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REPORT TO THE CONGRESS

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Audit Of The Export-Import Bank Of The United States Fiscal Year 1972

B-114823

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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APRIL 30, 1973

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114823

C1 To the President of the Senate and
The Speaker of the House of Representatives

This is our report on the audit of the Export-Import Bank of the United States for the fiscal year ended June 30, 1972. 170

Copies of this report are being sent to the Director, Office of Management and Budget, and to the President, Export-Import Bank of the United States.

Elmer B. Staats
Comptroller General
of the United States

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ABBREVIATIONS

FCIA Foreign Credit Insurance Association

PEFCO Private Export Funding Corporation

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

AUDIT OF THE EXPORT-IMPORT BANK OF THE UNITED STATES FISCAL YEAR 1972
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D I G E S T

WHY THE AUDIT WAS MADE

The Government Corporation Control Act requires the Comptroller General to make an annual audit of the Export-Import Bank of the United States (Eximbank). 170

FINDINGS AND CONCLUSIONS

Financial statements

In GAO's opinion, the financial statements--except for the treatment of sales of certificates of beneficial interest--present fairly Eximbank's financial position as of June 30, 1972, and the results of its operations and the source and application of its funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws. (See p. 33.)

Eximbank has sold financing instruments called certificates of beneficial interest which are based on financial participation in specific loans. The buyers of these instruments are not free to dispose of them except as permitted by Eximbank which also assumes full risk of default. Accordingly, GAO believes that these instruments should be considered as borrowing or financing transactions, which, if so handled on Eximbank's financial statements, would increase total assets and liabilities by about $415 million as of June 30, 1972. (See pp. 30 and 33.)

Eximbank's effect on the U.S. budget

The Export Expansion Finance Act of 1971 excluded the operations of Eximbank from the U.S. budget. Because the act was approved on August 17, 1971, however, not all of Eximbank's activities were excluded for fiscal year 1972. The exclusion of Eximbank activities from the budget from August 17, 1971, to the end of fiscal year 1972 reduced the budget deficit by $145.2 million. (See p. 6.)

Private Export Funding Corporation

Eximbank has entered into several financial agreements with the Private Export Funding Corporation (PEFCO) in hopes that this organization would attract new private capital to finance U.S. exports. P. 01589 Although PEFCO is a private corporation, its very existence is dependent on its agreements with Eximbank which place most of the risk of this form of export financing on Eximbank.

PEFCO was expected to increase private capital participation by obtaining most of its funds from the sale of long-term secured notes. The secured notes would be purchased by insurance companies, savings and loan banks, pension funds, and other long-term investors which

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have not generally been involved in financing exports.

However, after PEFCO was formed, the funding plans changed. PEFCO now intends to raise money in medium-term, private markets. This is the same money market Eximbank uses to finance its own operations. To the extent that PEFCO and Eximbank will be obtaining funds in similar markets, GAO doubts that PEFCO's operations will increase the sources of private capital for export financing. (See pp. 21 to 23.)

Even though PEFCO-secured notes will carry the full guarantee of Eximbank, which in turn is fully guaranteed by the U.S. Government, PEFCO's cost of money is somewhat higher than Eximbank's. Also, because its lending rate is determined by adding certain allowances for administrative costs, reserves, and profits to its cost of money, PEFCO's lending rates are from 1.8 to 3.05 percent higher than Eximbank's.

GAO questions the need for PEFCO unless it can obtain funds from sources other than those already reached by Eximbank. If PEFCO obtains funds from the same sources as Eximbank and charges higher interest rates, then PEFCO may be unnecessarily increasing the cost of U.S. exports. (See p. 25.)

Export Expansion Facility

Eximbank's Export Expansion Facility was created to support exports which would advance the long-term commercial interests of the United States but would not qualify under Eximbank's regular programs. Because these benefits were not documented, we were not able to evaluate the program. (See pp. 26 to 28.)

RECOMMENDATIONS OR SUGGESTIONS

In view of PEFCO's recent and probable future operating results, Eximbank should reexamine PEFCO's ability to attract new capital for export loans. If Eximbank judges PEFCO to be a viable concept, Eximbank should require it to obtain funds in markets different from those available directly to Eximbank. If PEFCO is judged to be increasing the cost of exports unnecessarily, Eximbank may wish to sever its relationship with PEFCO and finance directly exports that PEFCO would have financed. (See p. 25.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Eximbank states that it continually reviews its relationship with PEFCO. Eximbank believes that PEFCO will serve a useful role in export financing and that PEFCO's ability to reach new sources of capital is not as critical as GAO suggests; rather, the main issue should be whether PEFCO can offer loans on terms competitive with commercial banks.

GAO agrees that PEFCO could serve a useful role in export financing if it tailors its borrowings to reach new sources of funds. GAO thinks that PEFCO's rates should reasonably compare with Eximbank's. (See p. 24.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress may wish to encourage Eximbank to require PEFCO to obtain funds from new sources. If PEFCO cannot obtain new sources of funds, the Congress may wish to require Eximbank to sever its relationship with PEFCO and instruct Eximbank to finance directly those exports which PEFCO would have financed.

CHAPTER 1

INTRODUCTION

The Export-Import Bank of the United States, created in 1934, was made an independent agency by the Export-Import Bank Act of 1945 (12 U.S.C. 635). The principal activities of Eximbank have been to aid in financing and facilitating exports from the United States to foreign countries.

Eximbank makes loans to foreign borrowers to finance the export of U.S. capital equipment and services, military equipment and services, and agricultural commodities. Under its discount loan program, Eximbank makes loans to commercial banks against their holdings of export debt obligations. It also guarantees and insures commercial banks and U.S. exporters against commercial-credit and political risks of loss associated with exports. Recently Eximbank entered into an agreement with the Private Export Funding Corporation (PEFCO) in hopes of developing that organization into another source of funds with which to make export loans.

The Export Expansion Finance Act of 1971 (Public Law 92-126), excluded Eximbank's operations from the budget of the United States Government; extended the life of Eximbank from June 30, 1973, to June 30, 1974; increased the limitation on the aggregate amount of loans, guarantees, and insurance that Eximbank could have outstanding at any one time from $13.5 billion to $20 billion; and increased the limitation on the amount of guarantees, insurance, and reinsurance outstanding for which fractional reserves are maintained from $3.5 billion to $10 billion. At June 30, 1972, Eximbank had uncommitted lending authority of about $7.6 billion.

The act directs Eximbank to report to the Congress semiannually on the competitiveness of export financing offered by Eximbank versus that offered by other major foreign Government-related agencies. To do this, Eximbank is responsible for surveying all other major export-financing facilities of other governments.

MANAGEMENT OF EXIMBANK

Eximbank management is vested in the Board of Directors, consisting of Eximbank's President and First Vice President serving as the Chairman and Vice Chairman, respectively, and three additional members, all appointed by the President of the United States by and with the advice and consent of the Senate. The Board adopts bylaws as necessary for the proper management and functioning of Eximbank and designates the vice presidents and other officers and prescribes their duties.

