislation, we believe this could possibly discourage some insurers from entering the market. One domestic underwriter that left the market in 1986 cited this regulatory uncertainty as contributing to its withdrawal from this insurance.

Efficiency and Effectiveness of FCIA Operations

Since its inception, FCIA has insured nearly $70 billion in U.S. exports. The value of shipments insured grew from an average of $811 million annually between 1962 and 1974 to a high of about $7.4 billion in 1980. Program losses during the first 18 years were relatively small. However, a surge of claims starting in 1978 as a result of adverse economic conditions in Venezuela and the political situation in Iran and continuing through the developing countries' debt problems of the 1980s, caused cumulative program losses of about $360 million as of September 30, 1986. The value of insured shipments declined from $6.6 billion in 1982 to $3.4 billion in 1986 due to decreased demand for FCIA insurance.

Analysis of Program Operations

Until 1980, FCIA operated at a small profit, but major claims amounting to more than $290 million between 1981-84 have caused the program to generally operate at a deficit. Through 1986, FCIA has reported net losses of $44.6 million (cumulative losses of $221.1 million less $176.5 million ceded to Eximbank under its reinsurance agreement). In 1986, FCIA reported a $62 million profit (on a statutory accounting basis), which resulted from an accounting adjustment to its loss reserves to reflect an improvement in its underwriting experience.

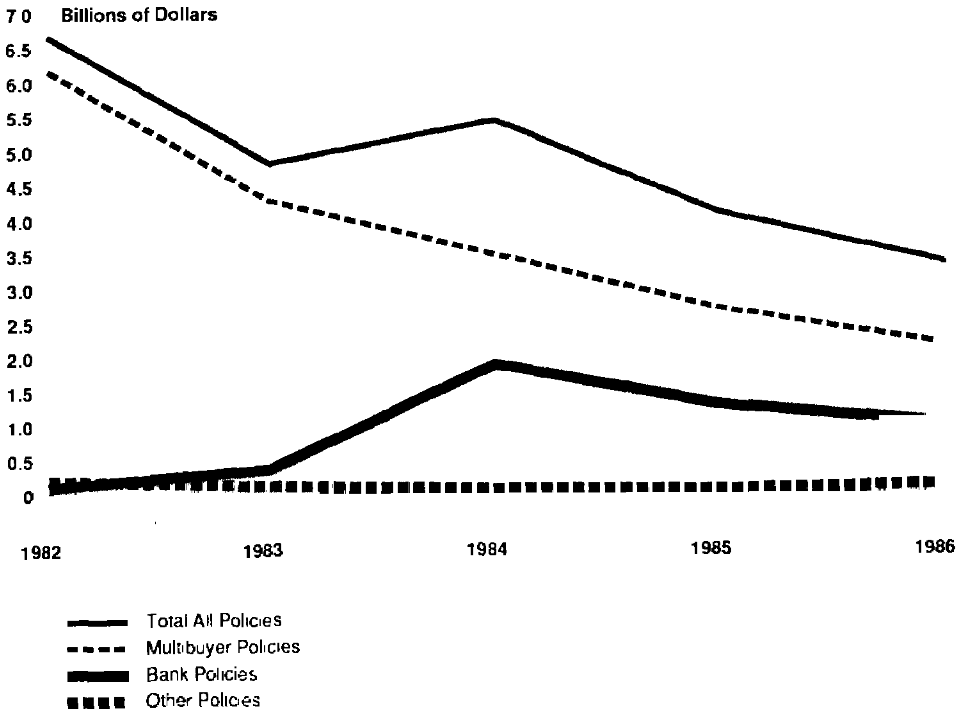
Eximbank reported an additional $141.4 million in cumulative net losses on insurance policies written for its own account, making the combined net loss of about $360 million as of September 30, 1986. The FCIA and Eximbank program results we summarized were not directly comparable because of differences in FCIA and Eximbank accounting methods and other accounting practices peculiar to the agency arrangement. The combined program results shown in appendix I, therefore, are estimates we derived from FCIA financial statements and Eximbank program reports.

Insured Shipments and Exposure

One measure of program effectiveness is the value of exports the insurance program supports. Our analysis of FCIA's shipment data showed that the program insured a generally increasing level of export shipments through 1980 before leveling off in 1981 and 1982 and declining thereafter. From 1962 to 1974 FCIA-insured shipments averaged $811 million per year; from 1975 to 1980 they grew to an average of $4.3 billion per year. Between 1981 and 1984 the insured value peaked at an average $5.7 billion per year, then fell to $4.1 billion in 1985 and $3.4 billion in 1986. Although total insured shipments have declined, FCIA continues to insure a significant volume of shipments to some of the riskier markets in Latin America, Africa, and other regions.

Figure 4.1 shows FCIA-insured shipments by policy type for fiscal years 1982 to 1986. Short-term multibuyer policies accounted for the largest share of FCIA's insured shipments in each fiscal year. Shipments under policies held by financial institutions rose from $85 million in 1982 to $1.9 billion in 1984 before declining to $1.0 billion in 1986. Shipments under policies which were medium-term (for credit sales usually from 1 to 7 years) fell from a total of $240 million in 1982 to $74 million, or 2.2 percent of total insured shipments in 1986. Shipments under all other FCIA policies amounted to $111 million, or less than 4 percent of total shipments in 1986.

