



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

Evaluation of the Relationship between Export-Import Bank of the United States and Private Export Funding Corporation



*September 29, 2023
OIG- EV-23-05*



Office of Inspector General

To: Mary Buhler, Chief Financial Officer

From: Michael T. Ryan, Assistant Inspector General for Special Reviews and Communications

Subject: Evaluation of the Relationship between Export-Import Bank of the United States and Private Export Funding Corporation Evaluation (OIG-EV-23-05)

Date: September 29, 2023

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This final report presents the results of the independent evaluation of the Export-Import Bank of the United States' (EXIM) relationship with the Private Export Funding Corporation (PEFCO). The objectives of this evaluation were to: (1) understand and assess the appropriateness of the structural and business relationships between EXIM and PEFCO, including adherence to principal agreements, policies, and procedures; the loss experience of the loans sold to PEFCO; and the extent of EXIM's monitoring of PEFCO; and (2) determine the added value of the partnership to EXIM's mission of supporting American jobs by facilitating the export of U.S. goods and services. Under a contract monitored by this office, OIG engaged the independent consulting firm of Guidehouse to perform the evaluation.

This evaluation was conducted in accordance with the *2020 Quality Standards for Inspection and Evaluation* as issued by the Council of Inspectors General on Integrity and Efficiency. Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our evaluation objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

During the course of the evaluation, a concern regarding a possible threat to independence was brought to OIG's attention. Guidehouse took steps to mitigate the concern to include the appointment of a Quality Control Director within the firm, who was independent of the evaluation team, to review the changes to the final report and to address quality standards. These actions were taken as part of the continual process of mitigating possible independence threats and taking action to eliminate independence threats or mitigate against those threats.

This report contains three recommendations. We consider management's proposed actions to be responsive. The recommendations will be closed upon completion and verification of the proposed actions. We appreciate the cooperation and courtesies provided to Guidehouse and this office during the evaluation. If you have questions, please contact me at (202) 565-3963 or michael.ryan@exim.gov.

EXECUTIVE SUMMARY

Evaluation of the Relationship between EXIM & PEFCO
OIG-EV-23-05 September 29, 2023

Why We Did This Evaluation

The Office of Inspector General contracted Guidehouse to conduct an independent evaluation of EXIM's relationship with PEFCO.

PEFCO was created to assist in the financing of U.S. exports by supplementing the financing available from commercial banks and other lenders. PEFCO does this by purchasing EXIM-guaranteed loans from private lenders in the secondary market and by directly funding transactions approved by EXIM. To be eligible for financing by PEFCO, the loans must be guaranteed by EXIM or another U.S. federal institution. In addition, all PEFCO programs are established in conjunction with EXIM and at its request or with its permission. More than 99 percent of loans made or purchased by PEFCO are guaranteed by EXIM, and other U.S. federal government institutions, whose obligations are backed by the full faith and credit of the United States.

The objective of the evaluation is to provide an independent assessment of the structural and business relationships between EXIM and PEFCO, with particular emphasis on the added value of the partnership to EXIM's mission of supporting American jobs by facilitating the export of U.S. goods and services.

What We Recommend

We are making three recommendations to improve the EXIM PEFCO relationship. We recommended that EXIM's Office of the Chair:

1. Direct staff to conduct a study and make recommendations to EXIM's Board of Directors, in order to build additional resiliency in the EXIM-PEFCO partnership.
2. Direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors, in order to ensure both organizations are measuring and incentivizing educational outreach.
3. Direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors, in order to better define the required elements and frequency of reporting requirements.

What We Found

Our evaluation found that for the period covered by this evaluation (January 1, 2020, to October 31, 2022), both EXIM and PEFCO complied with the terms and conditions of the agreements that govern their relationship. The Guarantee and Credit Agreement (GCA), the Guarantee Agreement (GA), the Master Substitution Agreement (MSA), and the policies and procedures contained in the Standard Operating Procedure (SOP) were all properly observed. EXIM's and PEFCO's compliance with these agreements ensured that communications remained well-functioning and policy priorities were being met, while also preserving the integrity of both institutions.

However, we found that PEFCO experienced a steep drop-off in the volume of transactions it could fund due to a decrease in EXIM's lending activities caused by a lapse in authorization and lack of Board quorum from 2015 to 2019. PEFCO's loan portfolio also declined due to scheduled loan amortizations and prepayments.

Nevertheless, PEFCO continues to provide value to EXIM by purchasing EXIM-guaranteed loans in the secondary market and operating its Direct Loan Program. According to EXIM officials, PEFCO's activities infuse liquidity into the export finance market and enable participating lenders to support more transactions than would have been possible without PEFCO, thereby increasing the volume of EXIM-supported transactions and facilitating more U.S. job creation through exports.

Export loan originators told us it would be very challenging to find a viable alternative to PEFCO, saying most commercial banks do not prioritize the types of transactions supported by EXIM and are generally hesitant to enter the export finance space. Some of these lenders are non-depository financial institutions and credit finance departments within manufacturing companies who do not have the deposit base to support holding the loans for the agreed loan term on their balance sheet. PEFCO is specifically designed to enhance activities within this sector.

Furthermore, lenders highlighted that PEFCO has provided unparalleled expertise and competency over the last 52 years that may be difficult to replace. PEFCO is viewed as a trusted partner for the financial intermediaries that access EXIM export finance products on behalf of their customers. By PEFCO providing this capital space, EXIM can grow its deal pipeline and further meet its mission of supporting U.S. export and job expansion.

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ABBREVIATIONS AND GLOSSARY

Term	Description
CIGIE	Council of Inspectors General on Integrity and Efficiency
ECA	Export Credit Agency
EXIM	Export-Import Bank of the United States
FY	Fiscal Year
GA	Guarantee Agreement
GCA	Guarantee and Credit Agreement
ITA	International Trade Administration
MSA	Master Substitution Agreement
OIG	Office of Inspector General, EXIM
PEFCO	Private Export Funding Corporation
SOP	Standard Operating Procedures

INTRODUCTION

On September 8, 2020, the Export-Import Bank of the United States (EXIM) Board of Directors (Board) voted unanimously to renew its ongoing partnership with Private Export Finance Corporation (PEFCO) for another 25 years, reflecting the agency's confidence in PEFCO's performance as a direct lender and facilitator of liquidity for EXIM-guaranteed and -insured transactions. However, the decrease in EXIM's lending activities caused by a lapse in EXIM's authorization and lack of Board quorum from 2015 to 2019 adversely affected the partnership between EXIM and PEFCO. According to Fitch Ratings, PEFCO has not been profitable since FY 2016, as generated revenues have been insufficient to cover interest and operating expenses. Furthermore, PEFCO's profitability ratios are structurally weak relative to those of commercial banks and other financial lenders.¹ This evaluation found that it is in EXIM's best interest that export-driven domestic employment and job growth continue to be supported by the private capital that PEFCO uniquely facilitates within the framework of EXIM's unequaled market offerings.

Guidehouse (previously Grant Thornton Public Sector) conducted this independent assessment on behalf of EXIM's Office of Inspector General (OIG) with a goal of evaluating the structural and business relationships between EXIM and PEFCO, with particular emphasis on the added value of the partnership to EXIM's mission of supporting American jobs by facilitating the export of U.S. goods and services. Specifically, our objectives were to:

1. Understand and assess the appropriateness of the structural and business relationships between EXIM and PEFCO, including adherence to principal agreements, policies, and procedures, loss experience of loans sold to PEFCO, and the extent of EXIM's monitoring of PEFCO.
2. Determine the added value of the partnership to EXIM's mission of supporting American jobs by facilitating the export of U.S. goods and services.