Eximbank also has an advisory committee of nine members, appointed by the Board of Directors to advise the Board on Eximbank's operations.

Eximbank's activities are conducted principally through its office in Washington, D.C. At June 30, 1972, Eximbank had 380 employees--an increase of 6 during the fiscal year.

The scope of our audit of Eximbank's financial statements is described on page 6 of this report. In addition, we have included comments on certain operations of Eximbank which we believe to be of interest to the Congress. Eximbank's comments on this report can be found on page 34.

EXIMBANK'S EFFECT ON THE U.S. BUDGET

The Export Expansion Finance Act of 1971 excludes the operations of Eximbank from the U.S. budget. It, however, requires the President of the United States to report to the Congress annually the effect of Eximbank's activities had its operations not been excluded from the budget. Because the act was approved on August 17, 1971, not all of Eximbank's activities were excluded from the budget for fiscal year 1972.

The U.S. budget deficit for fiscal year 1972 was increased by Eximbank's activities before passage of the act, as follows:

	Amount July 1 through Aug. 16, 1971
	(millions)
Total expenditures	$153.0
Less total receipts	114.3
U.S. budget deficit increase	$ 38.7

The deficit was reduced because of the exclusion of Eximbank's activities for the remainder of fiscal year 1972, as follows:

	Amount Aug. 17, 1971, through June 30, 1972
	(millions)
Total expenditures	$1,590.6
Less total receipts	1,445.4
U.S. budget deficit decrease	$ 145.2

CHAPTER 2

LOAN OPERATIONS

LOAN AUTHORIZATIONS

During fiscal year 1972, Eximbank authorized new loans, less cancellations and participations in current authorizations, totaling $2,384.7 million classified by Eximbank, as follows:

Type of credit	Number of authorizations	Amount
		(millions)
Long-term capital loans	608	$1,700.1
Commodity loans (note a)	6	85.0
Discount loans:		
Medium-term	885	599.6
Short-term	-	-
Total	1,499	$2,384.7

[a] Includes a 1-year credit for $75 million made annually to support the export of U.S. cotton to Japan and five small loans supporting the export of U.S. tobacco, wheat, soybeans, and tallow.

Long-term capital loans are dollar credits extended directly to borrowers outside the United States, generally on repayment terms of 5 years or longer for purchases of U.S. goods and services. The current interest rate charged on direct loans is 6 percent per annum, and repayment is normally made in semiannual installments beginning 6 months after delivery of purchases or completion of the project financed. Eximbank also charges the borrower a commitment fee equal to one-half percent per annum on the undisbursed balance of a loan.

The principal items being financed with the $1,700.1 million of net long-term capital loans authorized in fiscal year 1972 are: (1) nuclear power projects, $725 million or 43 percent of net authorizations, (2) jet aircraft, $475.4 million or 28 percent of net authorizations, and (3) defense articles and services, $190 million or 11 percent of net authorizations.

In February 1970 Eximbank adopted a policy for loans to developed countries for military equipment and services of charging interest rates equivalent to the rate charged Eximbank on its borrowings from the Treasury. During fiscal year 1972 this rate ranged from 6 percent to 6.5 percent.

The Foreign Military Sales Act of 1968 (22 U.S.C. 2751-2772) prohibits Eximbank from extending loans connected with sales of defense articles and services to economically <u>less developed</u> countries. Australia and Iran, which received loans for defense articles and services from Eximbank during fiscal year 1972, are considered <u>developed</u> countries.

To insure that Eximbank's financial resources supplement, rather than compete with, private sources of export financing and extend to the largest possible number of projects, Eximbank has adopted a policy of seeking, at all times, private financial participation in any transaction requiring Eximbank direct lending.

This policy, termed participation financing, combines Eximbank's direct lending at 6 percent per annum with loans by private sources and moderates the effective rate the borrower must pay to finance the transaction. Eximbank states that it is usually competitive with the rate of interest offered by non-U.S. suppliers on comparable sales.

During fiscal year 1972, Eximbank's other major lending program, the discount loan program, underwent major revisions. The most significant revision was the announcement of the short-term discount program, effective January 1, 1972. The medium-term discount program was revised to permit commercial banks to more effectively support U.S. exporters.

<u>SHORT-TERM DISCOUNT PROGRAM</u>

The short-term discount program represents the first time in Eximbank's 38-year history that it is prepared to provide financing for short-term exports. The program was made possible by new funding authority granted under the Export Expansion Finance Act of 1971. It is designed to expand exports by insuring commercial banks of adequate backup liquidity for short-term financing (up to 364 days) during periods of tight money.

Under this program, commercial banks can discount up to 100 percent of their current export credit paper if an advance commitment has been authorized and the transaction involves current exports. The discount rate varies with the amount and duration of the transaction, having a maximum discount of 2 percent for transactions of $250,000 or less with terms of 180 days or less and a minimum discount of 1 percent for transactions of $750,000 or over, regardless of the repayment terms. The discount rates are designed to cover the commercial bank's cost for the loans discounted but not to provide a profit incentive to use Eximbank's funds.

The short-term discount program is expected to have a great impact on exports, as evidenced by the $3 billion net authorization level approved, but is not expected to have an equivalent growth in Federal credit. During the program's first 6 months of existence, no authorizations were approved. This can be attributed to the loose money situation that existed during this period.

MEDIUM-TERM DISCOUNT PROGRAM

Eximbank has also revised its medium-term discount program by eliminating the minimum interest rate requirement; standardizing the discount rate to a spread of 1 percent, whether guaranteed or insured under Eximbank's respective programs or not; and operating the program on an advance-commitment basis, whereby Eximbank agrees in advance to allow a commercial bank to discount an approved loan any time during the life of the loan.

The medium-term discount program was initiated in September 1966 to assist commercial banks increase their financing of the export of U.S. products and services. The program is designed to provide credit for exports during periods of tight money. Because of revisions to the program, net new medium-term discount loan authorizations for fiscal year 1972 amounted to $599.6 million, almost an 80-percent increase from the net discount loans of $334.3 million authorized in fiscal year 1971. However, the relatively loose money situation in fiscal year 1972 resulted in limited loan disbursements under the program.

RESULTS OF LOAN OPERATIONS

The results of loan operations (excluding discount loans) during fiscal years 1972 and 1971 were, as follows:

	1972	1971
	(000 omitted)	
Interest and fee income	$338,904	$310,731
Other income	436	5
Total	339,340	310,736
Less:		
Interest expense	183,736	187,126
Administrative expenses	5,188	4,609
Other expenses and losses	406	111
Total	189,330	191,846
Net gain	$150,010	$118,890

The net results for the discount loan operations for fiscal years 1972 and 1971 were, as follows:

	1972	1971
	(000 omitted)	
Interest income	$2,416	$11,757
Less:		
Interest expense	2,228	10,637
Administrative expense	97	81
Total	2,325	10,718
Net gain	$ 91	$ 1,039

The primary reason for the lower discount program operations in fiscal year 1972 was because the commercial banks had more capital on hand than in fiscal year 1971 and did not find it necessary to discount their loans as often.

