



OFFICE OF INSPECTOR GENERAL
EXPORT-IMPORT BANK
of the UNITED STATES


Audit of
Export-Import Bank's
Short-Term Insurance Program

September 28, 2012
OIG-AR-12-05



To: Jeffrey Abramson
Vice President, Trade Finance

Walter Kosciow
Vice President, Trade Credit Insurance

From: Rebecca Sharek 
Assistant Inspector General for Audits

Subject: Audit of Export-Import Bank's Short-Term Insurance Program

Date: September 28, 2012

This memorandum transmits Audit Report OIG-AR-12-05, "Audit of Export-Import Bank's Short-Term Insurance Program". Cotton & Company LLP, under a contract issued by the Office of Inspector General, performed the audit. The objective of the audit was to determine whether the Export-Import Bank's Short-Term Insurance Program had effective policies and procedures to manage credit risks and losses as well as to identify and respond to fraud risk during fiscal years 2010 and 2011.

The audit found that (1) Short-Term Insurance Program procedures were not adequately documented or consistently followed; (2) duties were not always segregated appropriately; and (3) system calculations were not always accurate. The auditors made 10 recommendations for corrective action. Management concurred with 6 of the 10 recommendations. For Recommendations A1, A2, B1, B2, D3, and E, management's proposed actions are responsive to the intent of the recommendations. The recommendations are resolved and will be closed upon completion and verification of the proposed actions. Management partially concurred or nonconcurred with the remaining four recommendations. For Recommendations C1, C2, D1, and D2, management's comments and/or proposed actions are unresponsive and do not adequately address the concerns that prompted the recommendations. We reaffirm the basis for both the findings and recommendations and have referred the matter to the Export-Import Bank Audit Follow-Up Official for resolution.

We appreciate the courtesies and cooperation extended to the auditors during the audit. If you have questions, please contact me at (202) 565-3169 or rebecca.sharek@exim.gov.

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September 28, 2012

Rebecca Sharek
Assistant Inspector General for Audit
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Subject: Audit of Export-Import Bank's Short-Term Insurance Program

Dear Ms. Sharek:

We are pleased to submit this report in support of audit services provided to the Export-Import Bank of the United States (Ex-Im)'s Office of the Inspector General. Cotton & Company LLP conducted an independent audit of Ex-Im's short-term insurance program to determine if it had effective policies and procedures to manage credit risk and losses, as well as to identify and respond to fraud risk during FYs 2010 and 2011. Cotton & Company performed the work from March through August 2012.

We conducted this performance audit in accordance with generally accepted government auditing standards, as amended, promulgated by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Please feel free to contact me with any questions.

Sincerely,

COTTON & COMPANY LLP

Matthew Johnson, CPA, CISA, CGFM
Partner

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I. EXECUTIVE SUMMARY

The Export-Import Bank of the United States (Ex-Im Bank) offers export-credit insurance to assist United States (U.S.) exporters in selling their goods overseas by protecting them against the risk of foreign-buyer or other foreign-debtor default for political or commercial reasons. This allows U.S. exporters to extend competitive credit terms to their international customers with reduced risk. The short-term insurance program policies are issued for one year. They cover commercial and political risks; insure open-account or letter-of-credit sales for a large variety of consumer goods, non-durables, spare parts, and bulk agriculture products; and apply to shipments to one or multiple buyers. Ex-Im Bank has two divisions that conduct the short-term insurance program: the Trade Finance Division (TFD) and the Trade Credit Insurance Division (TCID).

Short-term insurance authorizations have significantly increased in recent years due to the worldwide financial crisis. Between fiscal years (FYs) 2007 and 2011, authorizations increased over 106 percent, from \$3.3 billion in FY 2007 to \$6.8 billion in FY 2011. The volume of short-term insurance claims has also increased. Specifically, claims rose 42 percent, from 200 claims in FY 2010 to 284 claims in FY 2011. The claims increase during FY 2011 was isolated to TCID's portfolio and was a result of several frauds that involved multiple exporters. These frauds represented approximately 100 claims.

Cotton & Company LLP, under a contract issued by the Office of Inspector General, completed an independent audit of the Ex-Im Bank short-term insurance program. We performed the audit to determine if the program had effective policies and procedures to manage credit risk and losses as well as to identify and respond to fraud risk during FYs 2010 and 2011.

Our audit found that although procedures exist, these procedures are not adequately documented or consistently followed; duties were not always segregated appropriately; and system calculations were not always accurate. Specifically, we identified the following areas for improvement:

- **Inadequate Written Policies and Procedures.** The strength of existing credit risk management procedures is a direct result of the long tenure and institutional knowledge of short-term insurance program employees. However, the short-term insurance program has not adequately documented its policies and procedures in the form of official policies and directives. Existing documentation was not comprehensive or complete, and in some instances was outdated. Furthermore, program documentation did not identify all risks, including fraud risk factors, and had not consistently identified procedures to address identified risks. (*Finding A*)
- **Inconsistent Character, Reputation, and Transaction Integrity (CRTI) Due Diligence.** The purpose of CRTI due diligence is to identify potential risks related to the trustworthiness of transaction participants, the possibility of negative publicity from Ex-Im Bank's involvement with the transaction, and the possibility that the transaction is not legitimate or involves fraud, corruption, or other suspect practices.