SCOPE AND METHODOLOGY

Guidehouse performed this evaluation in three phases: research and planning, fieldwork, and reporting. First, Guidehouse conducted research to determine the sources of information necessary to address the evaluation objectives. We reviewed EXIM's charter and bylaws; applicable policies and procedures; the EXIM-PEFCO Guarantee Agreement (GA); the EXIM-PEFCO Guarantee and Credit Agreement (GCA); EXIM-PEFCO Standard Operating Procedures (SOP); the EXIM-PEFCO Master Substitution Agreement (MSA); PEFCO's Code of Conduct; PEFCO's Corporate Governance Guidelines; PEFCO's By-Laws; and related internal EXIM and PEFCO reports and correspondence. We interviewed a total of 20 individuals, including senior officials from EXIM, PEFCO, and lenders and exporters who have participated in EXIM programs involving PEFCO. The interview topics included reporting requirements and compliance, congressional export initiatives, the

¹ Fitch Ratings, "Rating Action Commentary: Fitch Places Private Export Funding Corporation on Rating Watch Negative," May 25, 2023, <https://www.fitchratings.com/research/non-bank-financial-institutions/fitch-places-private-export-funding-corporation-on-rating-watch-negative-25-05-2023>.

competitiveness of EXIM and PEFCO products, business headwinds caused by the lack of EXIM Board quorum and the COVID-19 pandemic, and other pertinent points of discussion. We also issued five data calls to EXIM and PEFCO and reviewed and analyzed the resulting data to understand the volume of EXIM-guaranteed transactions in PEFCO's portfolio, PEFCO's claim activity, PEFCO's loss experience, and EXIM's and PEFCO's adherence to the terms and conditions of the existing SOP. We discussed with EXIM personnel their process for calculating jobs supported and its potential attributions to PEFCO, along with changes in the jobs model methodology since 2019. The Guidehouse team compared the information received through the data calls to notes taken during the interviews to form conclusions related to the evaluation objectives.

Guidehouse conducted this evaluation remotely from October 2022 to September 2023 in accordance with the 2020 *Quality Standards for Inspection and Evaluation* issued by the Council of the Inspectors General on Integrity and Efficiency.² The scope of the evaluation was from January 1, 2020, to October 31, 2022.

BACKGROUND

EXIM

EXIM, the official export credit agency (ECA) of the United States, was established in 1934 through Executive Order by President Franklin Roosevelt and was later made an independent Executive Branch agency in 1945 through congressional charter. EXIM's mission is to support American jobs by facilitating the export of U.S. goods and services. EXIM executes this mission by offering direct loans, loan guarantees, export credit insurance, and working capital loan guarantees to level the playing field for U.S. exporters of goods and services competing against foreign competition in overseas markets.³ Rather than crowding out private sector activity, EXIM supports U.S. exports only where private sector lenders are unable or unwilling to provide the financing required by commercial entities to transact cross-border. EXIM's financial products carry the full faith and credit of the U.S. Government. Applicants for EXIM financial support are required to evidence a reasonable assurance of repayment.

PEFCO

PEFCO was established in 1970 under Delaware law with support from the U.S. Department of the Treasury and EXIM. Its shareholders include U.S. commercial banks, industrial companies, and financial services companies. PEFCO contributes to EXIM's

² OIG directed Guidehouse to initiate a comprehensive quality control review of this report, specifically aimed at evaluating and mitigating a possible threat to the independence of the evaluators. Per the 2020 *Quality Standards for Inspection and Evaluation*, this quality control review was part of a continual process to ensure that possible independence threats are eliminated or reduced to acceptable levels.

³ *Direct Loans* are EXIM-underwritten loans given to international U.S. export buyers directly, as opposed to *loan guarantees* which are bank-arranged deals that obtain an EXIM guarantee after meeting specific criteria. *Export credit insurance* protects U.S. exporters in the situation that goods and services sold on credit to a foreign buyer are not paid. *Working capital loan guarantees* reassure lenders to provide necessary short-term capital to U.S. exporters for overseas transactions.

mission by raising private capital that supplements the financing already available from EXIM and other lending institutions. Through its Direct Loan Program, PEFCO deploys its private capital to fund EXIM-approved direct loans and to purchase EXIM-guaranteed loans from other lenders in the secondary market. PEFCO thus provides liquidity for bank and non-bank financial intermediaries, with the goal of increasing their participation in EXIM-financed activities and supporting American jobs at a larger scale than if they did not have support from PEFCO.⁴ As of PEFCO's fiscal year 2022 annual report, export loans guaranteed or insured by EXIM made up 93.53 percent of PEFCO's total guaranteed assets.⁵

According to EXIM and PEFCO officials, PEFCO liquidity support is particularly important for small bank lenders and non-depository financial institutions who have limited funds to lend. Both the direct lending and loan purchase activities of PEFCO are financed through the sale of its own securities to investors. PEFCO's activity is largely correlated with the activity of EXIM; PEFCO does not make its own evaluations of the credit risks inherent in the underlying EXIM guaranteed loans it purchases in the secondary market, but instead relies on EXIM to determine if a loan meets its threshold of acceptability (i.e., the reasonable assurance of repayment). In all cases, EXIM reviews all requests for financing support and assesses credit factors independent of the credit review conducted by traditional loan funding entities. Historically, PEFCO has participated in over half the medium-term loans that EXIM generates annually.

To date, PEFCO has established all its programs in collaboration with EXIM and at its request or with its permission. PEFCO requires EXIM's approval on the terms of its individual long-term direct loan commitments and its long-term secured notes. Additionally, PEFCO's surplus funds may only be invested in EXIM-approved types of assets and EXIM is entitled to representation at all meetings of PEFCO's Board.⁶

Impacts of Historical Events on PEFCO's Finances

EXIM's lending activities suffered as a result of the lapse in authorization and lack of Board quorum between July 2015 and May 2019. In particular, EXIM's medium- and long-term portfolio declined to nearly zero during this period. EXIM officials explained that medium- and long-term transactions are typically over \$10 million in size, which was the level at which Board approval was required. Even after achieving a Board quorum again in May 2019, EXIM's transaction growth has been slow. Total authorization under EXIM's medium and long-term loan and guarantee programs was approximately \$2.29 billion in FY 2021, representing an 82 percent drop from FY 2014, the year before the lapse in authorization and the lack of a Board quorum.⁷ In FY 2022 EXIM authorized approximately \$1.74 billion for the same programs—an additional 24 percent decrease. EXIM officials explained that medium- and long-term transactions often take several years to develop and a near total stoppage in lending activity has a long-term impact on the associated relationships and

⁴ Article II, Section 2.3 of the SOP.

⁵ Private Export Funding Corporation (PEFCO), *2022 Annual Report*, Page 18, https://pefco.com/wp-content/uploads/2023/01/PEFCO_AR2022.pdf.

⁶ Surplus funds refer to funds available to spend that are in excess of what has been distributed to purchase EXIM-guaranteed assets that provide liquidity support to the U.S. export credit market.

⁷ These figures have not been inflation-adjusted.

EXIM's ability to generate future new business. Furthermore, shocks to the global economy such as COVID-19 reduced lending activity even further.

The reduction in transaction approvals at EXIM resulted in a decrease in the volume of transactions PEFCO could fund. For FY 2021, PEFCO noted that new loan commitments in EXIM medium- and long-term loan programs it funded totaled \$1.3 billion; in FY 2022, PEFCO's new loan commitments further dropped to \$95 million—approximately a 93 percent reduction from the prior year.

RESULTS IN BRIEF

This evaluation concluded that PEFCO continues to aid EXIM's mission of supporting U.S. jobs via exports. PEFCO's purchase of EXIM products provides lenders the opportunity to increase their export credit volume without the need to raise additional funds. PEFCO thus provides a valuable service to private capital lenders who have otherwise maximized the capital they can obtain. Furthermore, PEFCO consistently provides this liquidity support regardless of market conditions, whereas traditional private lenders may modify their business strategy for various legitimate reasons. Therefore, PEFCO acts as a stabilization tool for the U.S. credit export market, using private market funds rather than the taxpayer funds that EXIM would need to provide for the same support. This evaluation found that PEFCO's funding activities reliably fill a market niche that ultimately supports domestic employment based on exports.⁸

During our interviews, lenders pointed out that PEFCO's purchases of EXIM assets are of particular value to small banks and non-depository institutions that lend to rural communities at a higher frequency than large, traditional lenders, which prefer deals with larger dollar volumes. With a limited amount of capital to lend, PEFCO's liquidity supports these lenders as well as the companies operating in rural areas of the United States. According to these lenders, their export loans support jobs that are often a source of steady, middle-class employment. Relevant stakeholders reiterated that PEFCO's steady purchase of EXIM assets likely generate job stability for small domestic communities.