CHAPTER 3

GUARANTEE AND INSURANCE OPERATIONS

Section 2(c) of the Export-Import Bank Act of 1945, as amended, authorizes Eximbank to guarantee, insure, coinsure, and reinsure U.S. exporters and foreign exporters doing business in the United States against commercial-credit and political risks of loss due to nonpayment arising in connection with U.S. exports. Commercial-credit risks include the insolvency of a buyer and the protracted default of payment by a buyer. Political risks include the actions taken by a foreign government--such as currency convertibility restrictions, export and import restrictions, war, revolution, civil commotion, and expropriation--which prevent consummation of payments for sales.

Eximbank does not insure nor guarantee the full amount or contract price of items exported; its liability as to principal is determined after deduction of the required cash downpayments and the percentage of the financed portion not underwritten and is based on the instructions established for the various risk markets. To assess premium fees and establish guidelines for its guarantee and insurance programs, Eximbank classifies foreign markets into four groups or risk markets--A through D. Countries are graded according to their degree of economic and political stability, the A market being composed of the lowest risk countries and the D market the highest.

Although U.S. exporters have available to them protection against the same types of commercial and political risks under the Eximbank insurance and guarantee programs, the approach under each of the two systems is different. In the case of insurance, it is the exporter who seeks the insurance from the Foreign Credit Insurance Association[1] (FCIA) and follows through with the necessary paper work. If he desires financing, he assigns the proceeds of the insurance policy to his bank. In the case of a guarantee, the commercial bank seeks the guarantee from Eximbank for a credit the bank is willing to extend to an exporter. The commercial bank, before submitting an application to Eximbank, must make a

[1] A nonprofit organization composed of about 50 private casualty, property, and marine insurance companies.

judgment as to the soundness of the transaction and do the necessary paper work.

The principal distinction between the general nature of Eximbank's guarantee and insurance programs involves the beneficiaries participating in the programs. Commercial banks are generally the beneficiaries in the guarantee program, whereas exporters are the beneficiaries in the insurance program.

GUARANTEE OPERATIONS

Eximbank issues guarantees, generally to commercial banks, to cover the repayments of their medium-term (6 months to 5 years) financing of U.S. export sales. Under the commercial bank exporter guarantee program, Eximbank guarantees the payment of export debt obligations acquired by U.S. banking institutions from U.S. exporters. Eximbank's financial guarantee program guarantees the repayment of direct loans made by financial institutions to foreign purchasers of U.S. goods and services. In certain instances Eximbank also extends its guarantees directly to exporters of U.S. goods and services.

During fiscal year 1972 Eximbank authorized 1,256 new guarantees and increases in existing guarantees for a total of about $1,743.5 million. As shown in the following summary, there has been a significant increase in the dollar value of the guarantees authorized over the past 3 fiscal years.

Fiscal year	Total amount of guarantees authorized	Amount by type of guarantees: Financial	Commercial bank exporter	Exporter
		(millions)		
1970	$ 612.5	$ 335.5	$265.1	$11.9
1971	1,419.6	1,046.1	335.1	38.4
1972	1,743.5	1,162.4	551.1	30.0

The substantial increase in the dollar amount of guarantees authorized over the past 3 fiscal years resulted from increased emphasis by Eximbank of its policy of seeking private financial participation in transactions requiring direct lending. Under this method of financing U.S. exports, which is called participation financing, Eximbank makes a direct loan at its current rate of interest of 6 percent per annum for a portion of the financing required and guarantees the repayment of credit extended by private lenders at the commercial rate of interest for the remaining portion of the financing under the financial guarantee program. Of the 405 financial guarantees authorized by Eximbank during fiscal year 1972, 402 were issued in combination with Eximbank direct loans. Before fiscal year 1970, only a limited number of financial guarantees were authorized in this manner.

Authorizations under the financial guarantee program also increased due to expansion of the program in August 1969 to cover loans made by foreign financial institutions for the purchase and exportation of U.S. goods and services. During fiscal year 1972, net activity resulted in 26 guarantees being issued to foreign financial institutions covering loans totaling over $78 million. With such a guarantee, a foreign financial institution may loan funds for exports with the assurance that Eximbank will absorb related losses, wholly or in part, if such a loan is not repaid in accordance with the respective loan agreement.

Foreign financial institutions currently eligible to participate in Eximbank's guarantee program include, but are not limited to, overseas offices of U.S. trading companies, foreign branches of U.S. commercial and investment banks, foreign trading companies, foreign public or private commercial investment and development banks.

As a general rule, a financial guarantee will not be extended to a foreign financial institution whenever private U.S. sources of funds are willing and able to finance the transaction on reasonable terms.

For fiscal year 1972 Eximbank records show a net loss from guarantee operations of about $1.6 million, compared with a net loss of $239,000 for fiscal year 1971.

	1972	1971
	(000 omitted)	
Guarantee fees	$3,622	$2,786
Claims recovered	586	384
	4,208	3,170
Less:		
Administrative expenses	1,343	1,231
Nonadministrative expenses	12	15
Claims paid (cash basis) (note a)	4,499	2,163
	5,854	3,409
Net loss	-$1,646	-$ 239

[a]The basic reason for the doubling of claims paid in fiscal year 1972 was a series of political risks claims totaling $3.5 million, a substantial portion of which related to Chile, which Eximbank paid during the year.

Accumulated net income from inception of the program to June 30, 1972, totaled $8,368,000. Since claims are accounted for on a cash basis, this amount does not give consideration to any provision for estimated future losses resulting from program activity through fiscal year 1972.

INSURANCE OPERATIONS

To discharge its responsibility for providing insurance for commercial-credit and political risks, Eximbank entered into an agreement in 1961 with FCIA. The original agreement, after numerous modifications during its 10-year existence, was replaced by a document referred to as the Agreement of July 1, 1971.

The agreement, according to FCIA and member's officials, places Eximbank and FCIA in an insurer-reinsurer relationship for the first time; a relationship common in the private insurance industry. Basically, the reinsurance aspects of the agreement provide that Eximbank will protect FCIA against catastrophic commercial losses in two basic ways.

1. Eximbank covers FCIA losses above $150,000 per buyer per calendar year.

2. Eximbank protects FCIA through "stop-loss" provisions which establish maximum total limits for losses FCIA must absorb in any calendar year or consecutive 10-year period.

Eximbank charges a fee of 10 percent of FCIA's comprehensive premium for this reinsurance service.

FCIA also issues political-risk insurance--but Eximbank assumes all risks on political policies. Additionally, FCIA may issue certain commercial-risk policies under the Export Expansion Program, in which case Eximbank will insure the remainder of the risks not taken by FCIA. The agreement provides that Eximbank pay FCIA a service fee which should be sufficient to cover FCIA's administrative costs for servicing these policies.

The agreement continues an expense-sharing ratio between Eximbank and FCIA which was established in 1969. However, a new stipulation was added which limits FCIA's total share of approved expenses to 27.5 percent of gross premium income after certain adjustments.