However, short-term insurance program personnel do not always perform proper CRTI due diligence. *(Finding B)*

- **Inconsistent Adherence to Procedures.** Ex-Im Bank personnel inconsistently apply procedures that ensure compliance with program requirements and proper credit risk management. *(Finding C)*
- **Lack of Segregation of Duties.** Ex-Im Bank does not segregate duties for underwriting and authorizing new short-term insurance program policies, new Special Buyer Credit Limits (SBCLs), enhanced assignments, or renewals of high-dollar or high-risk policies. While commercial banks may not always segregate these duties either, all Ex-Im Bank transactions are backed by the full faith and credit of the U.S. Government, and Ex-Im Bank has a duty to properly safeguard taxpayer resources under its stewardship. *(Finding D)*
- **Inaccurate Calculation of Exporter Score.** Ex-Im Online (EOL) calculations of the exporter score, which assists in determining the risk of an exporter for a multi-buyer policy, are not always accurate. *(Finding E)*

The lack of comprehensive written policies and procedures may result in inconsistent performance of duties, reduce the effectiveness of the program's controls, and reduce productivity. In addition, lack of compliance with the program's policies and procedures, improper segregation of duties, and reliance on inaccurate data may cause the program to assign the wrong level of risk to a transaction. As a result, insurance policies may be authorized with risk levels higher than Ex-Im Bank would otherwise accept, increasing the risk of financial loss to the Ex-Im Bank through claims or through issuance of insurance policies based on erroneous and potentially fraudulent information, or Ex-Im Bank may assign a higher level of risk than appropriate and not offer the insured the best policy terms.

To address these issues, we recommended that the short-term insurance program:

- Document and implement comprehensive policies and procedures for the short-term insurance program. This includes implementing enhanced procedures for applications that have elevated business risk or fraud risk. *(Recommendations A1 and A2)*
- Require that officials authorizing insurance policies verify that CRTI due diligence was completely performed and properly documented prior to approving the policy. *(Recommendation B1)*
- Develop and implement a monitoring process for periodically reviewing a sample of credit decisions and ensure that the due diligence performed complied with the program's policies and procedures. *(Recommendations B2, C2, and D3)*
- Develop and implement a due diligence procedure checklist that is completed by the official authorizing the short-term insurance policy prior to approval. *(Recommendation C1)*

- Require a separation of duties between staff performing the underwriting process and the official authorizing all new policies, new SBCLs over \$5,000, all enhanced assignments, all renewals over \$1 million, and all high-risk policy renewals. (*Recommendations D1 and D2*)
- Implement controls to ensure that exporter score calculations used during underwriting are reliable. (*Recommendation E1*)

Management's response to our recommendations is reprinted in Appendix III.

II. BACKGROUND

Ex-Im Bank is an independent executive agency and a wholly-owned U.S. government corporation. Ex-Im Bank assumes credit and country risks that the private sector is unable or unwilling to accept. It also helps U.S. exporters remain competitive by countering export financing provided by foreign governments on behalf of foreign companies.

Ex-Im Bank provides working capital guarantees (pre-export financing), export-credit insurance, and loan guarantees and direct loans (buyer financing). Ex-Im Bank offers export-credit insurance to assist U.S. exporters in selling their goods overseas by protecting them against the risk of foreign-buyer or other foreign-debtor default for political or commercial reasons. This allows U.S. exporters to extend competitive credit terms to their international customers with reduced risk. Insurance policies may cover short- or medium-term sales, commercial and political risks, and shipments to one or multiple buyers.

Ex-Im Bank's short-term insurance program policies insure open-account or letter-of-credit sales for a large variety of consumer goods, non-durables, spare parts, and bulk agriculture products produced in the U.S. Policies are available for terms up to 180 days for most products. Policies for bulk agricultural and capital and/or quasi-capital goods may be available for up to 360 days. Between FYs 2007 and 2011, authorizations increased over 106 percent, from \$3.3 billion in FY 2007 to \$6.8 billion in FY 2011. Ex-Im Bank authorized \$6.8 billion in short-term insurance during FY 2010. It authorized an additional \$6.8 billion in FY 2011.

To be eligible for Ex-Im Bank's short-term insurance program, goods must have more than 50 percent U.S. content and be shipped from the U.S. Services must be performed by U.S.-based personnel. Defense articles and services, as well as military buyers, are prohibited, although some exceptions may apply.

Ex-Im Bank has two divisions that conduct the short-term insurance program: TCID and TFD. Each division has multiple products supporting program objectives, as shown in the following table:

TCID	TFD
Multi-Buyer (Exporters): <ul style="list-style-type: none"> • Standard Policy • Standard Political-Only Policy • Reasonable Spread of Risk Policy • Small Business Policy • Small Business Environmental Policy • Small Business Express Policy 	Single Buyer (Exporters): <ul style="list-style-type: none"> • Comprehensive Policy • Political-Only Policy Single Buyer (Financial Institutions): <ul style="list-style-type: none"> • Financial Institution Buyer Credit Export Insurance – Buyer Credits • Financial Institution Buyer Credit Export Insurance – Supplier Credits Multi-Buyer (Financial Institutions): <ul style="list-style-type: none"> • Bank Letter-of-Credit Policies

Depending on the product, policy terms are typically one year and may be renewable. Coverage is normally 90-95 percent, and premiums are determined based on various risk factors. Claims may not be filed earlier than 90 days after a default date (60 days for Bank Letter-of-Credit policies). Similarly, claims may not be filed more than 8 months after a default date (120 days for Bank Letter-of-Credit policies and 150 days for Financial Institution Buyer Credit policies).

TCID’s multi-buyer portfolio consists of a high volume of small transactions, while TFD’s portfolio consists of lower-volume, higher-dollar transactions. In addition, the focus of the due diligence performed during underwriting differs. TCID performs due diligence on the insured—the exporter—and the insured’s ability to manage export credit decisions, especially because buyers are not usually known to Ex-Im Bank at the time of underwriting. TCID will, however, perform due diligence on a buyer if an SBCL is requested. TFD due diligence is performed on the insured as well as the primary source of repayment, which is typically the buyer.

The tables below show Ex-Im Bank’s total short-term insurance program policy authorizations and claims managed by TCID and TFD in FYs 2010 and 2011.¹

Authorizations

Insurance Program	Fiscal Year 2010		Fiscal Year 2011	
	Quantity	Value	Quantity	Value
TCID Multi-Buyer (Exporter)	2,061	\$1,805,809,201	2,340	\$1,953,152,136
TFD Single Buyer (Exporter)	378	166,733,572	388	162,310,102
TFD Single Buyer (Financial Institution)	180	541,549,000	200	733,198,000
TFD Multi-Buyer (Financial Institution)	<u>59</u>	<u>4,272,000,000</u>	<u>63</u>	<u>3,915,000,000</u>
Totals	2,678	\$6,786,091,773	2,991	\$6,763,660,238

¹ Represents all claims filed in the current and previous fiscal years with decisions made in either FY 2010 or FY 2011. Totals include approved, denied, and withdrawn claims.

