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Highlights

Highlights of GAO-04-531, a report to congressional committees

September 2004

EXPORT-IMPORT BANK

OMB's Method for Estimating Bank's Loss Rates Involves Challenges and Lacks Transparency

Why GAO Did This Study

The Export-Import Bank (Ex-Im Bank) facilitates U.S. exports by extending credit to foreign governments and corporations, mostly in developing countries. The Federal Credit Reform Act requires Ex-Im Bank to estimate its net future losses, called "subsidy costs," for budget purposes. Beginning with fiscal year 2003, the Office of Management and Budget (OMB) significantly changed its methodology for estimating a key subsidy cost component: the expected loss rates across a range of risk ratings of U.S.-provided international credits. In response to a congressional mandate, GAO agreed to (1) describe OMB's current and former methodologies and the rationale for the recent revisions, (2) determine the current methodology's impact on Ex-Im Bank, and (3) assess the methodology and how it was developed.

What GAO Recommends

GAO recommends that the Director of OMB provide affected U.S. agencies and Congress with technical descriptions of its current expected loss methodology and update this information when there are changes. GAO also recommends that the Director arrange for independent review of the methodology and ask U.S. international credit agencies for their most complete, reliable data on default and repayment histories, so that the validity of the data on which the methodology is based can be assessed over time.

www.gao.gov/cgi-bin/getrpt?GAO-04-531.

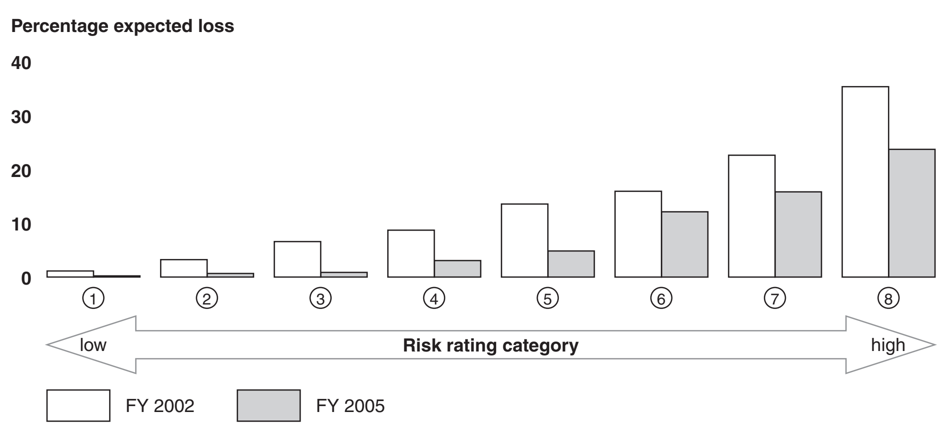
To view the full product, including the scope and methodology, click on the link above. For more information, contact Celia Thomas, (202-512-8987), thomasc@gao.gov.

What GAO Found

OMB changed its method for determining expected loss rates for U.S. international credits, with one basis being that emerging finance literature indicated the former approach might overstate losses to the government. While it formerly used only interest rate differences across bonds to derive expected loss rates, it now uses corporate bond default data, adjusted for trends in interest rates, to predict defaults and makes assumptions regarding recoveries to estimate expected loss rates. As the figure shows, expected loss rates fell under the new approach: they were higher across risk rating categories in fiscal year 2002 (the last year that the former method was used) than in fiscal year 2005. This drop has contributed to lower Ex-Im Bank projections of subsidy costs and budget needs.

OMB's current method for estimating expected loss rates involves challenges and lacks transparency. Estimating such losses on developing country financing is inherently difficult, and OMB's shift to using corporate default data has some basis, given the practices of some other financial institutions and limitations in other data sources. However, the corporate default data's coverage of developing countries has historically been limited, and their predictive value for Ex-Im Bank losses is not yet established. OMB's method generally predicts lower defaults than the corporate default data it used, whereas more recent corporate data show higher default rates. At the same time, OMB has assumed increasingly lower recovery rates, which serve to somewhat offset the lower default expectations, but the basis for the recovery rates and the changes over time has not been transparent. In addition, despite the method's complexity, OMB developed it independently and provided affected agencies with limited information about its basis or structure.

OMB Expected Loss Rates for U.S. Government International Credits by Risk Rating Category (Present Value Basis), Fiscal Years 2002 and 2005



Source: GAO analysis of OMB expected loss rates.