In early 1971 FCIA began offering a new type of coverage--master policies--which provides almost automatic coverage under a single policy for all an exporter's sales to overseas buyers on credit terms ranging up to 5 years. Previously, exporters applied for insurance only on sales to buyers they considered to be poor commercial or political risks. An Eximbank official informed us that the master policies will enable FCIA to insure a mix of both good and poor risks, thus lowering overall insurance rates.

There are two basic master policies, comprehensive and political. The comprehensive policy provides blanket coverage, usually 90 percent, for political and commercial risks for the exporters' eligible short- and medium-term credit sales. It includes deductible provision for commercial risks so that, in effect, the exporter is self-insured for this amount. The master political policy provides blanket coverage for 70 percent of losses from political risks for all of an exporters' eligible medium-term credit sales.

In November 1971 FCIA announced a Prequalification of Foreign Buyers Program which is designed to establish individual transaction credit limits for foreign buyers. The names and respective transaction credit limits of about 20,000 of the approximately 40,000 active foreign buyers of U.S. goods have been computerized and are available to all FCIA offices. FCIA officials hoped to have all the active buyers prequalified by the end of 1972. FCIA reports that the availability of this data will enable it to provide same-day answers to exporters regarding coverage limits for buyers and will significantly reduce the paperwork for each transaction.

FCIA has historically handled its insurance operations from its headquarters offices in New York, N.Y. To make their insurance more readily available to U.S. exporters, FCIA has planned a network of 12 branch offices in key industrial centers around the Nation. To date six of these offices have been opened, offering the full range of FCIA insurance services. Additionally, FCIA has established a service office in Washington, D.C., which serves as an intermediary between Eximbank and FCIA headquarters. The service office is designed to facilitate the data flow between the respective headquarters' offices and to assist in the prequalification of buyers, using Eximbank's computer.

RESULTS OF INSURANCE OPERATIONS

During fiscal year 1972 FCIA authorized the issuance of new and renewed policies totaling $2,200.4 million. A brief comparative summary of policies issued during fiscal years 1972 and 1971 follows.

Policy	1972 Number	1972 Amount (millions)	1971 Number	1971 Amount (millions)
Short term	1,026	$ 960.1	1,123	$ 886.6
Medium-term (note a)	1,619	571.8	1,645	412.8
Master	31	668.5	19	314.3
	2,676	$2,200.4	2,787	$1,613.7

[a]Includes repayment increases on revolving or repetitive-type policies.

Eximbank records showed a loss of $557,000 in the insurance program for the fiscal year ended June 30, 1972, a substantial increase over the $164,000 loss reported for fiscal year 1971. A brief comparative summary of the results of the insurance operations for fiscal years 1972 and 1971 follows.

	1972	1971
	(000 omitted)	
Premium income	$1,106	$1,037
Less:		
Administrative expenses	1,145	977
Claims and other losses (cash basis)	518	224
	1,663	1,201
Net loss	$ 557	$ 164

Eximbank records also showed a $3.2 million cumulative net loss since inception of the insurance program.

Cognizant Eximbank and FCIA officials and representatives of member companies informed us that the new agreement between Eximbank and FCIA was a significant improvement over previous ones and would be financially beneficial to both parties. In view of the relatively brief time that the agreement has been in existence--signed November 11, 1971, retroactive to July 1, 1971--and the term of some of the policies--up to 5 years--we are unable to make conclusions as to the ultimate fairness of the agreement at this time. We do note, however, that Eximbank is twice removed from actual commercial losses: (1) by the exporter's deductible and (2) by FCIA's $150,000 per buyer coverage. To this extent Eximbank is risking its assets only for unusual losses in the program.

CHAPTER 4

PRIVATE EXPORT FUNDING CORPORATION

Legislation provides that Eximbank should supplement and encourage private capital in financing the sale of U.S. exports. To further this objective, Eximbank has entered into several agreements with PEFCO which enable this private corporation to provide middle-term financing for U.S. exports. Indeed, PEFCO's existence and the feasibility of its operations are entirely dependent on the financial agreements and the cooperation of Eximbank.

PEFCO was originally conceived as a way to attract resources, not already involved in financing exports, to fill a financial gap which can exist on large export transactions. Because of changes in Eximbank's financing methods and changes in PEFCO's planned sources of funds, they will probably be obtaining funds in similar markets. If PEFCO cannot meet its original objective, GAO believes that PEFCO loans could be unnecessarily increasing costs of U.S. exports.

BACKGROUND

In 1967 an association of approximately 140 U.S. commercial banks commissioned a study to determine the feasibility of forming a publicly owned corporation to assist in the private market financing of jet aircraft exports. The study was commissioned because the bankers foresaw that future jumbo and supersonic aircraft would be so expensive that they would require private capital from sources other than commercial banks. The higher costs would also require longer repayment terms and a gap would develop between the customary repayment terms of the commercial banks and Eximbank. The assumption was that the Government could not, or should not, increase its share of the financing beyond one-half the financed portion.

The initial study, completed in April 1968, concluded that a vehicle such as PEFCO was needed to supplement existing financing, primarily Eximbank and U.S. commercial banks. It soon became apparent that a financing gap would also exist for such expensive exports as nuclear power stations. The basic concept of PEFCO is to mobilize previously untapped private market financial resources, such as pension funds, savings and loan associations, and life insurance companies, to fill the projected financing gaps.

In May 1969 the PEFCO concept was formally endorsed by the chairman of Eximbank; however, it was not until May 1971 that all the requisite governmental approvals were finalized and PEFCO stock was offered.

During the almost 3-1/2 years it took to form PEFCO, there were numerous changes in PEFCO's proposed operating methods and in Eximbank's financing. In general, PEFCO operations have become more dependent on Eximbank's cooperation and assistance and Eximbank has increased its direct financing in the private market.

A TYPICAL PEFCO TRANSACTION

A typical export transaction involving PEFCO might be for a nuclear power station. Assume the following facts about the export.

Total cost of nuclear power station	$100 million
Less required cash downpayment	10 million
Balance to be financed	$ 90 million

Repayment terms 10 years, payable semiannually.

In the above circumstances, Eximbank would generally be ready to provide 50 percent of the financing and would be repaid last, perhaps during the final 4 years. Commercial banks, on the other hand, generally would lend their funds for only the first 4 or 5 years. Thus a gap exists for the medium-term maturities (4 to 6 years in this case).

If PEFCO became involved, the final export financing package might look like this.

Eximbank loan: $45 million to be paid back from repayments 14 through 20 (last 4 years)

Commercial bank loan: $25 million to be paid back from repayments 1 through 7 (first 4 years)

PEFCO loan: $20 million to be paid back from repayments 8 through 13 (middle 2 years)

PEFCO'S ABILITY TO ATTRACT NEW RESOURCES QUESTIONABLE

PEFCO was created on the assumption that it would obtain its funds from sources not already involved in financing exports. Originally, it was thought that PEFCO would operate somewhat like a finance company, by issuing its own short-term commercial paper and long-term secured notes, and using these revenues to finance medium-term maturities of high-cost exports. PEFCO has obtained a $50 million line of short-term credit from Eximbank, which should provide adequate backup for its short-term credit requirements.