Claims

Insurance Program	Fiscal Year 2010		Fiscal Year 2011	
	Quantity	Value	Quantity	Value
TCID Multi-Buyer (Exporter)	178	\$4,724,944	266	\$12,542,781
TFD Single Buyer (Exporter)	4	352,409	4	481,005
TFD Single Buyer (Financial Institution)	18	26,635,811	14	21,302,013
TFD Multi-Buyer (Financial Institution)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Totals	200	\$31,713,164	284	\$34,325,799

Details for each of the short-term insurance program's products are in Appendix II.

III. OBJECTIVES

The audit objective was to evaluate whether Ex-Im Bank has effective policies and procedures to manage credit risk and losses and identify and respond to fraud risk for its short-term insurance program. Specifically, we determined if Ex-Im Bank had established effective policies and procedures related to short-term insurance credit-underwriting due diligence and, if applicable, exported merchandise was shipped to the approved, designated country. The objective also included determining if Ex-Im Bank complied with its own short-term insurance program policies and procedures and applicable laws, rules, and regulations.

IV. AUDIT RESULTS

Key elements to ensure that Ex-Im Bank has effective policies and procedures in the short-term insurance program to manage credit risk and losses, as well as fraud risk, include:

- Identifying internal and external risks to the program, including those related to fraud; analyzing the potential impact to the program; and identifying and implementing control activities that mitigate the risks.
- Documenting and communicating program policies and procedures to all relevant personnel.
- Ensuring that policies and procedures are carried out completely and consistently.

Our audit found that although procedures exist, the procedures are not adequately documented or consistently followed; duties were not always segregated appropriately; and system calculations were not always accurate. We identified the following areas for improvement.

A. Inadequate Written Policies and Procedures

Although the short-term insurance program generally employed effective procedures, we found that the program had not adequately documented those procedures in its formal policies and directives. Instead, the program relied heavily on the long tenure and institutional knowledge of its personnel; one-on-one knowledge transfer among personnel; and materials that are publically available, including marketing materials and instructions or

notices to applicants, to communicate program policies and procedures. We found that existing program documentation was not comprehensive or complete, and in some instances was outdated.

TFD does not have formal, written credit due diligence policies and procedures. Instead, it relies on an informal desk-procedures document, *Instructions for the Preparation of Credit Memoranda*, which provides guidance on the proper format and content of underwriting summary memoranda and serves as a guideline for the underwriting process. We noted that TCID is currently updating its policies and procedures; however, TCID had not updated its primary policy and procedure document, the *Exporter Underwriting Manual*, since 1998. We also found that Ex-Im Bank's *Short Term Credit Standards*, which is used internally by Ex-Im Bank's personnel as well as by customers and brokers, does not include credit standards for Ex-Im Bank's new Express Insurance product.

In addition, short-term insurance program documentation did not always clearly identify program risks, including fraud risks, and processes to address these risks. While Ex-Im Bank has identified general risk factors, the short-term insurance program documentation generally did not identify the risks specific to individual policy types. For the risks that were identified, the specific procedures or processes designed to address the risks were not always documented.

Finally, we observed that the level of due diligence performed was generally based on the dollar value of the transaction. While program personnel may perform additional due diligence on some transactions that may have higher business or fraud risk, the program does not have clear guidance as to when enhanced due diligence may be necessary and the amount of due diligence that may be appropriate. For example, if fraud risk factors are identified, expanded due diligence may include requiring financial statements that are reviewed or audited by a licensed certified public accountant (CPA), verifying that the CPA is licensed, and contacting the licensed CPA to confirm that they prepared the review or audit report.

Comprehensive policy and procedure documentation should clearly state program objectives, identify risks that impact the program's ability to meet its stated objectives, and identify procedures that the program employs to obtain reasonable assurance that stated objectives are met. The documentation should also provide personnel with a clear understanding of program objectives as well as management's policies and directives, and should enable personnel to carry out their job function.

U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* states:

Effective internal control helps in managing change to cope with shifting environments and evolving demands and priorities. As programs change and as agencies strive to improve operational processes and implement new technological developments, management must continually assess and evaluate its internal control to assure that the control activities being used are effective and updated when necessary...

Management is responsible for developing the detailed policies, procedures, and practices to fit their agency's operations and to ensure that they are built into and an integral part of operations....

Internal control and all transactions and other significant events need to be clearly documented [...] The documentation should appear in management directives, administrative policies, or operating manuals....

The lack of comprehensive written policies and procedures that reflect current practices and programmatic risks may cause gaps in the program's internal controls, create inconsistency in the performance of duties, reduce the effectiveness of the program's control, reduce productivity, and result in the loss of institutional knowledge. This increases the risk of financial loss to Ex-Im Bank through claims or through issuance of insurance policies based on erroneous and potentially fraudulent information.

We recommended that TCID and TFD:

- Document policies and procedures through the use of management directives, administrative policies, and operating manuals, and review and update them regularly (as needed or at least once every 3 years). Documentation should identify Ex-Im Bank's risks, including fraud risks, and procedures to address these risks.
(*Recommendation A1*)
- Implement enhanced due diligence procedures for insurance applications that may have elevated business risks or fraud risks, and document these procedures in the Short-Term Insurance Program's policy and procedure documentation.
(*Recommendation A2*)

Management's Response

The Vice Presidents of TCID and TFD stated that both divisions have drafted updated Operating Manuals as part of a Bank-wide effort to consolidate, document, and update policies and procedures across all Bank programs. According to the Vice Presidents, these policies and procedures will address enhanced due diligence procedures for applications that represent elevated business or fraud risks.