Figure 4.1: FCIA Insured Shipments by Policy Type



Source: FCIA

Eximbank and FCIA monitor potential liability for losses through outstanding insurance exposure, which measures the total of approved credit limits under all policies outstanding at any point in time. At September 30, 1986, FCIA reported total outstanding insurance exposure of nearly $5.2 billion, half of which was in the riskier markets of Latin America, the Middle East, and Africa. (See table 4.1.)

Table 4.1: Insurance Exposure by Geographic Region

	Exposure (millions)	Exposure (percent)
Latin America	$2,020	39
Europe	1,522	30
Asia	1,055	20
Middle East	308	6
Africa	261	5
Canada	15	•
Total	**$5,181**	**100**

Source FCIA

While Eximbank and FCIA tightened up on country limitations and underwriting policies after the major claim losses in 1982 and 1983, program shipment and exposure data indicate that they continue to insure a significant amount of business in developing countries.

Claims and Recoveries

From 1980 through 1986, FCIA and Eximbank paid $735 million in claims and collected about $205 million in recoveries. Our analysis of claims which were open for recovery as of September 30, 1986 ($525 million), showed that five countries—Mexico, Venezuela, Argentina, Ecuador, and Saudi Arabia—accounted for 74 percent of the total.

We did not attempt to estimate the portion of potential recoveries that can actually be realized, but inventories of recoverable claims could represent a substantial future recoupment of past claims losses.

Analysis of Administrative Expenses and Other Costs

Cumulative FCIA general and administrative expenses totaled $99.0 million through fiscal year 1986, and accounted for 36 percent of total premium income. In 1986, FCIA spent $9.8 million for general and administrative expenses—$5.7 million for salaries and employee benefits; $1.6 million for rent and depreciation; $590,000 for auditing, consulting, and employment agency fees; $311,000 for travel and entertainment; and $1.6 million for all other expenses.

In addition to these FCIA expenses, Eximbank spent an estimated $37.6 million for administering the insurance program through 1986. Eximbank allocates a portion of its expenses to the insurance program

($3.3 million in fiscal year 1986) based on estimates of staff time devoted to that program. Eximbank's current estimates of its administrative expenses for the insurance program were derived from staff time data for a sample 4-week period in 1983. The Eximbank administrative expense allocations therefore may not be representative of resources presently devoted to the insurance program.

The program's ratio of expenses to premium income has been significantly higher than those of other Berne Union member countries and also is high compared with the average for private property and casualty insurance firms. Private insurance firms' ratios have ranged between 25 to 30 percent during the last 20 years. The ratio of FCIA expenses (including taxes and commissions) to total premium income in 1986 was 53 percent. The expense ratio for the insurance program, including Eximbank expenses, was 69 percent. The program's expense ratio has been adversely affected by the recent downturn in business volume. To the extent that some of the expenses are fixed in the short term, the expense ratio could be reduced by increasing the volume of insured exports and premium income. Also, as noted in chapter 1, the program insures a large number of small exporters. These policies entail relatively high administrative costs. Yet, as a result of staff reductions and other cost controls, FCIA's general and administrative expenses have increased little in recent years.

Between 1981-86, FCIA's total general and administrative expenses increased by 6.5 percent, from $9.2 million to $9.8 million, and expenses for 1987 are again budgeted at $9.8 million. Average salaries and benefits have increased, but FCIA's total staff declined 34 percent from 1981 to 1986. Personnel turnover has been between 25 to 35 percent annually, and according to FCIA officials, has contributed to FCIA's financial and information management problems. (See table 4.2.)

Table 4.2: FCIA Staffing, Salary and Benefits, and Turnover (Fiscal Years 1981-86)

Year	Average staff	Salary and benefits: Total (millions)	Salary and benefits: Average	Turnover rate (percent)
1981	242	$5.8	$23,967	35
1982	223	6.0	26,906	28
1983	197	5.9	29,949	32
1984	191	5.6	29,319	32
1985	173	5.7	32,948	25
1986	159	5.7	35,849	34

Source: FCIA

Controls Over Expenses

FCIA uses annual budget and compensation reviews to control general and administrative expenses. This budget process requires that each of its divisions provide the Finance Department with a proposed operating budget during the last quarter of the fiscal year. Finance reviews the proposals along with the latest monthly expense report, comparing actual expenses to the current year's budget and FCIA goals and objectives as established by the Association's President. Any questions relating to the budget proposals are discussed and resolved with division management. The President reviews and approves all budgeted expense items, after they are compiled by the Finance Department. The consolidated FCIA budget is reviewed by FCIA's Budget Committee, which in turn makes recommendations to the FCIA Board of Directors. The Board normally approves the budget at its September meeting.

FCIA uses a similar review process for setting annual employee compensation. Compensation levels for all FCIA employees, including senior executives, are based on job requirements and data developed by a consulting firm. The consultant provides FCIA with an annual survey of salaries paid by more than 1,000 companies nationwide on a regional and industry basis. FCIA determines the reasonableness of its salaries through comparisons to the industry-wide averages.

FCIA management recommends annual salary increases for each employee based on the employee's performance compared with established goals. These recommendations are reviewed by the Human Resources Department and then submitted to FCIA's President for final approval. For the President and Senior Vice President, Eximbank directed that as of January 1, 1987, salaries be increased based on an inflation factor for the prior year. The factor is developed by the FCIA Compensation Committee and approved by the FCIA Board of Directors. As with the Budget Committee, the Compensation Committee is composed of two to three Eximbank and member firms' representatives and cannot include an officer or employee of FCIA.