However, as all PEFCO purchases of EXIM assets ultimately depend upon EXIM's initial underwriting productivity, EXIM's recent slowdown in deal volume has hurt PEFCO's ability to support U.S. exports and domestic employment. This evaluation recommends that EXIM determine how the partnership can build resiliency to best serve EXIM's mission and other relevant priorities of the U.S. government.

This evaluation found that EXIM and PEFCO would benefit from further collaboration to ensure that both organizations are measuring and incentivizing educational outreach capabilities granted within the SOP. Although the SOP provides PEFCO with discretion in the nature and frequency of outreach to stakeholders in the export credit market and does not require it do so, a more goals-oriented outreach strategy could ultimately expand business lending activity. EXIM should consider providing clearer guidance and expectations to PEFCO in the SOP to meet these goals and priorities. Implementing this

⁸ Appendix E.

recommendation would ultimately boost EXIM and PEFCO's visibility in the export credit market and lead to further exports and job support for the United States.

This evaluation also found that EXIM's and PEFCO's governing documents place the responsibility of losses solely on EXIM, even when PEFCO holds the loans. Although PEFCO records claims in its portfolio for EXIM-guaranteed loans that have fallen into default, because it plays no role in EXIM's credit underwriting process, the responsibility for any defaults or claims stemming from the credit evaluation process falls to EXIM. PEFCO's purchase of a loan has no bearing on whether the borrowing entities can make their payments or not. Fundamentally, PEFCO's business model is to fund or purchase any EXIM-guaranteed loan that has a higher return than PEFCO's cost to borrow.

Based on our analysis of loss experience data provided during the evaluation's scope of work, we identified no recommendations that would improve this aspect of the relationship. EXIM and PEFCO's partnership appears to work as intended, with EXIM underwriting transactions and issuing guarantees where it deems the credit risk to be acceptable and PEFCO funding or purchasing the guaranteed loans in the secondary market after the credit underwriting process has taken place.

Our evaluation also concluded that EXIM comprehensively monitors PEFCO on a regularly scheduled basis. Article III of the SOP requires PEFCO to provide various annual, quarterly, and monthly activity reports to EXIM, as appropriate, to ensure that it is achieving its objectives as EXIM's partner. If either EXIM or PEFCO were to fail in a material way to comply with the SOP, the other party would have grounds to end future business dealings and withdraw from the partnership. During Guidehouse's period of review, neither party has behaved in a manner resulting in a material breach of the SOP and neither party reported previous breaches of the agreement. No additional recommendation to further optimize reporting is necessary as the previous recommendation to better define the required elements and frequency of reporting extends to strengthening the monitoring process overall.

Our evaluation found that both EXIM and PEFCO adhered to the requirements in the documents governing their relationship,⁹ including the most recent reforms implemented by the EXIM Board to the EXIM-PEFCO SOP in September 2020.¹⁰ Material compliance with governing documents ensures that directives instituted from both government bodies and stakeholders within the relationship are honored and do not provide grounds for a termination of the partnership. Nevertheless, EXIM's Board could strengthen the relationship and promote accountability by better defining the required elements and frequency of reporting requirements in the SOP.

Ultimately, the relationship between EXIM and PEFCO is operating as intended with PEFCO benefiting EXIM's mission of supporting American jobs via exports. The recommendations in this report aim to enhance internal practices and controls in the relationship to ensure better accountability and resiliency for a strong future.

⁹ Governing documents refer to the Guarantee Agreement, Guarantee and Credit Agreement, Master Substitution Agreement, and Standard Operating Procedures.

¹⁰ See appendix C for a list of the 2020 reforms to the EXIM-PEFCO SOP.

FINDINGS

This evaluation found that PEFCO contributes to EXIM's mission of supporting American jobs and exports. In addition, EXIM and PEFCO are operating in accordance with their governing documents. Outlined below are the formal observations and recommendations under this evaluation's scope.

Finding 1: PEFCO Contributes to EXIM's Mission of Supporting American Jobs and Exports

This evaluation determined that PEFCO continues to support EXIM in a similar manner and spirit as what was intended when the partnership commenced in 1971. PEFCO's role in aiding EXIM to support U.S. exports and domestic employment remains fundamentally unchanged. PEFCO infuses liquidity into the export finance market by purchasing EXIM-guaranteed loans in the secondary market. PEFCO also funds certain EXIM-authorized loans at the point of origination (called the PEFCO Direct Loan Program). When private sector export lending priorities change due to macroeconomic shifts, evolving private business objectives, or any other legitimate reasons, PEFCO remains a liquidity vehicle for the U.S. export credit market.

Personnel within EXIM recognized the role PEFCO plays in the export finance lending space. One official noted that "EXIM benefits from PEFCO, particularly in the medium-term space, which typically does not see a lot of large commercial bank activity; it's typically relegated to smaller lenders." According to these officials, PEFCO's activity with smaller lenders "is not huge in dollar amount, but they are huge in individual transaction volume which helps to support American jobs. If PEFCO disappeared today, EXIM's activity in the small and medium-term space would shrink." These small lending firms do not have the deep capitalization of established commercial banks, but still provide lending that is crucial for U.S. exports and job support as well as meeting policy goals and mandates.

EXIM utilizes an International Trade Administration (ITA) jobs model, shared with other federal agencies with programs of a similar scope, to yield a consistent and uniform measure of the impact that various EXIM programs have on domestic employment.¹¹ PEFCO does not directly contribute to this jobs number, but instead provides an opportunity to expand lending volume to the export credit market through liquidity support.¹² Without PEFCO's purchase of EXIM-guaranteed loans in the secondary market, lender lines of credit would quickly deplete, resulting in less loan activity than otherwise occurs with PEFCO-provided support.

Lenders reported that PEFCO is their most dependable funding partner in the secondary market. One small business lender noted that "since 2020, PEFCO is wholly relied on to purchase EXIM guarantees. PEFCO is a huge part of (our company's) business that employs nearly four hundred people." Without this mechanism, lenders reiterated that other profitable lending activity may become constrained by their inability to raise

¹¹ Refer to Appendix E for more details regarding the jobs model.

¹² See appendix E for a description of EXIM's job measurement methodology.

necessary funds. EXIM, PEFCO, and private lending personnel told us that PEFCO functions in a manner similar to a revolving credit line for lenders, buying up EXIM-guaranteed assets when lending firms find additional opportunities.

PEFCO provided liquidity support for EXIM products throughout the duration of this evaluation's scope. PEFCO supported \$207 million in new loan commitments for fiscal year 2020, \$1.4 billion for fiscal year 2021, and \$215 million for fiscal year 2022; this totals to \$1.82 billion in new loan commitments over the three-year period.¹³ These figures reflect money that would otherwise be on various lender balance sheets, tying up capital rather than making it available to support additional export sales. By selling EXIM loans to PEFCO, lenders can free up their balance sheets to develop further EXIM-guaranteed loans without needing to expand their current pool of loan capital, which is much more difficult to do.

PEFCO is designed to act as a supplemental funding arm for EXIM by "mobilizing private capital to assist in financing exports of United States products and services" as stated in the GCA.¹⁴ PEFCO supports the export market broadly with its purchase of EXIM guarantees. Any firm can provide liquidity to lenders that underwrite EXIM-guaranteed loans; this is done through the purchase of these loans off lender balance sheets. However, both EXIM and private lenders reiterated that PEFCO's particular value is that it can always be relied upon by EXIM, while other firms have dynamic business interests that can cyclically change their export credit lending priorities.