TCID is completing final edits to its Manual update which will approach a total of 100 pages, encompassing risk management guidelines, credit decision making procedures, and insurance coverage tailoring advice for all TCID transaction types (Quotation, Renewal & Amendment of Exporter Multibuyer Insurance policies; Approval, Renewal, Amendment of [foreign] Buyer Credit Limit transactions; Approval, Renewal of Enhanced Assignment Agreements which protect lenders against exporter performance risk). TCID's Manual will be delivered on or before September 14, 2012 to both Cotton & Company and Ex-Im Bank's Credit Review Division.

Specifically with regards to fraud prevention and detection practices, TCID is also producing a brief manual of procedures and monitoring practices to diligently monitor the portfolio of approximately 90 Enhanced Assignment Agreements. These practices are intended to help manage this “elevated risk” portfolio component and to identify, deter, or initiate intervention where exporter fraud may be suspected.

TCID will have one Loan Specialist (without credit authority) assuming the Compliance Officer role to semiannually review each Enhanced Assignment exporter’s policy activity, review policy management/performance, request sample transaction documentation from each exporter’s respective lenders, and perform validation inquiries with shipping companies identified in the sample transaction documents to verify the exporter’s transactions were made. A semi-annual summary will be produced by the Compliance Officer on each Enhanced Agreement exporter and circulated to TCID and TFD management.

TCID is targeting September 14, 2012 for a vetting draft to be circulated to TFD, the Credit Review Division, and the Executive Working Group for internal consensus ahead of producing the final draft that will govern implementation (October 2012).

Evaluation of Management’s Response

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

B. Inconsistent CRTI Due Diligence

Short-term insurance program personnel are required to ensure that proper CRTI due diligence is completed before approving new or renewed authorizations. The purpose is to identify potential risks related to the trustworthiness of transaction participants, the possibility of negative publicity from Ex-Im Bank’s involvement with the transaction, and the possibility that the transaction is not legitimate or involves fraud, corruption, or other suspect practices. Specific controls include ensuring that TCID and TFD:

- Obtain a signed Ex-Im Bank Certifications and Notices Statement from the applicant confirming that all transaction participants comply with U.S. laws and regulations and international trade agreements, and are not on U.S. or international debarment lists.
- Submit the names of all relevant parties involved in each transaction to the Ex-Im Bank Library. The Library searches 19 databases, which include federal and international debarment and sanction lists, news items, and legal notices, for potential matches of names and addresses. Any match identified must be cleared by Ex-Im Bank’s Credit Review and Compliance Division. This search is required for all new policies, policy renewals, issuing bank credit limit (IBCL) requests, and SBCL requests.

Our testing confirmed that Ex-Im Bank did not always perform complete CRTI due diligence. During our testing of 159 authorizations and 19 SBCL or IBCL decisions during FYs 2010 and 2011, we noted the following:

- For nine authorizations, the program was not able to provide evidence that the applicant completed the Certification and Notices Statement.
- For five authorizations, the program was not able to provide evidence that a CRTI search was performed.
- For one authorization, TFD requested that a CRTI search be performed on the buyer, but not on the exporter.
- For two authorizations, the CRTI search was not performed because of an error in EOL transaction reporting. During early FY 2010, transactions selected for “Auto Underwriting” were not included in the activity report, which TCID uses to compile the list given to the Library to perform CRTI searches. This error was identified by TCID and corrected during FY 2010. We noted this same condition for two SBCL decisions tested during our additional claims testing.

Ex-Im Bank’s *Character, Reputational, and Transaction Integrity Due Diligence Internal Policies and Procedures* requires that applicants provide certifications and warranties that transactions are legitimate and that participants are of suitable reputation and character; that underwriters independently verify whether a known transaction participant (including lenders, exporters, and suppliers) appears on any of the Prohibited or Restricted Parties lists maintained by Ex-Im Bank, the U.S. Government, certain foreign governments, and/or multilateral organizations; and that all due diligence is maintained in the transaction file.

Without proper CRTI due diligence, short-term insurance policies may be authorized with risk levels higher than Ex-Im Bank would otherwise accept. This increases the risk of financial loss to Ex-Im Bank, either through claims or through issuance of insurance policies based on erroneous and potentially fraudulent information.

We recommended that TCID and TFD:

- Develop and implement policies and procedures to ensure that individuals with delegated authority verify that complete CRTI due diligence is performed and documented before approving a policy, such as requiring an indicator on the credit decision memo showing that CRTI due diligence was completed and properly documented. (*Recommendation B1*)
- Develop and implement a monitoring process for periodically reviewing a sample of short-term insurance program authorizations to ensure that CRTI due diligence complies with policies and procedures. (*Recommendation B2*)

Management's Response

The Vice Presidents of TCID and TFD stated that both divisions have established practices in place for performing CRTI due diligence as part their respective transaction credit decision making processes. Further, they noted that (1) this due diligence is inherently the responsibility of the individual exercising delegated credit authority, and (2) what may be inconsistent is how each individual with credit authority, or a subordinate credit officer producing the credit memorandum for the individual having Individual Delegated Authority, is documenting the CRTI performance. Credit decision memorandum templates or online system Underwriting Summaries can be amplified for a necessary memo indicator confirming performance of CRTI prior to formal transaction document production. In addition, the Vice Presidents expect that the Credit Review and Compliance Division will continue to perform regular reviews of transactions authorized under delegated authority that would encompass monitoring of the documentation of the CRTI process being completed. The Vice Presidents noted that the "hit rate" of matches determined through the current CRTI search process is extremely low which suggests that incremental risk is limited in this area.

Evaluation of Management's Response

Management's proposed actions, in conjunction with management's actions provided for in response to recommendations A1/A2, are responsive; therefore, the recommendations are resolved and will be closed upon completion and verification of the proposed actions.