FCIA employees are also eligible for special compensation bonuses based on performance which substantially exceeds requirements. The total amount of special compensation bonuses is limited to a maximum of one percent of the budgeted FCIA payroll.

In our opinion, the budget and compensation oversight procedures provide Eximbank with an adequate means for overseeing FCIA's general and administrative expenses.

Payment of State Taxes on Premium Income

The payment of state taxes is a program cost associated with the present FCIA/Eximbank relationship. State taxes are paid on the portion of premiums representing commercial credit risks insured. No state taxes are paid on the political risks insured directly by Eximbank. From 1984 to 1986, this state tax amounted to $957,000.

In 1985, Eximbank asked the Department of Justice to provide an opinion on various aspects of state regulation of export credit insurance. In 1986, after receiving an opinion on one aspect of state regulation, Eximbank renewed its request on other aspects and included in the request the issue of whether FCIA and/or Eximbank was required to pay state premium taxes. At the time we completed our review, the Department of Justice had not responded to the renewed request.

FCIA Plan to Improve Program Effectiveness

In 1984, FCIA developed a strategic plan to improve its operations. The plan addressed Eximbank's concerns about large claim losses and the drop in business during 1982 and 1983 and established four major goals: (1) to make a profit, (2) to promote U.S. exports, (3) to improve customer service, and (4) to improve its working relationship with Eximbank in support of the other goals. The plan outlined steps to redesign products; to improve marketing, customer service, and underwriting; and to increase recoveries.

In 1985, Eximbank's Board of Directors accepted FCIA's plan but modified its overall strategy to provide that FCIA develop and implement the financial, managerial, and underwriting techniques necessary to become a financially self-sustaining business by the year 1990. The Board also approved the following long-term objectives for FCIA.

- Promote U.S. exports by marketing, selling, and servicing credit insurance policies for the U.S. export community.
- Achieve and maintain a high level of service for all program users and a system to evaluate such service.
- Optimize the current and future role of private export credit insurance.
- Provide special products, facilities, and other support at the request of Eximbank.
- Develop and maintain a system to evaluate insurance products.

Each year the strategic plan is updated and performance monitored through an annual operating plan which reviews accomplishments and progress.

Product Development

Product development has been one of the areas considered most critical to FCIA's long-term viability. The strategic plan noted that FCIA's insurance products had remained nearly unchanged since inception and generally were not flexible enough for the markets they served. The product improvement plan included steps to develop products that reflected user needs and simplified existing policy conditions. FCIA also endeavored to develop new products and improve its existing products for small businesses, recognizing their lack of knowledge about exporting, vulnerability to large losses, and need for financing.

In 1984, FCIA established a product development unit for product research, development, and market introduction. It also formed a number of industry user advisory groups to help ensure that products were designed in response to market needs. Product development results have included the introduction of a number of new insurance policies and enhancements to existing policy offerings.

Marketing

In addition to using insurance brokers, FCIA uses a direct marketing approach. Regional offices have primary responsibility for selling FCIA insurance. However, most of its insurance premiums are generated through business serviced by brokers. FCIA has attempted to increase its sales through improving direct marketing efforts and through more effective use of brokers, banks, and other intermediaries.

FCIA's marketing department includes a marketing management unit at headquarters and regional marketing offices in Chicago, Houston, Los Angeles, Miami, and New York City. The cost of operating the regional offices accounts for about 80 percent of total marketing expenses (See table 4.3.) and is more than the amount paid annually in brokerage commissions.

Table 4.3: FCIA Marketing Expenses and Brokers' Commissions

Fiscal year	Marketing management	Regional offices	Total marketing expenses	Brokers' commissions
1985	$353,589	$1,879,680	$2,233,278	$1,242,000
1986	438,955	1,548,231	1,987,186	1,395,000
1987 (Budget)	431,600	1,478,080	1,909,680	1,550,000

Source: FCIA

The decrease in marketing expenses primarily was due to staff reductions, centralizing underwriting functions at headquarters, and transferring product development activities from the marketing department. Prior to 1985, regional offices were responsible for underwriting new policies, but all underwriting is now performed at FCIA headquarters.

FCIA's Vice President for Marketing told us that the primary new marketing strategy is to identify sales prospects through a direct mail campaign. Regional offices then make follow-up contacts with prospective clients. During fiscal year 1986, they conducted nearly 22,000 direct marketing calls and made approximately 3,300 visits to exporters and distributors, resulting in the addition of about 80 new policyholders. Data was not readily available to compute the average cost of soliciting these policies compared with the premium income generated, so we could not assess the cost-effectiveness of FCIA's direct marketing efforts.

More Effective Use of Intermediaries

FCIA has attempted to make better use of brokers by liberalizing its broker registration requirements, increasing financial incentives, and improving training. At its 1987 meeting with brokers, FCIA agreed to review a recent suggestion made by the brokers to substitute a higher first-year commission rate for the one-time bonus presently paid for policy renewals. The brokers indicated that this would be closer to the procedures followed by private insurers.