PEFCO officials said that PEFCO would offer its first secured notes during 1973. PEFCO has stated that the maturities of its secured notes will be scheduled to match the maturities of its export loans. Our review of loan commitments made by PEFCO through June 30, 1972, indicated that the average loan would be outstanding about 7 years. If PEFCO should, in fact, issue medium-term notes with maturities ranging from 5 to 10 years, these notes would probably not reach new sources of funds because Eximbank is already actively financing its own operations in these medium-term markets.

As discussed earlier, the Export Expansion Finance Act of 1971 removed Eximbank's operations from the U.S. unified budget. Eximbank states that it probably will fund itself in the future by borrowing directly from the private market rather than from the U.S. Treasury. During fiscal year 1972 Eximbank issued $800 million in debentures with maturities of 3, 5, and 7 years--generally considered medium-term securities. Eximbank advised us that the primary reason for the particular maturities was because it was seeking the cheapest funds at maturities which were reasonably related to their portfolio. Eximbank's Senior Vice President-Financing stated, however, that Eximbank was capable of selling long-term maturities and probably would do so if these funds were cheaper than medium-term funds. Should PEFCO seek the lowest cost funds available, its maturities will probably be similar or identical to those of Eximbank at comparable times.

To the extent that PEFCO securities are able to compete on the private market as Government-backed securities, investors will be making purchase decisions based on yields and terms. PEFCO has received an Internal Revenue Service ruling which will permit the PEFCO shareholder commercial banks to purchase all of PEFCO's short-term paper and up to one-half of PEFCO's secured notes. That PEFCO shareholder commercial banks might purchase significant portions of PEFCO-secured notes is evidenced by the fact that commercial banks initially purchased about 50 percent of the first two Eximbank debentures in fiscal year 1972. Eximbank officials and several commercial bankers told us that commercial banks' decisions to purchase PEFCO-secured notes would be made strictly on yield and term bases, rather than on efforts to expand their influence over PEFCO's operations. Since the major commercial banks are PEFCO shareholders, their purchases of PEFCO securities will not increase the sources of private funds for exports because they are already involved in export financing.

For these reasons it appears to us that PEFCO will be unable to accomplish its primary objective of mobilizing new sources of funds for exports.

EXIMBANK RELATIONSHIPS REDUCE PEFCO RISKS

Eximbank has entered into several financial agreements with PEFCO to reduce PEFCO's risks. Some of these agreements are outlined below.

--Eximbank guarantees payment of principal and full interest on all approved PEFCO loans.

--Eximbank-guaranteed notes collateralize PEFCO's secured notes and Eximbank guarantees all interest payments on approved PEFCO short-term and secured-note debt obligations.

--To insure prompt payment of principal on PEFCO's secured notes, Eximbank exchanges maturities of guaranteed foreign importer notes with PEFCO so that all loans pledged to secure the PEFCO-secured notes will mature on or before the due date of the issue.

Still other agreements tend to integrate the financing operations of the two organizations. Eximbank has extended to PEFCO a $50 million revolving line of short-term credit which can be used as an interim source of funds, allowing PEFCO to better "ride out" tight money conditions with its secured-note issuances.

Another agreement permits PEFCO to reduce its risk in committing funds for future disbursement. Should PEFCO's cost of money (secured-note cost plus an additive for operating costs and profit) be higher than originally forecast, Eximbank will increase its participation in the loan to allow PEFCO to cover its cost of money on the reduced loan amount so long as the overall cost to the borrower remains constant. This agreement, in fact, operates to protect PEFCO from a drain on its profits by shielding it against a rise in interest rates. PEFCO views this agreement as a valuable safeguard for purchasers of its secured notes.

We believe these agreements will make PEFCO's debt obligations as secure as U.S. Government agency paper and PEFCO will, in effect, be operating as an extension of Eximbank rather than as an independent private corporation. To the extent that PEFCO will be unable to meet its primary objective of obtaining funds from different sources than Eximbank, we question the need and validity for these agreements.

PEFCO OPERATIONS MAY INCREASE COSTS OF EXPORTS

Eximbank's various agreements with PEFCO should make PEFCO virtually risk-free and allow its secured notes to compare favorably with other Government securities. Whatever yields PEFCO must ultimately pay, however, will probably be somewhat higher than those of Eximbank because PEFCO is one step further from the ultimate U.S. Government guarantee of its securities.

PEFCO determines its effective lending rates by adding to its estimated cost of money the charges for administrative costs, reserves, profit, and guarantee fees. PEFCO's effective lending rates have ranged from 7.8 to 9.05 percent for loan commitments made through June 30, 1972. Eximbank, on the other hand, currently lends its funds at 6 percent. Thus PEFCO rates are 1.8 to 3.05 percent higher than Eximbank's.

Although we are not concluding that PEFCO's lending rates should be reduced, the fact remains that its lending rates will probably always exceed Eximbank's. We believe that PEFCO's participation in high-cost transactions may be unnecessarily increasing the costs of exports, particularly to the extent that PEFCO obtains funds from Eximbank or other sources which are already financing exports.

EXIMBANK VIEWS AND OUR COMMENTS

Eximbank's reply to our draft report (see app. I) states that PEFCO should play a key role in maintaining private capital participation with Eximbank if and when banks experience or anticipate tight money. Eximbank believes the main issue in question is whether PEFCO can offer financing on competitive terms with commercial banks and thereby expand private capital participation in export financing.

GAO believes that unless PEFCO can attract funds from different sources than Eximbank and commercial banks, its funds cannot be considered as additional private capital. Rather, the primary sources of current export financing would just be funneled through and identified as PEFCO and no expansion of private capital would take place.

Eximbank states that PEFCO should be competitive with commercial banks. It should be noted, however, that PEFCO was formed to fill a financial gap between Eximbank and commercial banks. If banks are unwilling or unable to lend funds, PEFCO is in direct competition with Eximbank.

Eximbank also believes GAO's statement that PEFCO's effective interest rates have been from 1.8 to 3.05 percent higher than Eximbank's is misleading because PEFCO's lending rates include one-half percent to cover Eximbank's guarantee fee. However, the one-half percent guarantee fee is paid to Eximbank to guarantee the foreign importer paper that PEFCO purchases. Although such a fee would be required if Eximbank guaranteed a commercial bank loan for U.S. exports, no such fee would be required if Eximbank made a direct loan. Without the guarantee fee, PEFCO's average interest rate has been 7.9 percent on disbursed loans and 7.5 percent on undisbursed loans, while Eximbank's is only 6 percent.

CONCLUSIONS

PEFCO was established to fill the financing gap, which could exist with high-cost exports, by attracting resources not already involved in financing exports. Current information indicates that PEFCO will not be able to attract funds from sources not already being directly reached by Eximbank. Because PEFCO's lending rates are higher than Eximbank's, PEFCO loans may unnecessarily increase the costs of exports.