C. Inconsistent Adherence to Procedures

We tested a sample of 167 short-term insurance policies authorized by TCID and TFD, as well as 15 SBCLs and 4 IBCLs, to determine if Ex-Im Bank complied with existing due diligence policies and procedures. We found:

- **One authorization tested did not meet Ex-Im Bank's U.S. content requirement.** During the underwriting process, the Relationship Manager (RM) reviews the short term insurance application to ensure that the applicant has affirmed the U.S. content of the goods being exported and that the product description on the application is likely to have more than 50 percent U.S. content. However, TFD authorized a Financial Institution Buyer Credit policy even though the application stated that the exported goods did not meet the U.S. content requirement. While the supplier may not have been known at the time of application and the insured would have received an "Exporter's Certificate" which would have provided evidence of the shipment's U.S. content after shipment in the event of a claim, the RM manager should have performed additional due diligence to determine if the exported goods would meet the U.S. content requirement.
- **One authorization was issued at an amount higher than what was recommended by both the underwriter and approver.** The insured requested a \$2.1 million policy, which was entered into EOL. TFD determined that the requested

exposure was too high a repayment risk for Ex-Im Bank and recommended and approved a lower policy limit of \$1.0 million. Neither the underwriter nor approver changed the original insurance policy amount in EOL, nor was the error detected prior to the approval or the issuance of the authorization.

- **One SBCL with a credit limit of \$200,000 was approved although the Short-Term Credit Standards (STCS) were not met.** Ex-Im Bank has established STCS as the standardized basis for evaluating the creditworthiness of parties for each type of short-term policy. Any standards not met should be mitigated by some additional information that helps increase the likelihood of repayment. For a SBCL of \$200,000, STCS require a favorable credit agency report and one of the following: a trade reference with similar amount and terms, the applicant's ledger experience with similar amount and terms, or the buyer's signed financial statement for the two most recent fiscal years. However, we observed that for one SBCL with a credit limit of \$200,000, the credit report that TCID obtained on the buyer was not favorable, and TCID did not obtain a favorable trade reference, ledger history, or financial statements as required. Furthermore, the missed STCS were not mitigated by the underwriter.

During our review of the underwriting history of policies that had claims, we also found one SBCL authorization in which the buyer did not meet the STCS requirement for years of experience. Per the underwriting summary, TCID mitigated the missed standard based on the buyer's favorable credit report and financial condition. TCID was not able to provide the credit report that supports these mitigating factors.

Content Policy for Short-term Programs (Inst-12-010) states that to be eligible for Ex-Im Bank support, "Each Product must have more than 50% U.S. content based on labor, material, and direct overhead, exclusive of any profit."

Office of Management and Budget Circular A-123, *Management Accountability and Control*, states that management should develop controls that reasonably ensure that "reliable and timely information is obtained, maintained, reported and used for decision making."

Ex-Im Bank Short Term Credit Standards (EIB 99-09) states that:

...the criteria Ex-Im Bank will apply in evaluating the creditworthiness of the primary source of repayment or, in the case of the multi-buyer product, the ability of the exporter to manage and evaluate credit in a reasonable and prudent manner...

Ex-Im Bank will consider approval of an application that does not entirely meet the standards if mitigating credit factors exist.

By not adhering to underwriting policy and procedures, Ex-Im Bank authorized a policy that did not comply with its mission to assist in financing the export of U.S. goods and services. In addition, Ex-Im Bank authorized a policy and an SBCL with risk levels higher than what Ex-Im Bank would otherwise accept and that did not conform to Ex-Im Bank's standards.

We recommended that TCID and TFD:

- Develop and implement a due-diligence procedure checklist that is completed by individuals with delegated authority to approve authorizations, SBCLs, and IBCLs. (*Recommendation C1*)
- Develop and implement a monitoring process for periodically reviewing a sample of authorizations to ensure that the decision complied with Ex-Im Bank's policies and procedures. (*Recommendation C2*)

Management's Response

The Vice Presidents of TCID and TFD stated that they do not believe that a checklist that simply indicates whether basic action has been taken, without the result of that action, enhances a decision-makers ability to establish that sufficient action has been taken. Furthermore, they stated that decision-memorandum templates were developed in an effort to guide loan officers to address essential items of analysis in a manner that allows the decision-maker to assess whether or not the due diligence performed was sufficient.

The Vice Presidents stated that Ex-Im Bank's Short Term Credit Standards serve a dual purpose of offering customers transparency and a means to assure consistency on how their credit transactions are being evaluated. The Standards also offer credit officers, with or without Individual Delegated Authority, a framework for their credit analysis. However, each transaction may have unique material adverse issues or require comprehensive justification to mitigate a missed credit standard. The Vice Presidents noted that the Bank's Credit Review and Compliance Division annually audits random sample TCID and TFD transactions with the objective of assessing the quality of the credit decision making justifications and adherence to prescribed due diligence practices.

Evaluation of Management's Response

Our recommendation to develop and implement a due-diligence procedures checklist is intended to ensure individuals with delegated authority to approve authorizations consider all variables when making determinations. We agree that such a checklist by itself will not enhance a decision-maker's ability to establish that sufficient action has been taken; however, it will provide a tool for ensuring that decision-makers have taken all factors into consideration prior to making a determination.

Additionally, management should establish review procedures to monitor decisions for compliance with policies and procedures.

Management's comments are considered unresponsive; therefore, the recommendations are unresolved and will be referred to the Ex-Im Bank Audit Follow-Up official.

D. Lack of Segregation of Duties

The TCID multi-buyer portfolio consists of a high volume of small transactions. During FYs 2010 and 2011, TCID authorized over 4,300 policies, as depicted in the following table:

	FY 2010		FY 2011	
	Count	Total	Count	Total
New Policies	472	\$385,646,600	523	\$331,459,290
Policy Renewals	1,569	\$1,366,562,601	1,814	\$1,621,201,539
Total	2,041	\$1,752,209,201	2,337	\$1,952,660,829

We noted that the same individual performed both underwriting and approvals of 62 of the 98 TCID authorizations included in our testing. This is allowed under Ex-Im Bank's Board of Directors' Individual Delegated Authority Board Resolution dated July 26, 2010, and authorized individuals approved all policies. TCID could, however, strengthen its controls over authorizations by segregating underwriting and approving functions. This segregation of duties exists in TFD.