EXIM and PEFCO's relationship experienced novel challenges between 2015 and 2019, when EXIM lacked a Board quorum and was unable to approve new transactions valued at over \$10 million. A senior EXIM official noted that one long-term impact from the loss of Board quorum was firms began to question EXIM's reliability as a long-term partner. PEFCO's ability to fund new, long-term deals correspondingly evaporated during this time. Although EXIM regained Board quorum at the end of 2019, it has taken time for the agency to bring back customers and grow its business pipeline. EXIM, in an effort to reduce issues involving Board quorum to approve large deals in the future, raised the transaction cap needing Board approval from \$10 million to \$25 million in 2019.¹⁵

Further unprecedented challenges for PEFCO stemmed from the COVID-19 pandemic. Throughout PEFCO's history, it has been a major direct funder of aircraft deals. According to EXIM and PEFCO officials, pandemic lockdowns resulted in consumer travel dropping to historical lows and the airline industry engaging in major cost-cutting. An EXIM official noted that project finance and aircraft deals are the two main funding buckets for PEFCO, and both types of transaction dried up during this time period. Industries that had historically relied on EXIM for funding support no longer had the requisite demand to justify new capacity.

The compounding effects of the lack of EXIM Board quorum and the COVID-19 pandemic damaged PEFCO's financial position. PEFCO's major shareholders have a fiduciary responsibility to support PEFCO in a manner conducive for long-term sustainability and

¹³ Private Export Funding Corporation (PEFCO), *2022 Annual Report*, Page 18, https://pefco.com/wp-content/uploads/2023/01/PEFCO_AR2022.pdf

¹⁴ GCA, Page 1.

¹⁵ Appendix F.

growth; meeting these responsibilities naturally assists EXIM in its efforts to maximize U.S. exports and domestic employment. Under typical circumstances, PEFCO operates well as a liquidity source to spark further lending activity. However, without the necessary volume of EXIM products to fund, PEFCO is constrained in the total amount of transactions it can fund, resulting in an elevated level of idle liquidity capacity.

Ultimately, PEFCO can only do as much business as EXIM authorizes because PEFCO's funding is directly correlated to EXIM loan volume. The sooner EXIM can grow its pipeline of transactions, the sooner PEFCO can deploy its available capital to provide liquidity support as intended.

RECOMMENDATION

To ensure the sustainability of the relationship between EXIM and PEFCO, EXIM's Office of the Chair should:

1. Direct staff to conduct a study and make recommendations to EXIM's Board of Directors, in order to build additional resiliency in the EXIM-PEFCO partnership.

Finding 2: PEFCO Is Not Actively Educating U.S. Exporters and Foreign Buyers and Borrowers as Allowed by the SOP

We found that PEFCO could strengthen its educational outreach to assist EXIM in its mission of increasing the volume of U.S. exports. According to EXIM and PEFCO personnel, PEFCO has historically relied on EXIM to educate potential customers and drive new business volume. PEFCO officials said following the loss of EXIM's Board quorum between 2015 and 2019 and the subsequent damage to PEFCO's business and profitability, both organizations could benefit from PEFCO's increased participation in education and outreach. Although PEFCO is allowed to conduct outreach per the SOP and could be leveraging optional educational tools that EXIM has made available to them, multiple senior EXIM officials informed Guidehouse that PEFCO has yet to take full advantage of the educational outreach tools available to them during the scope of this review.

Article I, Section 1.3 of the EXIM-PEFCO SOP states, "PEFCO will not directly solicit business from U.S. exporters or foreign buyers or borrowers; however, it may communicate with such parties in order to educate them about PEFCO's products and services and the use of those products and services in specific transactions". Accordingly, PEFCO has the ability to educate export finance participants and by so doing make these organizations aware of their existence without directly soliciting their services.

EXIM officials told us that there are ways PEFCO could conduct education and outreach without directly soliciting business. For example, they said PEFCO staff attend relevant tradeshows but do not actively participate to highlight their product offerings. Although PEFCO officials told us that they have spoken to tradeshow attendees about the organization, PEFCO's outreach role was limited. PEFCO did not have formal speaking roles and did not participate in panels, host events, or maintain booths at these tradeshow events. According to EXIM and third-party representatives, PEFCO does not participate in the speaking roles of these industry events and instead relies on word-of-mouth to reach customers. If PEFCO were to participate more actively in tradeshows, whether virtual or in-

person, it could yield prospective transactions and thereby increase export volume for both parties.

PEFCO's need to actively conduct market outreach was necessitated by EXIM's loss in authority to underwrite new loans larger than \$10 million between 2015 and 2019 due to lacking Board quorum. During this period, foreign ECAs actively competed for activity that historically would have likely sought an EXIM guarantee, leading to a reduction in the volume of EXIM's guarantee authorizations and a corresponding decline in available funding opportunities for PEFCO. This, in turn, has limited PEFCO's ability to deploy available capital, resulting in reduced revenue and earnings for PEFCO since the loss of EXIM's Board quorum.

The lack of effective educational outreach by PEFCO limits its visibility in the export finance market. Although EXIM and PEFCO officials told us they have begun to rebuild EXIM's pipeline since EXIM's Board re-achieved quorum in 2019, PEFCO officials reiterated to Guidehouse that more EXIM loan-guarantees need to be issued in order for PEFCO to provide the liquidity support at scale necessary to strengthen the U.S. export industry.

In addition to the recommendation below, EXIM may consider whether additional actions are required to increase the visibility of PEFCO's offerings.

RECOMMENDATION

To improve awareness of EXIM and PEFCO's export offerings, EXIM's Office of the Chair should:

2. Direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors, in order to ensure both organizations are measuring and incentivizing educational outreach.

Finding 3: EXIM and PEFCO's Governing Documents Place Responsibility for Losses Experienced by Loans Sold to PEFCO on EXIM

According to EXIM and PEFCO's governing documents, EXIM is solely responsible for underwriting transactions and providing a full guarantee of interest and principal. EXIM's role as the exclusive credit evaluator in its underwriting process means that losses or claims filed on EXIM products are attributable solely to EXIM. PEFCO relies on EXIM to underwrite the credit risks of the borrowers and evaluate all relevant credit factors, including the economic conditions in domestic or foreign locations. Consequently, issues of delayed payment or non-payment associated with guaranteed loans purchased or funded by PEFCO cannot be attributed to any failure or non-performance on PEFCO's part.

PEFCO has an obligation to inform EXIM of any incidences of delayed payment or non-payment of interest and principal,¹⁶ and has historically done so once per month. When a borrower fails to make a payment, PEFCO notifies EXIM and has a contracted period of time during which it must file a claim. Although both PEFCO and EXIM track loss experience, applying loss experience of loans sold to PEFCO as a measure of PEFCO's value to EXIM is inaccurate given, PEFCO makes no credit decisions.¹⁷ Therefore, while EXIM can review PEFCO's reports of loss experiences to find potential abnormalities within its own internal credit underwriting process, PEFCO's business operations and practices do not have any bearing on the creditworthiness of the loans it assumes.

Given the nature of PEFCO's relationship with EXIM, PEFCO cannot do anything to rectify potential underwriting issues. PEFCO purchases loans from financial intermediaries on the secondary market after EXIM has approved the transactions and issued its guarantee. When PEFCO is the funding institution, it funds a transaction only after EXIM approves it and issues a guarantee. Consequently, the performance or non-performance of PEFCO loans cannot be credited to PEFCO because it makes no assertions as to the credit quality of any of the loans it acquires or funds. One PEFCO official stated that "no commitment to a deal is authorized within PEFCO unless an EXIM guarantee is in place." Therefore, the loss experience of PEFCO-purchased loans does not speak to the assistance PEFCO ultimately brings to EXIM in supporting American jobs via exports.

The structure of EXIM and PEFCO's partnership prevents PEFCO from assuming any credit risk for the loans it purchases or originates, as it does not make decisions on projects that EXIM supports. Under the guarantee provided from the GA, losses are attributed solely to EXIM. EXIM makes payment on all fixed-rate loans in accordance with the agreed upon installment plan. For floating-rate loans, EXIM uses the Accelerated Payment Method¹⁸ to make payments on the transaction, unless such method is at a cost to PEFCO.