We suggest that Eximbank reexamine PEFCO's basic goals in view of recent and probable future operating results. If Eximbank thinks it possible for PEFCO to attract new sources of funds, Eximbank should exercise its considerable control over PEFCO's operations to insure that PEFCO reaches these unused resources. If PEFCO cannot economically obtain such funds, Eximbank should recognize that PEFCO's operations unnecessarily increase the costs of exports and should sever its relationships with PEFCO. Eximbank should then offer funds to exporters that would have been provided by PEFCO, at rates which would approximate Eximbank's cost of funds.

CHAPTER 5

EXPORT EXPANSION FACILITY

Eximbank's basic legislation provides that loans, guarantees, and insurance should be made only when, in the judgment of the Board of Directors, there is "reasonable assurance of repayment." Because of increased concern over deteriorating U.S. balance of payments and the realization that exports were being lost because they could not meet the stringent credit standards of Eximbank, the Congress authorized Eximbank's export expansion facility in 1968 (82 Stat. 296).

This act provided that Eximbank devote up to $500 million of its resources to the support of export transactions which offer merely a sufficient likelihood of repayment. These higher risk transactions were to support only truly additional exports--those that would not have been approved under Eximbank's regular programs--which would advance the long-term commercial interests of the United States.

The legislation provided that Eximbank must specifically designate the loans, guarantees, and insurance made under the program and that, in the event of any losses, the first $100 million of losses be borne by Eximbank, the second $100 million be borne by the Treasury, and all additional losses be borne by Eximbank.

Eximbank's liability under the export expansion facility as of June 30, 1972, is summarized below.

Types of financing	Amount outstanding (millions)
Loans	$248.3
Guarantees	60.6
Insurance	64.7
Total	$373.6

Eximbank officials advised us that engineering, planning, and feasibility studies of foreign projects were financed through the facility. Eximbank officials stated that these kinds of studies had been considered before establishment of the export expansion facility but had never been approved under the regular bank programs because of the high risk of nonpayment if the clients did not like the studies' results. Shortly after the facility was authorized by the Congress, however, these types of loans were made and charged against the facility.

An Eximbank official stated that the very existence of the facility created a favorable psychological impact on loan officers; that is, loan officers are more apt to consider riskier cases, knowing full well that they can be charged against the facility if they cannot meet regular program standards.

Eximbank guidelines governing the use of the export expansion facility state that each transaction should provide "leverage" to advance the Nation's long-term commercial interests. Such leverage could be expected if the transactions would help to maintain or establish a market presence or offered a strong likelihood of significant follow-on sales.

In our report on Eximbank's activities for fiscal year 1970 (B-114823, June 21, 1971), we stated that our examination of selected loans, guarantees, and insurance approved by Eximbank under the export expansion facility indicated that, in evaluating the applicants, primary emphasis was placed on determining whether a sufficient likelihood of repayment existed rather than on the benefits to be expected from the acceptance of higher risk transactions. To determine if this situation continued to exist, we examined all loan, guarantee, and insurance transactions approved for the facility in October 1971 and February 1972. Of the 62 case files examined, 39 contained a pro forma statement that the buyers' financial standings were expected to improve and that follow-on sales could be expected but contained no evidence of how this judgment was reached and 21 contained no evidence or documentation of the leverage expected to accrue from Eximbank's support of the exports. In addition, an Eximbank official informed us that FCIA charged the facility for small policies involving first-time customers rather than running expensive time-consuming credit checks. In these instances, no attempt is made to justify the additional leverage to be obtained from these transactions. Because of this lack of documentation, we believe these types of transactions may not be in keeping with the spirit and intent of the guidelines established for the export expansion facility.

CONCLUSION

Our review of individual loan, guarantee, and insurance transaction case files indicated that some of these transactions were being charged to the export expansion facility without evidence that they were responsive to the long-term commercial interests of the United States. Although Eximbank may be taking additional risks from transactions charged to the facility, we believe that management should increase the effort to provide some measurement of the potential trade growth or leverage developing from consummation of the individual transactions. Such data would permit top management and the Congress to measure the effectiveness of the facility in expanding U.S. exports. Because these benefits are not documented, it is not possible to evaluate the program.

CHAPTER 6

OPINION OF FINANCIAL STATEMENTS

The accompanying financial statements (schs. 1, 2, and 3) are those contained in Eximbank's annual report to the Congress.

We have examined the statement of financial condition of the Export-Import Bank of the United States, a wholly owned Government corporation, as of June 30, 1972, and the related statements of income and expense and analysis of retained income reserve and source and application of funds for the year then ended. This examination, pursuant to the Government Corporation Control Act (31 U.S.C. 841), was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The interest and other financial expense reported by Eximbank include interest charges on a significant part of the borrowings from the U.S. Treasury at rates lower than the rate prevailing at the time the funds were borrowed. Had the Treasury charged Eximbank interest rates approximating the full cost of the funds, the Bank's interest and other financial expense would have been increased by about $9.9 and $11.9 million in fiscal years 1972 and 1971, respectively, and the net income from operations for the years then ended would have been correspondingly reduced.

We were advised by Eximbank officials that in the past these special borrowing arrangements were made with the Treasury to compensate, in part, for Eximbank's having financed its operations through the sale of participation certificates and certificates of beneficial interest and for Eximbank's having made certain relatively low-interest-rate loans, all in furtherance of national policy. During the latter part of fiscal year 1971, the Eximbank and Treasury entered into a new agreement with regard to the borrowings, whereby such low-interest borrowings from Treasury are tied in directly to the rate, term, and amount of the outstanding balances of those loans which Eximbank states have been made at concessionary terms in the national interest. The effect of the new agreement, however, eliminates only a portion of the concession given Eximbank on its low-cost borrowings from the Treasury. Because the interest rates on the loans made by Eximbank are less than the Treasury's cost of borrowing the funds, the Treasury will be absorbing that portion of the cost between its lending rate to Eximbank and the cost of obtaining the funds.

The net income reported by Eximbank is stated before any provision for losses that may be sustained on loans receivable and related accrued interest or on guarantees and insurance. All accumulated net income, after dividends, has been reserved as a provision for future contingencies, defaults, or claims. (See note 2 to financial statements.)

The contingent liabilities reported by Eximbank as loan maturities sold subject to contingent repurchase commitments include participations in specific loans, in support of which Eximbank issued instruments called certificates of beneficial interest. The buyers of these instruments are not free to dispose of them except as permitted by the Eximbank, which also assumes fully the risk of default. Accordingly, we believe that such intruments should be considered as borrowing or financing transactions, which, if so handled on the Eximbank's financial statements, would increase the Eximbank's total assets and liabilities by about $415 million as of June 30, 1972.