TCID has historically employed this risk-based approach, which identifies and measures risk based on the dollar value of the transaction and delegates authority based on the knowledge, skills, and qualifications of personnel, because of the high volume of TCID transactions. While similar practices may occur in the commercial market, Ex-Im Bank has a duty to the taxpayer to safeguard its resources, as all Ex-Im Bank transactions are backed by the full faith and credit of the U.S. Government.

U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* states:

Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

Because the same individual within TCID frequently performs underwriting, approval, and authorization, policies may be authorized with risk levels higher than Ex-Im Bank would otherwise accept. This increases the risk of financial loss to Ex-Im Bank, either through claims or through issuance of insurance policies based on erroneous and potentially fraudulent information.

We recommended that TCID:

- Require separate individuals to perform the underwriting and approving functions for all new multi-buyer policies, all new SBCLs over \$5,000, and all enhanced assignments. (*Recommendation D1*)

- Require separate individuals to perform the underwriting and approving functions for all policy renewals with a limit over \$1 million or with an enhanced assignment or if the transaction has elevated business or fraud risks. (*Recommendation D2*)
- Develop and implement periodic reviews of authorizations underwritten and approved by the same individual to ensure that decisions complied with Ex-Im Bank's due diligence policies and procedures. (*Recommendation D3*)

Management's Response

The Vice President of TCID stated that the division processes well over 16,000 transactions annually, many of which are small (less than \$300,000) foreign buyer credit limits. Cycle times and customer service goals are tight, hence it is impractical to segregate underwriting and authorizing duties on each TCID transaction. The Vice President proposed that segregation of duties apply on only the most elevated risk transactions, represented by all Enhanced Assignment Agreement transactions, \$1,000,000 or larger multibuyer policies with loss ratios exceeding 100 percent, and buyer foreign credit transactions where footnotes 4, 5, 11, and 13 apply or the per buyer exposure exceeds \$1,000,000. The Vice President noted that the online system currently is programmed to require segregated duties for both policy and buyer credit limit decision making based on progressively higher amounts and some of the noted footnotes.

Further, the Vice President proposed that, in addition to the Credit Review and Compliance Division's annual audit of sample TCID transaction underwriting, TCID management conduct its own internal, annual audit of transaction samples of each officer with Individual Delegated Authority. The summary findings would be shared with the Credit Review and Compliance Division.

Regarding segregation of duties within TFD, management noted that TFD intends to shortly grant Individual Delegated Authority to loan officers who would then both underwrite and authorize certain short-term transactions. TFD intends to limit the amount and risk profile of transactions that could be processed under this authority. Each transaction would continue to require prior supervisor screening for directing the loan officer towards decision making action under their own authority.

Evaluation of Management's Response

Key duties and responsibilities must be divided or segregated among different individuals to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing, processing and recording, and reviewing transactions, as well as for handling any related assets. No one individual should control all key aspects of a transaction or event.

Management's proposed actions are considered unresponsive; therefore, recommendations D1 and D2 are unresolved and will be referred to the Ex-Im Bank Audit Follow-Up official.

With respect to our recommendation D3 for developing and implementing periodic reviews of authorizations underwritten and approved by the same individual, TCID proposed that management conduct annual internal audits of transaction samples for each officer with Individual Delegated Authority. These audits, when accomplished, should satisfy the recommendation. The recommendation is resolved and will be closed upon completion and verification of the proposed actions.

E. Inaccurate Calculation of Exporter Score

TCID relies on the exporter score to quantify potential exporter risk during the credit underwriting process for short-term multi-buyer policies. The score is a composite of ten components and is calculated by EOL from data in the application or from information entered by the RM. During our testing, we observed that EOL did not always properly calculate the exporter score. Specifically, we noted that during renewal underwriting, 2 of the 10 components were not always updated. This error resulted in an exporter score that was less favorable for the exporter than it would have been had the score been calculated correctly. TCID did not detect this error.

Office of Management and Budget Circular A-123, *Management Accountability and Control*, states that management should develop controls that reasonably ensure that “reliable and timely information is obtained, maintained, reported and used for decision making.”

TCID relies upon exporter scores that may be inaccurately calculated during renewal, which may result in a score that is lower than it would be had it been calculated correctly. As a result, the short-term insurance program may determine that an exporter or transaction is a higher risk to Ex-Im Bank than it actually is, thus providing the exporter with less favorable terms for the insurance policy than is appropriate.

We recommended that TCID work with Information Technology Systems Engineering to implement controls to ensure that EOL’s exporter score calculations used during underwriting are accurate. (*Recommendation E*)

Management’s Response

The Vice President of TCID noted that the “Exporter Score” is calculated and used only in the underwriting of an exporter short term multibuyer policy. The score is intended to differentiate multibuyer policy exporters based on the quality of their foreign receivable portfolio and how well they manage foreign credit. The score is then used towards consideration of granting nominal delegated credit authority (Discretionary Credit Limit) to the exporter for making smaller foreign buyer credit decisions, effectively reducing a large administrative burden on TCID staff (approximately 15,000 buyer approvals annually). The score also contributes towards TCID loan officer’s underwriting Special Buyer Credit Limits which are required for transactions exceeding the exporters delegated credit authority or if the Country Limitation Schedule restricts use of that authority.

The Vice President stated that TCID is requesting modifications within EOL to assure accurate calculation is made on quotations, renewal, and amendment of multibuyer policies. The requirements have been presented to the IMT Division and programmer/developers will build in the modifications for user acceptance testing by the end of 2012. The tested functionality should be operable by January 2013. In the meantime, instruction has been disseminated to TCID staff to manually validate accurate Exporter Scores at each policy renewal.