FCIA has also recognized the importance of banks and others (e.g., trade associations) as distribution outlets for its insurance. FCIA officials told us that banks often directed exporters to purchase FCIA insurance prior to financing their foreign receivables. As a result, banks play an important role in the sale of FCIA insurance to small and medium-sized businesses. Administrators of umbrella policies can also help FCIA in reaching small and inexperienced exporters. FCIA officials also noted that the Commerce Department's International Trade Administration as well as state and county agencies could enhance FCIA's marketing through promotion of the insurance program.

Overall, FCIA's marketing efforts during 1986 cost about $2 million and brought in 350 new insureds. Eighty of these insureds resulted from FCIA direct marketing efforts and the other 270 were obtained through FCIA's joint efforts with brokers, banks, and other intermediaries. Based on these results, we believe that FCIA should examine the cost-effectiveness of its direct marketing program and consider whether more emphasis should be placed on promoting its products through brokers and other intermediaries.

Customer Service

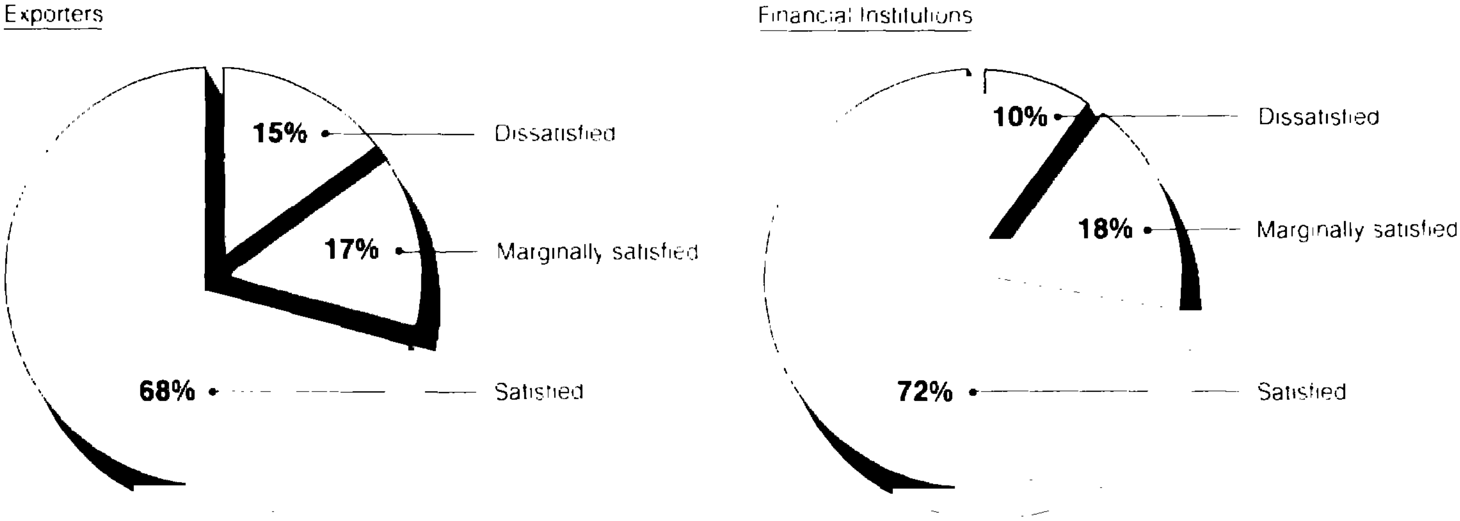
FCIA's strategic plan concluded that the general level of its service was not as good as that of the private sector and cited the loss of some major customers (representing annual premiums of $1.3 million) to private insurers as evidence of customers' desire for more responsive service. Therefore, its number one priority for the past several years has been to improve customer service. FCIA's President stated that the previous high level of customer complaints has been reduced and that FCIA is endeavoring to streamline its operations while improving service.

Two areas of particular importance in the customer service area include the processing of insurance applications and processing of claims. For example, buyer underwriting, for the most part, has been able to process complete applications within the service standard time of 5 days and exporter underwriting has been able to renew the majority of the multibuyer policies prior to their expiration dates. However, underwriting decisions requiring Eximbank review generally take longer than those made by FCIA. Our analysis of 100 applications reviewed by Eximbank showed an average processing time of about 3 weeks for applications requiring Loan Committee review and 5 weeks for Board of Directors review.

FCIA officials told us that turnaround time for insurance claims has been reduced significantly. Moreover, FCIA has focused its efforts on promoting customer retention and a service-oriented image and informing exporters and banks about the value of export credit insurance in developing their international business activities.

Our survey of FCIA policyholders found that, overall, there was a relatively high level of customer satisfaction with FCIA service. (See fig. 4.2.)

Figure 4.2: Policyholder Satisfaction With FCIA Service.



Source GAO Survey of Policyholders

Although a large majority of policyholders expressed satisfaction with FCIA's services, there were several areas where some policyholders were not satisfied. About 70 percent of the exporters and financial institutions which applied for buyer or bank credit limits, and which responded to our question, noted that FCIA took 15 days or longer to act on these requests; 23 percent of the exporters and financial institutions considered this response time to be inadequate.

The time required to settle claims was also cited by the policyholders as an area of concern; 23 percent of the exporters and 39 percent of the financial institutions which had completed the claims process considered the settlement times to be unsatisfactory. Another 30 percent of the exporters and 6 percent of the financial institutions considered the settlement times to be marginally satisfactory.

Claims documentation requirements were considered to be moderately or very excessive by 25 percent of the financial institutions and 12 percent of the exporters responding to our survey.