In our opinion, the accompanying financial statements, subject to our comments in the paragraph directly above, present fairly the financial position of the Export-Import Bank of the United States at June 30, 1972, and the results of its operations and the source and application of its funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

EXPORT-IMPORT BANK OF THE UNITED STATES

COMPARATIVE STATEMENT OF FINANCIAL CONDITION FISCAL YEARS 1972-1971

ASSETS	June 30, 1972		June 30, 1971	
Cash:				
In banks, in transit, and on hand	$ 9,437,520		$ 5,679,201	
With U.S. Treasury	207,433		84,192,836	
		$ 9,644,953		$ 89,872,037
Loans Receivable:				
Outstanding loans and undisbursed authorizations	10,523,884,643		9,177,443,776	
Less undisbursed balance of authorized loans	4,567,655,552		3,512,716,426	
Outstanding loans receivable (Notes 2 and 3)		5,956,229,091		5,664,727,350
Accrued Interest and Fees Receivable on Loans and Guarantees		89,085,254		67,667,294
Other Assets:				
Due from Foreign Credit Insurance Association	363,360		353,025	
Due from Borrowers	6,733,480		1,079,025	
Miscellaneous	26,884		48,206	
		7,123,724		1,480,256
Furniture and Equipment:				
Less accumulated depreciation (1972, $306,252; 1971, $384,635)		203,543		297,466
Deferred Charges —				
Unamortized balance of financial expense		2,809,178		1,519,409
Total assets		$6,065,095,743		$5,825,563,812

LIABILITIES, CAPITAL, AND RESERVE

	June 30, 1972		June 30, 1971	
Liabilities:				
Portfolio Participation Certificates payable (Note 3)	$ 618,654,917		$1,224,895,706	
Debentures payable	1,200,000,000		400,000,000	
Short-term notes payable	-0-		1,000,000,000	
Notes payable to U.S. Treasury (Note 1)	1,743,431,053		783,465,737	
Dividend payable (Note 1)	50,000,000		50,000,000	
Guaranteed letters of credit payable	7,298,295		8,501,821	
Accrued interest payable	20,857,555		31,422,257	
Other	6,097,888		6,744,336	
Total liabilities		$3,646,339,708		$3,505,029,857
Deferred Income		5,829,802		5,469,867
Capital and Reserve:				
Capital stock held by U.S. Treasury (Note 1)	1,000,000,000		1,000,000,000	
Retained income reserve for contingencies and defaults (Note 2)	1,412,926,233		1,315,064,088	
Total capital and reserve		2,412,926,233		2,315,064,088
Total Liabilities, Capital, and Reserve		$6,065,095,743		$5,825,563,812

The Notes to the Financial Statements on page 33 are an integral part of this statement. See Note 1 for composition of the U.S. Government's investment in Eximbank.

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EXPORT-IMPORT BANK OF THE UNITED STATES

COMPARATIVE STATEMENT OF INCOME AND EXPENSE AND ANALYSIS OF RETAINED INCOME RESERVE

	Fiscal Year Ended June 30, 1972	Fiscal Year Ended June 30, 1971
Revenues:		
Interest and fees on loans	$ 341,320,002	$ 322,487,909
Insurance premiums and guarantee fees	4,730,338	3,824,969
Other income	336	5,989
Total Revenues	346,050,676	326,318,867
Expenses:		
Interest and other financial expense	185,527,760	197,762,130
Administrative and other expenses	8,229,397	7,035,615
Total Expenses	193,757,157	204,797,745
Operating Income	152,293,519	121,521,122
Claims paid — net of recoveries	4,431,374	2,003,114
Net Income	147,862,145	119,518,008
Less: Dividend declared on capital stock (Note 1)	50,000,000	50,000,000
Addition to Retained Income Reserve (Note 2)	$ 97,862,145	$ 69,518,008
Analysis of Retained Income Reserve:		
Balance at beginning of fiscal year	$1,315,064,088	$1,245,546,080
Addition to reserve (Note 2)	97,862,145	69,518,008
Balance at End of Fiscal Year	$1,412,926,233	$1,315,064,088

COMPARATIVE STATEMENT OF SOURCE AND APPLICATION OF FUNDS

SCHEDULE 3

		June 30, 1972		June 30, 1971
Funds Provided:				
Net income from operations	$147,862,145		$119,518,008	
Add depreciation expense for the year	40,160		50,448	
Funds provided by operations		$ 147,902,305		$ 119,568,456
Sales of short-term notes		-0-		2,500,000,000
Sales of debentures		800,000,000		-0-
Repayments and other credits to loans receivable		978,931,559		1,186,573,485
Sales of individual loan maturities		238,782,875		268,622,907
Borrowings from U.S. Treasury—Net		959,965,316		-0-
Other—Net		39,874,909		(47,772,288)
Total Funds Provided		$3,165,456,964		$4,026,992,560
Funds Applied:				
Repayment of U.S. Treasury borrowings—Net		$ -0-		$ 802,975,111
Payment of dividend to U.S. Treasury		50,000,000		50,000,000
Disbursements and other additions to loans, including capitalized interest—1972, $10,584,798; 1971, $7,941,029		1,509,216,175		1,406,114,450
Repayments on Portfolio Participation Certificates		606,240,789		267,902,999
Redemptions of short-term notes		1,000,000,000		1,500,000,000
Total Funds Applied		$3,165,456,964		$4,026,992,560

The Notes to the Financial Statements on page 33 are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS – JUNE 30, 1972

Note 1

Eximbank's authority to borrow from the U.S. Treasury is limited to $6 billion outstanding at any one time, and the authority to lend, guarantee, and insure is limited to $20.0 billion. Of this latter amount, up to $10.0 billion of outstanding guarantees and insurance may be charged against said lending authority at 25 percent of the contractual liability assumed.

At June 30, 1972 the uncommitted authority to lend, guarantee, and insure totaled $7,640.1 million.

The investment of the U.S. Government in Eximbank is comprised of the following

	June 30, 1972	June 30, 1971
Notes payable to U.S. Treasury	$1,743,431,053	$ 783,465,737
Capital stock held by U.S. Treasury	1,000,000,000	1,000,000,000
Dividend payable	50,000,000	50,000,000
Retained income reserve (Note 2)	1,412,926,233	1,315,064,088
Total investment	$4,206,357,286	$3,148,529,825

A dividend of $50 million was declared on June 29, 1972 and was paid on July 24, 1972.

Note 2

Loans with delinquent installments of 30 days or more at June 30, 1972 are summarized in millions of dollars as follows:

Country	Number of loans	Oldest past due installment	Total outstanding principal	Delinquent installments		
				Principal	Interest	Total
Cuba	5	1958	$ 36.3	$26.9	$23.8	$50.7
Chile	27	1971	309.6	26.4	9.6	36.0
Argentina	3	1966	1.5	1.5	.1	1.6
Pakistan	8	1971	20.7	3.7	1.4	5.1
Sierra Leone	1	1971	10.8	1.3	.6	1.9
Other	10	1970	15.4	2.2	.4	2.6
Totals	54		$394.3	$62.0	$35.9	$97.9

In addition, by agreement, the Republic of China is not at this time being called upon to make payments on that portion of four loans made to the Republic of China prior to 1947, when the seat of the government was on the mainland, which relates to assets no longer under the government's control. The total outstanding principal of this portion of these loans was $26.4 million at June 30, 1972; on that date $40.9 million ($22.4 million principal plus $18.5 million interest) was matured and outstanding, the oldest past due installment having matured in 1949.