Evaluation of Management’s Response

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

V. SCOPE AND METHODOLOGY

The Office of Inspector General engaged Cotton & Company to conduct this audit. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted our fieldwork from March 14 – June 21, 2012. To accomplish our objectives, we assessed Ex-Im Bank’s policies and procedures over its short-term insurance program. Our methodology required that we interview key Ex-Im Bank staff from TCID and TFD to obtain an understanding of Ex-Im Bank’s short-term insurance program and to obtain relevant information and documentation applicable to the program. We also obtained documentation from Ex-Im Bank’s external financial statement auditors to assist us in our understanding of the program.

We also selected samples from policies authorized, SBCL and IBCLs approved, and claims paid in FYs 2010 and 2011. Sample sizes by policy types are shown below.

Authorizations Sampled

Policy Type	New		Renewals		Amendments		Totals	
	Count	Amount	Count	Amount	Count	Amount	Count	Amount
Multi-Buyer	65	\$61,400,000	33	\$91,100,000	2	\$6,500,000	100	\$159,000,000
Single Buyer	22	88,810,426			3	2,944,858	25	91,755,284
Financial Institution Buyer	24	187,514,000			3	11,295,000	27	198,809,000
Bank Letter of Credit	<u>10</u>	<u>185,000,000</u>	<u>5</u>	<u>51,000,000</u>	<u>0</u>	<u>0</u>	<u>15</u>	<u>236,000,000</u>
Sample Total	121	\$522,724,426	38	\$142,100,000	8	\$20,739,858	167	\$685,564,284
Population Total	2,114	\$2,446,541,118	3,495	\$10,989,764,140	60	\$113,446,752	5,669	\$13,549,752,011
Percent of Population	6%	21%	1%	1%	13%	18%	3%	5%

SBCLs and IBCLs Sampled

Policy Type	SBCL\IBCLs	
	Count	Amount
Multi-Buyer	15	\$6,200,000
Bank Letter of Credit	<u>4</u>	<u>17,704,829</u>
Sample Total	<u>19</u>	<u>\$23,904,829</u>

Claims Sampled

Product	Count	Amount Paid
Multi-Buyer	44	\$3,474,480
Single Buyer	1	224,761
Financial Institution Buyer Credit	2	1,294,871
Bank Letter of Credit	<u>0</u>	<u>0</u>
Sample Total	<u>47</u>	<u>\$4,994,112</u>
Population Total	484	\$66,038,963
Percent of Population Tested	10%	8%

For each of the sampled policies, we tested Ex-Im Bank's compliance with existing policies and procedures and evaluated them for adequacy. For claims, we evaluated compliance with policies and procedures and evaluated the sufficiency of Ex-Im Bank claim reviews. We also reviewed the underwriting history for 31 of the claims tested, as shown below.

Underwriting Review of Claims

Product	Claims	
	Count	Amount Paid
Multi-Buyer	28	\$2,234,172
Single Buyer	1	224,761
Financial Institution Buyer Credit	2	1,294,871
Bank Letter of Credit	0	<u>0</u>
Sample Total	31	\$3,753,804

APPENDIX I
ACRONYMS

ACRONYMS

CPA	Certified Public Accountant
CRTI	Character, Reputation, and Transaction Integrity
EOL	Ex-Im Online
Ex-Im Bank	Export-Import Bank of the United States
FY	Fiscal Year
IBCL	Issuing Bank Credit Limit
RM	Relationship Manager
SBCL	Special Buyer Credit Limit
STCS	Short-Term Credit Standards
TCID	Trade Credit Insurance Division
TFD	Trade Finance Division
U.S.	United States

APPENDIX II
SHORT-TERM INSURANCE PROGRAM PRODUCTS

SHORT-TERM INSURANCE PROGRAM PRODUCTS

Policy Name	Multi-Buyer	Single Buyer	Financial Institution Buyer	Bank Letter of Credit
Policy Holder	Exporter	Exporter	Financial Institution	Financial Institution
Insures	An exporter's sales to multiple foreign buyers against the risk of non-payment.	An exporter's sales to a single foreign buyer against the risk of non-payment.	A financial institution's short-term direct buyer credit loan or reimbursement loan made to a foreign buyer financing U.S. exports.	The U.S. financial institution's irrevocable letters of credit issued by foreign financial institution that finance U.S. exports.
Risk covered	Commercial and Political			
Exports Covered	Exports must contain more than 50% U.S. content. Exporters of military and defense-related goods and materials are usually excluded.			
Rate of Coverage	100% for sovereign buyers 95% for private buyers 98% for approved agricultural commodities	100% for sovereign buyers 90% for private buyers 98% for approved agricultural commodities	100% for sovereign obligors or guarantors 90% for private obligors or guarantors 98% for approved agricultural commodities	100% for sovereign financial institutions 95% for private financial institutions 98% for approved agricultural commodities
Standard Terms	Policies are authorized for one year and may be renewed. Transaction repayment terms must be no more than 180 days for most goods and services, with the exception of 360 days for some qualifying transactions			
Premiums	Composite rate is calculated based on spread of risk, buyer type, and length of credit terms extended. Requires an advance deposit of \$500.	Varies depending on country, type of buyer, and length of credit term. Minimum premiums are required.	Varies depending on country, type of buyer, and length of credit term. Requires an advance deposit of \$2,000.	Uses a risk-based pricing system that reflects major risk elements of each transaction. Requires an advance deposit of \$2,000.

APPENDIX III
MANAGEMENT RESPONSE



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

MEMORANDUM

September 18, 2012

TO: Alice Albright, Chief Operating Officer

CC: John McAdams, Senior Vice President, Export Finance
Charles Tansey, Senior Vice President, Small Business

FROM: Walter Kosciow, Vice President, Trade Credit Insurance
Jeffrey Abramson, Vice President, Trade Finance

SUBJECT: Management Response to OIG Draft Audit (conducted by Cotton and Company) on Short-term Insurance Programs—OIG-AR-12-05

The follow is the management response to the Office of the Inspector General's draft audit report of August 15.

Recommendations A1/A2: Document comprehensive short term insurance policies/procedures (A1) and implement enhanced due diligence procedures (A2)
Both the Trade Finance Division (TFD) and Trade Credit Insurance Division (TCID) have drafted updated Operating Manuals as part of a Bank-wide effort to consolidate, document and update policies and procedures across all bank programs. These policies and procedures will address enhanced due diligence procedures for applications that represent elevated business or fraud risks.