We also surveyed a sample of 53 former policyholders; 29 of them, or 55 percent, indicated they had been generally or very satisfied with FCIA service. Most of them attributed their satisfaction to having had few or no problems with FCIA or to the helpful and attentive service they received. However, 11 former policyholders were generally or very dissatisfied with the level of service provided. Our survey also showed that 37, or nearly 70 percent of the former policyholders, would consider using FCIA insurance again in the future.

Underwriting

FCIA has centralized all exporter and buyer underwriting functions at its New York headquarters.[1] In 1985, it transferred all buyer underwriting from the regional offices to headquarters, and organized it into foreign geographic areas. This centralization reduced costly and time-consuming buyer information transfers between the regional offices and headquarters and has enabled underwriters to become specialists in their assigned geographic areas. In 1986, FCIA also centralized exporter underwriting at headquarters. According to FCIA records, centralization has reduced FCIA's processing time for buyer credit limits to 5 days or less in most cases; prior to centralization it may have taken weeks, according to FCIA officials. Processing time for policy renewals has also been improved; for example, during June 1987, 88 percent of policy renewals were performed on time, whereas previously only about 49 percent were performed on time.

Increased Emphasis on Recoveries

Since 1983, FCIA has more than doubled the number of staff in its recovery department. It has reorganized its management of recoveries into geographic areas of responsibility and presently maintains contract representatives in three foreign offices—Guadalajara and Mexico City, Mexico, and Caracas, Venezuela. Typically, these offices assist the recovery department by contacting overseas buyers and attorneys on recovery cases as well as assisting on Eximbank collections. FCIA estimated the cost of operating these offices in 1986 at $215,000.

FCIA's commercial recoveries increased from $3.5 million in 1983 to $23.2 million in 1986. Recovery expenses in 1986 were about $1.1 million.

[1] Exporter underwriting is the process used to establish insurance policy limits based on the evaluation of an exporter and its export sales. Buyer underwriting is the process used for establishing credit limits for specific buyers.

Financial and Information Management Problems

During its audit of FCIA's financial statements for fiscal year 1986, Arthur Andersen & Co. identified accounting deficiencies, staffing problems (e.g., high turnover, lack of training) and a lack of written procedures for the accounting functions. This created a weak overall internal control environment, according to the independent auditors.

FCIA's accounting department has lost key management staff and other experienced personnel during recent years, leaving it with a lack of adequately trained accounting supervisors and personnel. At the time of our review, FCIA was hiring additional staff and had replaced its chief financial officer.

Most of the internal accounting control weaknesses identified by Arthur Andersen & Co. required corrective actions to reconcile or make adjustments to accounting records. These accounting problems raised questions regarding the reliability of FCIA's records and caused a delay in completing the annual audit. In a letter to FCIA in July 1987, the auditors noted that FCIA had addressed the control weaknesses and had corrected its accounting records. The auditors rendered an unqualified opinion on FCIA's financial statements for fiscal years 1985 and 1986.

Problems in Management of Information Resources

According to an FCIA official, FCIA's April 1986 conversion to a new automated information system contributed to the accounting and reporting deficiencies. For example, during the conversion, shipment data had to be manually entered into the new system. Because of data entry errors, some account balances in the new system were inaccurate.

Initially, FCIA computer processing services were provided by an outside service bureau. However, FCIA officials thought it would be more efficient and cost-effective to have their own automated information system. In December 1983, Eximbank authorized FCIA to purchase a computer and to develop its own data information system. Completion of this project was not smooth, in large part because of the early, unplanned termination of FCIA's contract with its service bureau (which was going out of business) and the lack of systems expertise at FCIA.

During the testing of the new system, changes and enhancements were made. Because the new system had to be used earlier than planned, the FCIA staff was primarily devoted to converting data from the old systems into the new system. Software programs were not sufficiently tested, and data entered into the new system were not adequately validated.

During the conversion, FCIA and Arthur Andersen and Co. identified several deficiencies. For example:

- converted data were not thoroughly verified against the service bureau data for accuracy and completeness;
- many files were converted through manual data entry with no initial comparison of the data entered with the source documents to ensure that the converted files were valid; and
- some of the data that should not have been converted were inadvertently carried over into the new data base and data that should have been converted were not.

When it became apparent that FCIA lacked the management information systems expertise necessary for the conversion, a new director was hired for the management information department. FCIA, working with Arthur Andersen & Co. systems consultants, is currently testing the software, making modifications, improving the programs, and verifying converted data to ensure their accuracy and reliability. According to FCIA officials, completion of the conversion project will require an additional 2 to 3 years.

As part of our audit of Eximbank's financial statements for fiscal year 1986, we recommended that the Chairman of Eximbank direct the Eximbank's Treasurer-Controller to monitor and report on FCIA's progress toward resolving internal accounting control system weaknesses, including completing and implementing the new computer system, to ensure that financial information is accurately processed by FCIA and correctly reported to Eximbank for inclusion in its financial statements (GAO/AFMD 87-61, Aug. 31, 1987).

Government Involvement in Export Credit Insurance and Our Conclusions

Congressional concern about the government's role in export credit insurance was prompted by changes in the private export credit insurance market, FCIA's function in providing the government insurance, and the government's willingness to underwrite export sales in less-developed countries.