According to PEFCO's annual report, "EXIM is underwriting the credit risk and receives a credit exposure fee from the borrower to prudently compensate for this credit exposure."¹⁹ According to the EXIM Credit Processes document, "The life cycle of a transaction begins with the underwriting divisions. When a transaction is underwritten (Stages 1 - 3), the risk is assessed and borrowers with a reasonable assurance of repayment are recommended for approval."²⁰ PEFCO supports EXIM and its intermediaries through its purchase of EXIM-guaranteed loans in the secondary market. These lenders may desire to offload their EXIM

¹⁶ Article III, Section 3.02 of the GA states: "The only duty of PEFCO to EXIM in administering each Loan Agreement shall be to notify EXIM promptly of the occurrence of any Event of Default known to PEFCO or of the receipt of any notice from the Borrower of an intention not to pay or an inability to pay amounts due or to become due on the Borrower's Obligations and upon the receipt of any such notice EXIM may elect to deal directly with the Borrower. PEFCO shall cooperate fully with EXIM.... in the collection of the defaulted payments for which EXIM has paid PEFCO and in the enforcement of the provisions of a Loan Agreement."

¹⁷ Loss Experience Data Shown in Appendix D.

¹⁸ The "Accelerated Payment Method" refers to EXIM paying the guaranteed loan amount in one single payment.

¹⁹ [PEFCO 2021 Annual Report](#), Page 30.

²⁰ Appendix F.

assets to PEFCO in order to free up lending capital, to buy higher yielding assets, or pursue other business interests. EXIM intermediaries reiterated their trust in PEFCO and know that PEFCO's purpose is to provide liquidity to the export credit industry. Per the GCA, PEFCO has no decision-making authority; it states, "PEFCO agrees that it will not purchase any obligation guaranteed by EXIM unless it shall have received the prior approval of such purchase from EXIM."²¹ This business dynamic reflects the fact that EXIM is the only decision maker for the loans it guarantees and PEFCO's role as liquidity provider does not make it accountable for loan performance.

In accordance with the GA, EXIM's lending policy, and the EXIM-PEFCO SOP, PEFCO purchases any loans for which EXIM has issued guarantees, regardless of underlying creditworthiness. One PEFCO official noted that "PEFCO doesn't really turn away any EXIM transactions" and PEFCO aims to do as much business as it possibly can under that guarantee.

There are no recommendations to improve the relationship. PEFCO's relationship with EXIM appears to be working as intended, with EXIM underwriting transactions and issuing guarantees where it deems the credit risk to be acceptable and PEFCO funding or purchasing the guaranteed loans on the secondary market to provide greater liquidity to lenders.

Finding 4: EXIM Monitors PEFCO on a Regularly Scheduled, Agreed Timeline

We found that EXIM and PEFCO complied with the monitoring standards agreed upon in Article III of the SOP, as amended in September 2020.²² Under Article III, PEFCO is required to provide the following to EXIM:

- Quarterly and annual activity reports;
- Annual report on PEFCO's use of Secured Notes and Collateralized Notes;
- Annual report on PEFCO's support for various mission sensitive segments of export finance;
- Annual report on the protections PEFCO has put in place to protect the interest on PEFCO's Secured Notes

According to EXIM officials, EXIM and PEFCO were following this reporting and evaluation process prior to the most recent revision to the EXIM-PEFCO SOP in September 2020, but formalized these requirements in that revision in response to a congressional request to clarify the relationship and common business activities between EXIM and PEFCO. The revised SOP also includes seven key reforms that were conditional to the EXIM Board approving the EXIM-PEFCO partnership renewal in September 2020.²³

Both organizations are appropriately following the monitoring guidelines within the SOP, including the provision of ad hoc monitoring requests as stipulated by Section 3.8 in the

²¹ Article 4, Section 4.05 of the GCA.

²² Appendix B.

²³ Appendix C.

SOP.²⁴ Outside of Article III requirements, PEFCO also provides monthly loan reports to EXIM to provide further detail of their business activities. EXIM and PEFCO officials also communicate on an ad hoc basis as necessitated by various business circumstances. EXIM officials acknowledged that there have been instances in which EXIM granted waivers to the SOP or set temporary guidelines between SOP review periods. The same EXIM officials noted that neither party has failed to materially comply with the agreed upon SOP.

Prior to the congressional request to formalize business standards of monitoring and reporting between EXIM and PEFCO, EXIM had an informal approach to monitoring PEFCO. According to EXIM and PEFCO officials, the two organizations did not require formalized reporting and monitoring because both parties were communicating regularly. However, in response to congressional concerns that the informal reporting dynamic might create risks for the relationship, EXIM and PEFCO formalized existing practices in the most recent version of the SOP.²⁵ In formalizing PEFCO's monitoring and reporting guidelines, EXIM has been more able to hold PEFCO accountable and promote transparent business dealings.

The reporting requirements in the revised SOP have also allowed for third party analysts to better understand PEFCO's adherence to its agreements with EXIM and make recommendations that are well-informed and relevant. The newly enumerated guidelines provide an auditable trail for various personnel, inside and outside the organization, to ensure that proper business practices are being followed. Prior to September 2020, it would have been difficult for an intermediary to determine the correct timelines and formats for the completion of various reporting requirements and other business needs. Required tasks, both internally mandated and congressionally mandated, might have been omitted by mistake without the SOP serving as a reference point. With clear, written guidelines, any internal or external party can ensure that EXIM and PEFCO are both meeting the standards they have mutually agreed upon.

If either organization fails to materially comply with the SOP, the other could refuse future business dealings involving the partnership. This provides an incentive for both organizations to act in accordance with the SOP. EXIM personnel also pointed out that PEFCO's required reports will help to inform SOP changes to be made in the future.

No recommendation is currently needed regarding EXIM's monitoring of PEFCO. We conclude that formalizing the reporting standards in the SOP in September 2020 allowed EXIM to monitor and hold PEFCO accountable to supporting its mission and policy goals.

Finding 5: PEFCO Adhered to the Terms of the Guarantee Agreement, Guarantee Credit Agreement, Master Substitution Agreement, and Standard Operating Procedures

We found that PEFCO generally adhered to the terms of documents governing its relationship with EXIM during the scope of this evaluation. Moreover, PEFCO complied with the terms in the governing documents related to congressionally directed allocations of EXIM's exposure cap, such as those related to small businesses and Sub-Saharan Africa.

²⁴ Appendix B.

²⁵ Appendix B.

According to PEFCO's annually provided Lending Policy Objectives Report to EXIM, as required by Section 3.4 of the SOP, PEFCO supported 44 small business loans valued at \$128.1 million in FY 2021 and 27 small business loans valued at \$26.3 million in FY 2022. Regarding Sub-Saharan Africa loans, PEFCO supported one loan valued at \$2.4 million and did not support any additional transactions in FY 2022. According to PEFCO personnel, low transaction levels were driven by a lack of demand from the region.

The structure of the EXIM-PEFCO partnership is outlined in the Guarantee Agreement (GA), Guarantee and Credit Agreement (GCA), the Master Substitution Agreement (MSA), and guided by the Standard Operating Procedures (SOP). Under the GA, EXIM "guarantees fully the due and punctual payment of the principal and interest...on all obligations."²⁶ PEFCO maintains its end of the deal by engaging in financial transactions with prior EXIM approval and does not alter the terms of a loan agreement without the prior approval of EXIM.

We compared the terms and conditions of the GCA, which was last amended September 8, 2020, against actions taken by the two institutions over the period of review and determined that both PEFCO and EXIM were in full compliance with the terms of the arrangement. Specifically, PEFCO complied with the provisions of Article IV by providing all required financial statements and operating budgets to EXIM within required timelines. EXIM and PEFCO also complied with the provisions of Article V by ensuring that the termination rights of each respective entity in the partnership have been followed appropriately where applicable.²⁷

Both EXIM and PEFCO adhere to the provisions of Section 1 of the MSA regarding the acquisition of guarantees under the 1971 guarantee arrangement for medium-term transactions. The same holds true for Section 2 related to long-term guarantee transactions. All other notices and legal recognitions in the MSA were being honored.