TCID is completing final edits to its Manual update which will approach a total of 100 pages, encompassing risk management guidelines, credit decision making procedures, and insurance coverage tailoring advice for all TCID transaction types (Quotation, Renewal & Amendment of Exporter Multibuyer Insurance policies; Approval, Renewal, Amendment of (foreign) Buyer Credit Limit transactions; Approval, Renewal of Enhanced Assignment Agreements which protect lenders against exporter performance risk. TCID's Manual will be delivered on or before September 14, 2012 to both the Cotton Co. and Ex-Im Bank's Credit Review Division (CRD).

Specifically with regards to fraud prevention and detection practices, TCID is also producing a brief manual of procedures and monitoring practices to diligently monitor the portfolio of approximately 90 Enhanced Assignment Agreements (EA). These practices are intended to help manage this "elevated risk" portfolio component and to identify, deter, or initiate intervention where exporter fraud may be suspected.

TCID will have one Loan Specialist (without credit authority) assuming the Compliance Officer role to semiannually review each EA exporter's policy activity, policy management/performance, request sample transaction documentation from each exporter's respective lenders, and perform validation inquiries with shipping companies identified in the sample transaction documents to verify the exporter's transactions were made. A semi-annual summary will be produced by the Compliance Officer on each EA exporter and circulated to TCID and TFD management.

We are targeting September 14, 2012 for a vetting draft to be circulated to TFD, CRD, EWG for internal consensus ahead of producing the final draft that will govern implementation (October 2012).

Recommendations B1/B2: Perform, Document and Monitor CRTI Due Diligence

TCID and TFD have established practices in place for performing CRTI due diligence as part their respective transaction credit decision making processes. This due diligence is inherently the responsibility of the individual exercising delegated credit authority (IDA). What may be inconsistent is how each individual with credit authority, or a subordinate credit officer producing the credit memorandum for the individual having IDA, is documenting the CRTI performance. Credit decision memorandum templates or online system Underwriting Summaries can be amplified for a necessary memo indicator confirming performance of CRTI prior to formal transaction document production. In addition, we expect that the Credit Review and Compliance Division will continue to perform regular reviews of transactions authorized under delegated authority that would encompass monitoring of the documentation of the CRTI process being completed. We note that the "hit rate" of matches determined through the current CRTI search process is extremely low which suggests that incremental risk is limited in this area.

Recommendations C1/C2: Develop a due-diligence procedures checklist and monitor compliance with policies and procedures for transactions authorized via Individual Delegated Authority

We do not believe that a checklist that simply indicates whether basic action has been taken, without the result of that action, enhances a decision-makers ability to establish that sufficient action has been taken. The decision-memorandum templates were developed in an effort to guide loan officers to address essential items of analysis in a manner that allows the decision-maker to assess whether or not the due diligence performed was sufficient.

Ex-Im Bank's Short Term Credit Standards serve a dual purpose of offering customers transparency and a means to assure consistency on how their credit transactions are being evaluated. The Standards also offer credit officers, with or without IDA, a framework for their credit analysis. However, each transaction may have unique material adverse issues or require comprehensive justification to mitigate a missed credit standard. The Bank's Credit Review and Compliance Division annually audits random sample TCID and TFD transactions with the objective of assessing the quality of the credit decision making

justifications and adherence to prescribed due diligence practices. (Please also refer to response to Recommendations D1-D3 on “Segregation of Duties” as it relates to TCID)

Recommendations D1-D3: Lack of Segregation of Underwriting Duties

TCID processes well over 16,000 transactions annually, many of which are small (less than \$300,000) foreign buyer credit limits. Cycle times and customer service goals are tight, hence it is impractical to segregate underwriting and authorizing duties on each TCID transaction. We propose that segregation of duties apply on only the most elevated risk transactions, represented by all Enhanced Assignment Agreement transactions, \$1,000,000 or larger Multibuyer policies with loss ratios exceeding 100%, and buyer foreign credit transactions where footnotes 4, 5, 11, and 13 apply or the per buyer exposure exceeds \$1,000,000. The online system currently is programmed to require segregated duties for both policy and buyer credit limit decision making based on progressively higher amounts and some of the noted footnotes.

TCID proposes that in addition to the Credit Review and Compliance Division’s (CRCDD) annual audit of sample TCID transaction underwriting, that TCID management conduct its own internal, annual audit of transaction samples of each officer with IDA. The summary findings would be shared with the CRCDD.


TFD intends to shortly grant delegated authority (IDA) to loan officers who would then both underwrite and authorize certain short-term transactions. TFD intends to limit the amount and risk profile of transactions that could be processed under this authority. Each transaction would continue to require prior supervisor screening for directing the loan officer towards decision making action under their own authority.

Recommendation E: Implement Controls to Assure Accurate Calculation of Exporter Scores

Note: The “Exporter Score” is calculated and used only in the underwriting of an exporter short term multibuyer policy. The score is intended to differentiate multibuyer policy exporters based on the quality of their foreign receivable portfolio and how well they manage foreign credit. The score is then used towards consideration of granting nominal delegated credit authority (Discretionary Credit Limit) to the exporter for making smaller foreign buyer credit decisions, effectively reducing a large administrative burden on TCID staff (approximately 15,000 buyer approvals annually). The score also contributes towards TCID loan officer’s underwriting Special Buyer Credit Limits which are required for transactions exceeding the exporters delegated credit authority or if the Country Limitation Schedule restricts use of that authority.

TCID has concluded requesting modifications within Ex-Im Online to assure accurate calculation is made on quotations, renewal and amendment of multibuyer policies. The requirements have been presented to our IMT Division and programmer/developers will build-in the modifications for user acceptance testing by the end of this calendar year.

The tested functionality should be operable by January 2013. In the meantime, instruction has been disseminated to TCID staff to manually validate accurate Exporter Scores at each policy renewal



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