Some of the transactions presently insured by the government are potentially insurable in the private market. The availability of private insurance, however, is subject to market forces, which make it an inconsistent source of risk protection for exporters. FCIA's function has changed from that of an insurer of commercial credit risks to that of a cost-reimbursed administrator for the government program. Heavy program losses, due principally to the debt problems in developing countries, caused FCIA members to withdraw their risk participation. Former member firms generally are not inclined to return to a risk-bearing role under present circumstances. While FCIA has experienced some management problems, steps have been taken to address many of these matters and additional measures can be pursued to improve the economy, efficiency, and effectiveness of the program and FCIA operations. The extent of risk that should be taken by the government is a policy decision that must consider the goal of encouraging exports and a judgement as to whether there is a sufficient likelihood that the insured debt will be repaid. In some instances, Eximbank's underwriting limits and restrictions govern FCIA's actions. However, FCIA and Eximbank data show that substantial risks were taken.

The export credit insurance program has broad objectives for assisting in the expansion of U.S. exports and providing a facility comparable to those available to foreign exporters in major competitor countries. Various other objectives are also pursued in the execution of the program, such as assisting small exporting firms, involving the private sector in delivery of the services, and operating the program to be self-sustaining. Congressional assessment of the government's proper role and the amount of government resources that would be justified would have to consider the degree of emphasis desired on these various objectives.

Government Involvement Necessary to Meet Present Program Goals

When the Congress established the export credit insurance program in 1961, it recognized that the private market did not provide these services. The private export credit insurance market developed somewhat during the 1970s and early 1980s. However, few firms offer this insurance and only one domestic insurer offers coverage comparable to that offered by FCIA. The private market has also been volatile; some firms have discontinued business in the last year, and others were starting up operations at the time of our review. The current private capacity for export credit insurance is also subject to the cyclical swings inherent in the property and casualty insurance industry. This can cause severe contractions or expansions in the availability of private insurance.

Private insurers' business practices are generally more conducive to dealing with the larger and more experienced exporters than with small exporters. Banks also are not generally sought as policyholders by private insurers because of the potential for debt rescheduling or other unfavorable claims experience. A complete withdrawal by the government from the export credit insurance business would likely leave a gap that would not be filled by private firms at the present time. Considering the restrictions placed on FCIA insurance and the practices of private insurers, the marketplace appears to have niches for both the government and the private sector.

At the same time, there is some competition for business between FCIA and private insurers, particularly for certain large and experienced exporters. How much of this business could or would be assumed by the private sector if the government withdrew cannot be determined with any certainty as it would depend on future decisions by the private underwriters. Some of the business currently underwritten by the government could potentially be insured in the private sector.

Potential Impact of Program

The level of U.S. exports depends on such factors as exchange rates and demand for U.S. products. In our opinion, the availability of export credit insurance by itself will not necessarily have a major impact on increasing export sales. For example, its availability will not affect the buying decisions of developing countries attempting to stabilize their economies. Reducing imports has been one measure taken by countries with debt problems to help stabilize their economies.

While recognizing the small portion of U.S. exports affected by the government's insurance, the program may be helpful as a defensive strategy. To ensure that U.S. exporters have a stable and reliable supply of export credit insurance and to meet certain of the congressional objectives (e.g., assuring U.S. exporters of a facility comparable to those of major foreign competitors, supporting exports to risky markets, and supporting small exporters) the government would need to provide this insurance, at least in the near term.

As discussed below, FCIA policyholders perceive this insurance as important in helping them to expand their export sales as well as to obtain financing and allay general risk concerns. Also, the policyholders perceive that some of the insured exports would proceed and some would be halted or be uncertain in the absence of the government's insurance. Considering the small portion of exports covered by FCIA's insurance, these perceptions would not necessarily evidence a need for the government program overall.

Policyholders' Perceptions on the Need for Insurance

During our review, we asked exporters how important several factors were in their decision to obtain export credit insurance. About 58 percent cited their desire to expand export sales as crucial or very important; about 55 percent cited commercial risk of exporting to foreign countries as crucial, and 47 percent cited the need to obtain bank financing as crucial or very important.

One of the ways Eximbank supports exports is by supporting the financing of such transactions. Banks are subject to regulatory as well as internal limits on foreign lending exposures. Eximbank's insurance can reduce the amount of exposure subject to the limits, thereby making additional financing available. In answers to our questionnaire, 87 percent of financial institutions (predominantly banks) cited political risk as crucial or very important. Also, about 83 percent cited serving clients' needs as crucial or very important; and about 68 percent cited commercial risk as crucial or very important.

Responses to our survey of FCIA policyholders also suggested that 11 percent of the dollar value of insured exports of financial institutions and 73 percent of exporters' insured shipments would proceed in the absence of government insurance.

About 55 percent of the exporters responding to our survey indicated that without this insurance they would either halt or be undecided about 20 percent or more of their exports. About 33 percent indicated that they would proceed with all their exports if the insurance was unavailable, while the remaining exporters estimated that from 2 to 10 percent of their exports would be in question.

An even higher percentage of financial institutions said that they would withdraw significant financing for exports if government insurance was unavailable. Approximately 95 percent indicated they would withdraw or be uncertain of financing 20 percent or more of their clients' insured exports. About 63 percent said that they would halt all financing of the insured exports.

Extent of Government Involvement Could Vary

The extent of government involvement could vary from the present program, which offers insurance to all applicants that meet the program eligibility criteria, to a program in which the government would act only as an insurer of last resort.