The SOP requires PEFCO to communicate to EXIM, on an annual basis, the extent to which it achieved its financing goals and lending policy objectives. This is accomplished with the Lending Policy Objectives report, which summarizes the number of loans and loan amounts across each product type and details PEFCO's efforts and diligence when purchasing or funding transactions over each FY. We reviewed PEFCO's Lending Policy Objectives Report and found that PEFCO adhered to the SOP terms in Articles III, VI, and VII related to reporting and documentation.²⁸

Per the GA, PEFCO provides secondary market liquidity for financial intermediaries that participate in EXIM's export finance guarantee programs. EXIM's guarantees cover principal and interest payments and, per the GCA, provide PEFCO with a revolving line of credit to better fulfill EXIM's mandates. PEFCO does not conduct an analysis of the credit risk of any borrower behind an EXIM guaranteed loan it purchases or funds; it relies on EXIM to determine whether a borrower meets EXIM's own credit risk threshold. It is only after EXIM has determined that a borrower meets its minimum level of credit risk acceptability and has issued its guarantee that PEFCO funds or purchases the loan.

²⁶ GA, page 2.

²⁷ Since the GCA remained in effect throughout this evaluation's period of review, the termination rights of any outstanding guarantees were not exercised by EXIM or PEFCO and thus are not applicable.

²⁸ Appendix B.

Therefore, the performance of any EXIM guarantee or direct loan purchased or funded by PEFCO can only be credited to EXIM.

The day-to-day business interaction between EXIM and PEFCO is governed by the SOP, which was most recently updated in September 2020. It dictates the reporting and operational guidelines between PEFCO and EXIM and functions like a working guide with the flexibility to allow for amendments and updates. Although the text of the SOP notes that it “does not create any legally enforceable rights or obligations[,]”, it states that “both parties agree that failure by a party to materially comply with the terms of this SOP would, in and of itself, be sufficient grounds for the other party to refuse to participate in future transactions.” Although EXIM and PEFCO stakeholders told us that the status-quo approach has worked for them thus far, new language in the SOP explicitly ensuring legal enforceability may allow both parties to the SOP to seek enforcement of its terms.

Careful analysis of the SOP makes evident that reporting requirements may be more flexible than necessary regarding how PEFCO can report to EXIM. While a certain level of operational discretion is necessary for the partnership to optimally function, a pivot to more substantive language regarding explicit requirements is likely to positively impact the relationship. Thus, better defining the elements and frequency of reporting requirements within the SOP should be undertaken.

Summary analysis of stakeholder interviews concluded that both EXIM and PEFCO have taken steps to optimize their relationship for the betterment of U.S. export competitiveness over the course of their 52-year relationship. The current SOP reflects improvements in the business practices that underpin the relationship. We found that both EXIM and PEFCO followed the governing documents during our review period. In our interviews with EXIM and PEFCO stakeholders and reviews of documents, we observed no material breaches of the SOP during our evaluation’s scope of review.

RECOMMENDATION

To better clarify EXIM’s and PEFCO’s roles and responsibilities and ensure both parties are adhering to the relationship, EXIM’s Office of the Chair should:

3. Direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM’s Board of Directors, in order to better define the required elements and frequency of reporting requirements.

MANAGEMENT RESPONSES TO RECOMMENDATIONS

OIG provided a draft of this report to EXIM stakeholders for their review and comment on the findings and recommendations. OIG issued the following recommendations to EXIM. Appendix A includes the agency’s complete response.

Recommendation 1: EXIM’s Office of the Chair should direct staff to conduct a study and make recommendations to EXIM’s Board of Directors, in order to build additional resiliency in the EXIM-PEFCO partnership.

Management Response: In its September 28, 2023, response, EXIM concurred with this recommendation.

OIG Reply: OIG considers the recommendation resolved. The recommendation can be closed when OIG receives and accepts documentation that EXIM conducted a study and made recommendations to EXIM's Board of Directors to build additional resiliency in the EXIM-PEFCO partnership.

Recommendation 2: EXIM's Office of the Chair should direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors, in order to ensure both organizations are measuring and incentivizing educational outreach.

Management Response: In its September 28, 2023, response, EXIM concurred with this recommendation.

OIG Reply: OIG considers the recommendation resolved. The recommendation can be closed when OIG receives and accepts documentation that EXIM proposed amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors to ensure both organizations are measuring and incentivizing educational outreach.

Recommendation 3: EXIM's Office of the Chair should direct staff to propose amendments to the EXIM-PEFCO SOP to EXIM's Board of Directors, in order to better define the required elements and frequency of reporting requirements.

Management Response: In its September 28, 2023, response, EXIM concurred with this recommendation.

OIG Reply: OIG considers the recommendation resolved. The recommendation can be closed when OIG receives and accepts documentation that EXIM proposed amendments to the EXIM-PEFCO to EXIM's Board of Directors to better define the required elements and frequency of reporting requirements.

CONCLUSION

Guidehouse determined that the relationship between EXIM and PEFCO is a mutually beneficial one—enhancing EXIM's ability to meet its mission of supporting U.S. job creation, prosperity, and security through exporting while at the same time returning strong value to PEFCO investors. Both PEFCO and EXIM adhered to the terms and conditions of all contractual arrangements and policies and procedures as detailed in the existing SOP. EXIM's monitoring of PEFCO is formalized and comprehensive enough for EXIM to be informed as to PEFCO's activity without being invasive. The recommendations contained in this report therefore aim to strengthen PEFCO's support of EXIM's mission, while acknowledging that PEFCO's performance is directly tied to EXIM's activities.

APPENDIXES

Appendix A: Management Response



Helping American Businesses Win the Future

DATE: September 28, 2023

TO: The Honorable Parisa Salehi, Inspector General, Office of Inspector General

THROUGH: Mary Buhler, Senior Vice President, and Chief Financial Officer

FROM: Courtney Chung, Senior Vice President, and Chief Management Officer

SUBJECT: Evaluation of the Relationship between Export-Import Bank of the United States and Private Export Funding Corporation (OIG-EV-23-05)

COURTNEY CHUNG
Digitally signed by COURTNEY CHUNG
Date: 2023.09.27 16:12:05 -0400

Dear Inspector General Salehi,

Thank you for providing the Export-Import Bank of the United States (“EXIM” or “EXIM Bank”) management with the Office of Inspector General’s (“OIG”) Evaluation of the Relationship between Export-Import Bank of the United States and Private Export Funding Corporation (OIG-EV-23-05), dated September 21, 2023 (the “Report”).

EXIM is pleased that the OIG acknowledged that EXIM “for the period covered by this evaluation (January 1, 2020, to October 31, 2022), both EXIM and PEFCO complied with the terms and conditions of the agreements that govern their relationship. The Guarantee and Credit Agreement (GCA), the Guarantee Agreement (GA), the Master Substitution Agreement (MSA), and the policies and procedures contained in the Standard Operating Procedure (SOP) were all properly observed. EXIM’s and PEFCO’s compliance with these agreements ensured that communications remained well-functioning and policy priorities were being met, while also preserving the integrity of both institutions.” EXIM also notes that the OIG recognized that “PEFCO continues to provide value to EXIM by purchasing EXIM-guaranteed loans in the secondary market and operating PEFCO’s Direct Loan Program.”

We concur with the recommendations and thank the OIG for your effort to ensure EXIM’s standard operating procedures continue to improve, as well as the work you do with us to protect EXIM funds from fraud, waste, and abuse.

OIG has made three recommendations in this report:

Recommendation 1: Direct staff to conduct a study and make recommendations to build additional resiliency in the EXIM-PEFCO partnership.