The entire retained net income is reserved for contingencies and defaults. This amount of $1,412,926,233 substantially exceeds the total outstanding balances of both principal and interest on the foregoing delinquent loans. Because of the unpredictable nature of future economic and political conditions throughout the world, the risk of loss on Eximbank's loans, guarantees, and insurance is not susceptible to accurate measurement. The management of Eximbank believes therefore that its accumulated net earnings should be retained as a reserve for contingencies and defaults.

The contingent liabilities of Eximbank are summarized below in millions of dollars as of June 30, 1972.

Loan maturities sold subject to contingent repurchase commitments	$ 426.4
Guarantees	3,054.0
FCIA Insurance	2,477.8
Total contingent liabilities	$5,958.2

Note 3

From May 1, 1962, to June 30, 1968, 19 issues of guaranteed Certificates of Participation in portions of Eximbank's loan portfolio were sold. On June 30, 1972 this designated portion of loans totaled $1.5 billion. Certificates of Participation outstanding at June 30, 1972 totaled $.6 billion.

EXPORT-IMPORT BANK OF THE UNITED STATES
WASHINGTON, D.C. 20571

PRESIDENT
AND
CHAIRMAN

CABLE ADDRESS "EXIMBANK"
TELEX 89-461

February 5, 1973

Dear Mr. Stovall:

Thank you for your transmittal on January 15, 1973, of the draft GAO Report for FY 1972, and your request for our comments on the draft. We believe some clarification and changes should be made in sections of the Report concerning the Private Export Funding Corporation (PEFCO). As we understand it, you have concluded that if Eximbank believes PEFCO is a "viable concept worthy of retention", Eximbank should require PEFCO to obtain funds in markets different from those available to Eximbank. If, on the other hand, Eximbank believes PEFCO is "unnecessarily driving up the costs of U. S. exports", Eximbank should consider ending its agreement with PEFCO and make the loans that would have been provided by PEFCO "at rates which would approximate Eximbank's cost of funds".

We continually review our relationship with PEFCO and still believe PEFCO will serve a useful role in export financing. It should be remembered that the idea of PEFCO was conceived at a time when banks were experiencing and anticipating relatively tight money. By the time PEFCO was established, financial conditions in the United States had changed and substantially more money was available in the banking system. The day will most likely come again when funds are relatively tight and traditional sources of private capital may find it necessary to retrench their financing of exports. Experience has shown that one of the early and most damaging casualties in a period of tight money is export financing. If and when such circumstances arise again, we believe PEFCO will play a key role in maintaining private capital participation with Eximbank. Your report notes the fact that it took approximately four years of study and negotiation for PEFCO to come into existence. It would be very shortsighted if we now dismantle the arrangements which we worked out with PEFCO over so many years because it may not be vitally needed at this moment. The nation's interests deserve a better decision. We also believe that the existing agreements are necessary in order for PEFCO to raise funds in the market at the most favorable rates and thereby avoid any undue increase in financing costs. Let me assure you that we take very seriously the effect of financing costs on U. S. exports, and Eximbank has not and will not approve PEFCO's participation in any case in which the cost of PEFCO's participation could in any way jeopardize the export sale.

Mr. Oye V. Stovall, GAO

Your report calls attention to the fact that PEFCO's organizers initially hoped that it would tap unutilized sources of capital, particularly investors in long-term securities such as insurance companies and pension trusts. You conclude that if this cannot be done, PEFCO's purpose cannot be achieved. There is no evidence to indicate that borrowing from these sources would be impossible, although it has not been attractive to date. We do not believe, however, that this point is as critical as you suggest. The main point is not whether PEFCO borrows on long, medium, or short term, but whether PEFCO can offer financing on competitive terms and thereby expand private capital participation in export financing. If PEFCO happens to borrow approximately the same maturities as Eximbank, proceeds from its borrowing would displace Eximbank direct loans. Therefore, the more financing PEFCO can do, the less call there will be on Eximbank funds and therefore the less Eximbank will have to borrow in the market. It is the Administration's and Eximbank's policy to utilize private resources to the fullest extent practicable and that includes PEFCO when a commercial bank wants PEFCO to participate and it can do so on reasonable terms.

In addition to the foregoing general observations there are some specific points we would like to make:

1. On page 22 you state PEFCO's effective interest rates have ranged from 1.8% to 3.05% higher than Eximbank funds. We believe this statement is misleading. First, each rate includes 1/2% to cover Eximbank's guarantee fee. This fee would be added whenever a private financial institution lends funds with Eximbank's guarantee--whether it be a commercial bank or PEFCO. The more critical questions, however, are how do PEFCO's rates compare with those of other private financial institutions and are they competitive. As noted earlier, Eximbank will not approve PEFCO's participation in a particular transaction if PEFCO's financing charges will jeopardize the sale. In each case PEFCO has participated in, we satisfied ourselves that PEFCO's rate was reasonable in the light of the money market rates existing <u>at that time</u>. PEFCO's rates obviously will vary from time to time and will be directly related to money market conditions. Recently PEFCO has quoted a fixed rate of 7% and a floating rate of 7/8 of 1% over Chase Manhattan Bank's prime, which today would result in a rate of 6-7/8%. This is the same rate charged by Chase itself in the particular transaction in question.

[See GAO note, p. 36.]

[See GAO note.]

[See GAO note.]

Accordingly, we believe your Report should be revised to take into account the general and specific points set forth in this letter; and we would be pleased to meet with you or your representatives to discuss the matter more fully.

Sincerely yours,

Henry Kearns

Mr. Oye V. Stovall
Director
General Accounting Office
Washington, D. C. 20548

GAO note: The deleted comments relate to matters in the draft report but revised in this final report.

PRINCIPAL OFFICIALS OF THE EXPORT-IMPORT BANK OF THE UNITED STATES AT JUNE 30, 1972

	Position	Date of appointment
BOARD MEMBERS:		
Henry Kearns	President and Chairman	3-20-69
Walter C. Sauer	First Vice President and Vice Chairman	9-28-62
Tom Lilley	Director	10-26-65
R. Alex McCullough	Director	5-21-69
John C. Clark	Director	6- 3-69
R. H. Rowntree	Economic Advisor to Board of Directors	2-10-70
OFFICERS:		
Don Bostwick	Executive Vice President	3-18-70
John E. Corette, III	General Counsel	5- 1-69
J. Patrick Dugan	Senior Vice President and Treasurer Controller	6- 2-69
Warren W. Glick	Senior Vice President--Financing	9-21-69
Delio E. Gianturco	Senior Vice President--Exporter Credits, Guarantees, and Insurance	8-22-71
Rosemary A. Mazon	Senior Vice President--Planning and Export Expansion	6- 1-72
Joseph H. Regan	Secretary	12-14-65

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