Retaining the present level of involvement continues an overlap between some transactions which may be insured in the private market or by the government. An insurer of last resort role would place emphasis on reducing government interference with the private market and would direct some of the current business to the private sector. Under either option, there are additional actions that the government could take to encourage the development of the private market.

Insurer of Last Resort

Under this option, the government would only insure transactions which the private sector would not insure on reasonable terms and conditions. This would likely benefit the development of the private market by shifting the business of some of the larger experienced exporters to private insurers. To the extent that this shift in clients' exports caused the government program to be concentrated on higher risk and higher administrative cost business, the program would no longer be based on spread of risks and, therefore, might represent a direct subsidy to exporters supported under the program. Retention of an objective for the program to be self-sustaining could require substantial increases in insurance premiums, which could make it less attractive to exporters it sought to help and less competitive with other foreign programs.

Under the last resort approach, controls would be needed to ensure that the government did not write insurance in cases where the private sector would be willing to do this directly. Giving private insurers the right of first refusal by requiring all applicants to seek quotes or to fill out private applications could entail unnecessary delays and costs, since the private market is not inclined to underwrite many transactions presently insured by the government. Moreover, determining whether the terms and conditions offered by private insurers are "reasonable" might also be difficult.

Ways That Government Could Encourage Development of Private Insurance Market

Underwriters, FCIA member firms, and others we contacted pointed out that one important way to encourage the development of the private export credit insurance industry would be for the government to decline to write insurance that the private sector would take on commercial terms. Other suggestions included providing various forms of technical and information assistance. Particular support was expressed for the government to provide reinsurance to private insurers for transactions for which the private sector lacked capacity.

Providing Reinsurance

The provision of facultative reinsurance (based on transaction-by-transaction decisions to underwrite) to qualified private insurers could serve to stabilize and improve the capacity of the private insurers to take on some transactions and might encourage some new insurers to enter the market. Suitable guidelines would have to be developed and underwriting, risk assumption, and fee-sharing agreements would have to be negotiated to ensure that government objectives were appropriately served. Under this arrangement it would be important to assure that private insurance firms retain a sufficient level of risk in the transactions underwritten to ensure that sound underwriting practices are maintained.

In addition, this approach would need to consider the availability of private reinsurance to keep the government from competing with and displacing private reinsurance. With the capacity fluctuations in the insurance market, the advisability of providing such reinsurance would have to be continually monitored.

Assuming that reinsured transactions are those that would have otherwise been insured directly by the government, there would be little additional administrative cost to the government for providing the reinsurance. The government would need to periodically evaluate this reinsurance to ensure that its objectives were being accomplished in a cost-effective manner.

Other Government/ Industry Relationships

Other options for government relationships with private insurers include purchasing reinsurance from private insurers and joint underwriting of risks (coinsurance).

Purchasing reinsurance places the private insurers in more of a passive insurance role and leaves the government as the primary insurer. It would reduce the government's potential exposure in the program and attain some private participation. With the present capacity constraints in the private insurance market, this approach may not be feasible now. As noted earlier, FCIA considers this to be a future option.

Coinsurance arrangements could produce mutual benefits to both the government and private sector. Coinsurance would require close monitoring by Eximbank to ensure that the government did not indirectly support exports in contravention of existing program guidelines. Such arrangements would benefit U.S. exporters by broadening the scope of programs available to them. It would keep private insurers more directly involved with the underwriting and claims process and also draw on the relative strengths of the private market in non-traditional credit terms and supplementary coverages. Such joint underwriting arrangements are common practice within the insurance industry and would not entail either the assumption of greater risk or cost to the government.

Continued Use of FCIA as Government's Agent

Eximbank's use of FCIA has provided for private sector involvement in the delivery of its insurance program. Recently FCIA experienced a series of major claims and, since 1983, all but four of the private member companies ended their participation in the Association. This forced Eximbank to restructure its agency relationship with FCIA. Since this restructuring, FCIA has continued to operate as a private association, but with complete indemnification from losses by Eximbank. At present FCIA, in substance, is a cost-reimbursed contractor existing solely to serve as administrator of the government's export credit insurance program.

The present non-risk-bearing role for FCIA is not what was intended when the Association was established in 1961. Given the changes that have taken place in the FCIA/Eximbank relationship and the uncertain prospects for future private sector risk participation, the need for the present agency arrangement is not as compelling as it was in 1961. In view of the various functions already performed by Eximbank under this program, some or all of the functions now performed by FCIA could, over time, be assumed by Eximbank. Whether Eximbank could maintain or improve upon the level of service that FCIA has attained, however, is unknown. A number of significant advantages in this arrangement continue to exist, however, and FCIA's services would be difficult to replace in the short term. To do so could involve major program disruption if not properly planned and implemented.

FCIA has initiated actions to improve its operations, reduce costs, and make its service more responsive. Also, its clients are generally satisfied with the services provided and FCIA has certain advantages, including recognized expertise and experience for delivering this specialized line of insurance. It is a flexible resource and personnel can be added or reduced in an efficient and effective manner to accommodate workload changes.