Management response: EXIM concurs with this recommendation. EXIM staff has been evaluating different methods that would allow PEFCO to become more resilient and less dependent on EXIM medium- and long-term guarantee authorizations. EXIM staff is currently preparing recommendations for amendments to the Standard Operating Procedures between EXIM and PEFCO as a way to enable use of these methods, as feasible. These recommendations, which increase PEFCO's resiliency in the near-term, will be presented to EXIM's Board of Directors for decision in the first quarter of fiscal year 2024.

Recommendation 2: Amend the SOP between EXIM and PEFCO to ensure both organizations are measuring and incentivizing educational outreach.

Management response: EXIM concurs with this recommendation. EXIM staff is currently preparing recommendations for amendments to the Standard Operating Procedures between EXIM and PEFCO. These recommendations, which include measuring and incentivizing educational outreach, will be presented to EXIM's Board of Directors for decision in the first quarter of fiscal year 2024. Furthermore, staff will, by no later than April 2025, have more extensive discussions with key stakeholder groups regarding PEFCO's outreach to ensure such measurements and incentives are appropriate and effective.

Recommendation 3: Direct staff to revise the EXIM-PEFCO SOP to better define the required elements and frequency of reporting requirements.

Management response: EXIM concurs with this recommendation. EXIM staff is currently preparing recommendations for amendments to the Standard Operating Procedures between EXIM and PEFCO. These recommendations, which better define the required elements and frequency of reporting requirements, will be presented to EXIM's Board of Directors for decision in the first quarter of fiscal year 2024.

CC:

The Honorable Reta Jo Lewis, President, and Chair of the Board of Directors
Hazeen Ashby, Acting Chief of Staff and Whitehouse Liaison
Larry Decker, Acting Deputy Chief of Staff and Senior Advisor to the President and Chair
James Cruse, Senior Vice President of Policy Analysis & International Relations
Kenneth Tinsley, Senior Vice President, and Chief Risk Officer
David Sena, Senior Vice President, Office of Board Authorized Finance
Derek Kitchen, Deputy Director of Congressional, and Intergovernmental
James Burrows, Senior Vice President, and Acting Chief Business Officer
Jonathan Feigelson, Senior Vice President, and General Counsel
Stephanie Deatherage, Deputy Senior Vice President, Policy Analysis & International Relations
Kevin Warnke, Vice President of Congressional & Intergovernmental Affairs
Lark Grier-Hapli, Deputy General Counsel
Inci Tonguch-Murray, Senior Vice President, and Deputy Chief Financial Officer
Nicole Wharton, Attorney Advisor, Trade Finance & Insurance Counsel

Appendix B: SOP Compliance Check (Analysis Conducted by Guidehouse on Behalf of OIG)

SOP Article III

Section 3.1: PEFCO will prepare and provide to EXIM quarterly and annual activity reports in form and substance acceptable to EXIM.²⁹

- **3.1 Compliance:** Quarterly and annual activity reports were provided to confirm compliance for this evaluation.

Section 3.2: PEFCO will prepare and provide to EXIM, on an annual basis, a report on PEFCO's use of Secured Notes and Collateralized notes, including the EXIM programs that each debt issuance program supports. The first annual report is due no later than December 31, 2021.

- **3.2 Compliance:** Secured Note and Collateralized Note reports were shared to confirm compliance for this evaluation.

Section 3.3: As part of a long-run objective of engaging PEFCO more fully across the entire spectrum of EXIM programs, EXIM will prepare an analysis as to whether there is a "gap" in funding support for some small business exporters, including whether some small business exporters are unable to get a bank to "fund"/buy the insurance policy they purchase from EXIM. If so, EXIM will share the details of its research findings with PEFCO and ask PEFCO to evaluate whether such a market gap might be addressed by PEFCO without additional risk to EXIM. The results of EXIM's research and any PEFCO evaluation will be contained in the next SOP review, along with any recommendations for change in PEFCO programs.

- **3.3 Compliance:** EXIM has not generated this report. An EXIM official noted that EXIM's short-term business teams do not see a liquidity gap that PEFCO could fill in the short-term market. Because this report is to be contained in the next SOP review, which has yet to take place, we are marking this as not applicable.

Section 3.4: PEFCO will prepare and provide to EXIM, on an annual basis, a report on PEFCO's support for Small Business Exports, SSA Exports, China-Competitive Exports, and Transformational Exports. This report should be made on the activity in the prior fiscal year. The first annual report is due no later than December 31, 2021.

- **3.4 Compliance:** Lending Policy Objectives reports were shared to confirm compliance with this evaluation.

Section 3.5: PEFCO will update its definition of small business activity from short- and medium-term transactions to the Small Business Administration's definition, which is also used by EXIM.

- **3.5 Compliance:** EXIM confirmed that PEFCO is complying with this requirement.

Section 3.6: As part of the next SOP review, PEFCO will engage a third-party consultant with experience in working with U.S. and global export credit markets, and knowledge of

²⁹ Each section of this appendix provides a line-item review conducted by Guidehouse of specific requirements outlined in the SOP.

PEFCO's and EXIM's history and operations to (a) review PEFCO's role and value add within the export finance community, including whether PEFCO compliments or competes with commercial lending, and (b) determine whether other entities can provide a similar product if they had access to the special provisions of guarantee on debt issuance and expedited claims processing as PEFCO.

- **3.6 Compliance:** PEFCO has yet to contract with a third-party for this review. The report is not due until September 30, 2023.

Section 3.7: PEFCO will prepare and provide to EXIM, on an annual basis, a report on the mitigants and protections that PEFCO has in place for the interest on PEFCO's Secured Notes—EXIM's additional exposure to PEFCO. Such a report should compare the trends in exposure as well as the value of mitigants and protections. This report should be made on the activity in the prior fiscal year. The first annual report is due no later than December 31, 2021.

- **3.7 Compliance:** Secured Note Coupon reports were shared to confirm compliance with this evaluation.

Section 3.8: PEFCO will provide EXIM with any other such reports as EXIM may reasonably request from time-to-time.

- **3.8 Compliance:** EXIM has not voiced any concerns regarding PEFCO being unwilling to supply other reports requested from time-to-time in this evaluation.

SOP Article VI

Section 6.1: PEFCO shall at all times maintain (i) at least sixty million dollars (\$60,000,000) of capital; and (ii) a maximum loan to capital ratio of 75 to 1.

- **6.1 Compliance:** As of the end of September 30, 2022, PEFCO is compliant with the SOP. Per PEFCO's 2022 Annual Report, they have \$66.3 million in capital and \$2.294501 billion dollars in outstanding loans, within the capital range and loan to capital ratio.

Section 6.2: On an on-going basis, PEFCO may not pay more than thirty-five percent (35%) of its earnings as dividends.

- **6.2 Compliance:** PEFCO is compliant as PEFCO's 2022 Annual Report states that "PEFCO did not declare a dividend for the fiscal year ending September 30, 2022."

Section 6.3: PEFCO shall maintain a rating no lower than the rating of the U.S. Government from a major rating agency on all secured debt issued by PEFCO.

- **6.3 Compliance:** PEFCO is compliant, as provided Fitch and Moody's credit reports show that PEFCO's rating is no lower than the rating of the U.S. Government as of October 31, 2022.

SOP Article VII

Section 7.1: EXIM approved PEFCO's issuance of long-term debt (according to Section 1.5 of the Guarantee and Credit Agreement, As Amended) under the Collateralized Notes program on September 8, 2020.

Section 7.2: EXIM approved PEFCO's ability to prepay long-term debt (according to Section 1.5 of the Guarantee and Credit Agreement, As Amended) under the Collateralized Notes program on September 8, 2020.

Section 7.3: For each Collateralized Note issuance that qualifies as long-term debt, PEFCO must certify to EXIM which assets are in the collateral pool and that its cost of funding when it goes to market will not be higher than the purchase price of the assets in the collateral pool.

Section 7.4: Due to the contingent risk of PEFCO failing to pay interest on the Secured Notes, PEFCO is required to hold \$50 million in a reserve account, from which interest on the Secured Notes will be paid in the event that PEFCO fails to make an on-time interest payment to the Indenture Trustee.