FCIA considers its present servicing agent status as temporary. However, its plans to reattract private sector risk involvement have not been tested nor have deadlines been established for accomplishing this. Risk participation through member firms seems doubtful at the present time and, because of present conditions in the private insurance market, FCIA is not presently attempting to obtain private reinsurance. Eximbank has mandated that FCIA become self-supporting by the year 1990. Whether or not it can achieve that goal depends on many factors, some of which are beyond FCIA's control. Much depends, for instance, on U.S. exporters' future demand for export credit insurance and on the stability of the world marketplace.

Overall, we found that FCIA has pursued the government's objectives for the export credit insurance program and is providing satisfactory services to its policyholders. We therefore support continuing the use of FCIA as Eximbank's agent.

While FCIA has restrained the growth in its general and administrative expenses in recent years, the program's overall expense ratio is still relatively high. Areas needing attention include personnel turnover, financial and information management, marketing costs, and some inefficiencies in Eximbank and FCIA approval processes and data processing functions.

FCIA has experienced a high level of employee turnover and problems in financial and information resources management. If uncorrected, these problems can adversely affect operating efficiency and internal controls. As part of our recent audit of Eximbank financial statements, we recommended that Eximbank monitor and report on FCIA's progress in resolving internal accounting control system weaknesses. Eximbank's Treasurer-Controller acknowledged the need for corrective action and stated that he has been monitoring this situation. We believe that reducing employee turnover should also be given particular emphasis as a way of improving FCIA's internal controls as well as the efficiency of its operations.

FCIA's direct marketing program which cost about $1.5 million in 1986 added relatively few new policyholders and its cost-effectiveness needs to be compared to results obtained through brokers and other intermediaries. To the extent that greater use could be made of the brokers and other intermediaries in marketing FCIA insurance, the government's costs might be reduced. Additional assessment of this potential is needed, however.

Eximbank and FCIA should work together to streamline their agency relationship to assure that the program is administered in the most efficient and effective manner. For example, attention should be paid to reducing the times required for underwriting and claims decisions. Underwriting decisions requiring Eximbank approvals take several weeks in many cases. Some policyholders we surveyed cited lengthy underwriting processing time and the time required to settle claims as areas of service that were not satisfactory. In addition, a better integration of FCIA and Eximbank's automated data systems would reduce some of the inefficiencies in the exchange of data between these organizations.

Agency Comments

We discussed a draft of this report with the President of FCIA and appropriate Eximbank officials, including the Senior Vice President for Insurance and Banking and the Treasurer-Controller. The officials considered our assessment of the export credit insurance program to be fair. They also provided technical comments which were considered in preparing this report. These officials agreed that there was a need for FCIA and Eximbank to address FCIA's employee turnover, the cost-effectiveness of the direct marketing program, and the inefficiencies in the FCIA-Eximbank relationship.

Eximbank Insurance Program Results Fiscal Years 1962 - 1986

($ 000 Omitted)

	Cumulative through 9/30/80	1981	1982	1983	1984	1985	1986	Cumulative through 9/30/86
FCIA results								
Premiums earned[a]	$96,625	$22,960	$19,412	$11,610	$13,232	$13,268	$12,242	$189,349
Less:								
Losses and loss adjustment expenses incurred[b]	42,687	21,329	51,435	167,214	73,622	1,073	−60,782	296,578
Commissions and state premium taxes	14,904	3,431	4,748	1,472	1,669	1,554	1,676	29,454
General and administrative expenses	42,786	9,197	9,387	9,360	9,127	9,400	9,774	99,031
Underwriting income	−3,752	−10,997	−46,158	−166,436	−71,186	1,241	61,574	−235,714
Other income	8,653	2,403	1,805	1,091	453	162	62	14,629
Net income	$4,901	−$8,594	−$44,353	−$165,345	−$70,733	$1,403	$61,636	−$221,085
Ceded to Eximbank	$0	$0	−$10,190	−$158,595	−$70,733	$1,403	$61,636	−$176,479
Eximbank results								
Net premium income	$37,007	$6,106	$6,037	$7,312	$7,888	$9,780	$9,251	$83,381
Less:								
Administrative expenses	20,411	2,069	2,211	2,824	3,215	3,533	3,319	37,582
Claims, net of recoveries	43,673	2,576	2,926	9,350	118,485	33,560	37,809	248,379
Underwriting income	−27,077	1,461	900	−4,862	−113,812	−27,313	−31,877	−202,580
Adjustments and deferred income	2,576	−302	−10	−976	939	58,979[c]	−65	61,141
Net income	−$24,501	$1,159	$890	−$5,838	−$112,873	$31,666	−$31,942	−$141,439
Combined net income[d]	−$19,600	−$7,435	−$43,463	−$171,183	−$183,606	$33,069	$29,694	−$362,524

[a]Premiums net of unearned premium reserves and allocations to Eximbank for reinsurance of comprehensive policies. Premiums for 1980 through 1983 include fee income of $1.7 million for servicing Eximbank sole risk policies. This fee arrangement was discontinued in 1983.

[b]Gross claims losses and loss adjustment expenses net of recoveries.

[c]1985 amount includes a $58.1 million accounting adjustment for accrual of claims and recoveries.

[d]Combined net income and losses of FCIA and Eximbank, including income and losses ceded to Eximbank by FCIA.

Source: The insurance program results were derived from FCIA financial statements and internal Eximbank program reports and, accordingly, are not intended to correspond with Eximbank's audited financial statements.

U.S. G.P.O. 1987-201-749:60111

Requests for copies of GAO publications should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each publication are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

Address Correction Requested

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100