Section 7.5: PEFCO's Collateralized Notes issuances are understood to primarily fund EXIM-guaranteed assets that do not qualify for the 1971 guarantee, such as partially purchased EXIM-guaranteed assets that qualify for the 1971 guarantee and other U.S. government assets can be part of the collateral pool for any issuance.

- **7.1-7.5 Compliance:** PEFCO is compliant by virtue of the fact that there have been no Collateralized Notes issuances since 2020.

Appendix C: Seven Most Recent SOP Reforms³⁰

1. Require regular reviews of PEFCO - Every time the SOPs are renewed (typically every two or three years), a third-party will conduct a study and EXIM will request that the EXIM Inspector General evaluate PEFCO and make recommendations to EXIM regarding the partnership. The EXIM Board will evaluate these recommendations to modify the SOPs, evaluate the usefulness and appropriateness of PEFCO, and determine whether EXIM should continue the partnership.
2. Enhance PEFCO's reporting to EXIM - Require PEFCO to provide numerous reports on various topics including its annual activity towards each of EXIM's mandates and an annual analysis of the mitigants and protections that PEFCO has in place for EXIM's exposure to PEFCO. Additionally, PEFCO will be required to contribute information to an EXIM report on market gaps for small business exporters and potential market-based solutions, as well as harmonize its small business definition with EXIM's definition in order to better support U.S. small businesses.
3. Lower PEFCO's dividend cap - Under the new SOPs, PEFCO's dividend cap is reduced from 50 percent to 35 percent of earnings, to ensure PEFCO's long-run capital position will be prioritized over short-term stockholder gains.
4. Further U.S. competitiveness with China - Adds EXIM's new congressional mandates on China and Transformational Exports to PEFCO's organizational goals, encouraging the role of private capital in this strategic effort, one of the most important mandates in EXIM's [over] 86-year history.
5. Restrict PEFCO activity with China - Consistent with Section 408 of EXIM's 2019 reauthorization, restricting PEFCO's support of EXIM-guaranteed transactions over \$25 million in which the government of China is the end user, lender, or obligor.
6. Encourage small business support - Adds credit unions to PEFCO's list of eligible lenders, encouraging PEFCO's funding of small businesses across the country.
7. Protect the taxpayer - With this Board action, EXIM approved PEFCO's Collateralized Notes program (which does not receive EXIM's guarantee on interest) as an ongoing authority, allowing for more tailored use of the Secured Notes program (which does receive EXIM's guarantee on interest) and potentially limiting EXIM's exposure to PEFCO in the future.

³⁰ These seven reforms were provided in the appendix by Guidehouse to highlight the most recent changes made by the EXIM Board to the SOPs as a part of the partnership renewal in September 2020.

Appendix D: Loss Experience of Loans Sold to PEFCO

PEFCO does not underwrite its own loans, and instead relies “on EXIM Bank and other involved parties” according to EXIM personnel. In addition, EXIM developed its own credit process, specifically for medium and long-term transactions. “The life cycle of a transaction begins with the underwriting divisions. When a transaction is underwritten (Stages 1 - 3), the risk is assessed and borrowers that EXIM deems to exhibit a reasonable assurance of repayment are recommended for approval.”³¹

PEFCO purchases the EXIM-underwritten and guaranteed loan. As a result, loan defaults are not credited to PEFCO given that it makes no assertions as to the bankability of any particular transaction. EXIM is the entity that underwrites the loan and makes the determination that a borrower met its credit risk threshold and thus bears any responsibilities for risk. Therefore, the loss experience of the portfolio of EXIM guaranteed loans funded by PEFCO or purchased by PEFCO in the secondary market, even when compared to the loss experience of other guaranteed loans in EXIM’s portfolio, does not reflect on PEFCO’s decision making or activities.

Calculating loss exposure further reveals PEFCO’s reactivity towards EXIM’s loan pipeline. While EXIM did not have a full Board (2015-2019), new long-term loans could not be approved. As a result, PEFCO was unable to fund new transactions above \$10 million, and claims were lower because the financing pipeline was severely limited. One senior EXIM official stated that “since 2015, the lack of income has been unsustainable.” Soon after EXIM achieved a full Board, the COVID-19 pandemic began, which both negatively affected new business and resulted in defaults going up.

According to data provided by PEFCO, from January 1, 2020, to September 30, 2022, EXIM paid out approximately \$138.2 million in claims to PEFCO under the Guarantee Agreement. This encompassed claims in all product categories for loans guaranteed by EXIM. Approximately \$91 million of the \$138.2 million was related to missed payments by borrowers attributable to the impact of the COVID-19 pandemic on their businesses. The \$91 million in claims span beyond the loan authorization scope of FY 2017 to FY 2022 examined below. The other approximately \$47.2 million represent claims from six defaulted loans that were not deemed to be connected to COVID-19. EXIM authorized these six loans within the loan authorization scope of FY 2017 to FY 2022.

Analyzing the claims data provided by EXIM and PEFCO, of the loans authorized from FY 2017 to FY 2022 by EXIM, its claims payments made from January 1, 2020, to September 30, 2022, totaled approximately \$192 million. PEFCO’s share of non-COVID related claims payments thus made up 24.6% of the total sum of claim payments from EXIM in the aforementioned period.

³¹ Source document is in Appendix F.

Appendix E: EXIM's Job Methodology

EXIM uses an aggregate jobs model to showcase the number of jobs the agency supports each year; the model relies solely on the total export value of EXIM's products sold each year and makes no distinction in the weighting of jobs supported by the various EXIM products offered. The model is managed by the ITA within the U.S. Commerce Department and is altered each year by ITA to better reflect global and domestic market conditions.

Through this non-proprietary model, EXIM, in concert with other government agencies, is leveraging an independent assessment tool to calculate the number of jobs supported by the agency. The change to this methodology was made in fiscal year 2019 and recommended by the Office of Management and Budget. EXIM does not make any changes to the ITA model presented each year to make sure there is uniformity in comparison across similar federal government agencies.

The ITA jobs model formula is a jobs per billion ratio multiplied by the total export value of EXIM's approvals in a given year. According to EXIM officials, tracking jobs supported at the individual transaction level would be overly granular and provide no additional benefit to an agency that has as many annual deals as EXIM; this approach would likely be very taxing to both EXIM personnel and EXIM customers.

Guidehouse asked EXIM why individualized loan data regarding jobs could not be obtained during the initial underwriting stages to better assess jobs figures rather than using the blunt ITA model.³² There are significant hurdles to this approach: The lender, rather than the borrower, is the entity that submits loan information to EXIM. Getting first-hand estimates from the international borrower regarding U.S. jobs supported thus becomes trickier with this insight. Additionally, asking a foreign borrower to estimate how many jobs their loan may support within the United States is unlikely to yield accurate results; verifying this provided data would also prove to be difficult. Furthermore, this would be an additional layer of red tape that may further restrict EXIM's reach in the export credit industry. According to EXIM officials, a dedicated team of economists within the ITA are better suited to make this analysis at the aggregate level.

EXIM staff reiterated to Guidehouse that any effort to assign a "jobs supported" statistic to PEFCO is ultimately misguided. PEFCO's sole purpose with EXIM is to purchase EXIM-guaranteed products to provide liquidity to both the seller of the product and the broader export market. PEFCO is not supporting jobs in its own name, but rather expanding opportunities in the market for EXIM to support jobs. PEFCO does not discriminate in the EXIM products it purchases; as long as they can purchase at a profitable price, they will do so. PEFCO also does not assess the likelihood of default on an EXIM loan because the underwriting process is exclusively the domain of EXIM and transacting parties. EXIM personnel made it very clear that these misinterpretations could impose false goals onto what PEFCO can really accomplish for exporters. Any PEFCO activity must ultimately be considered EXIM activity.

³² The "bluntness" of the ITA jobs model refers to the fact that it treats all loans with the same number of jobs per dollar of export value, while the individual loans may support differing amounts of jobs per dollar of export value in actuality.

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