

GAO

Report to the Chairman, Committee on  
International Relations, House of  
Representatives

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September 1997

# OVERSEAS INVESTMENT

## Issues Related to the Overseas Private Investment Corporation's Reauthorization



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**National Security and  
International Affairs Division**

B-277618

September 8, 1997

The Honorable Benjamin A. Gilman  
Chairman, Committee on International Relations  
House of Representatives

Dear Mr. Chairman:

The Overseas Private Investment Corporation (OPIC), an independent government corporation created to promote investment in emerging market economies, has been the focus of debate in recent months. Unless Congress reauthorizes it, OPIC's charter expires September 30, 1997. Among the issues subject to debate on whether to reauthorize OPIC are questions relating to public sector investment support, OPIC's cost to the government, and the potential liabilities OPIC subjects the government to in pursuing foreign policy objectives by making investments in developing countries.

As you requested, we reviewed (1) trends in private sector investment in developing markets and the role of the public sector in these markets; (2) OPIC's risk management strategy and the steps that OPIC may take, if it is reauthorized, to further reduce portfolio risks while pursuing U.S. foreign policy objectives; and (3) the issues to be addressed and the time it would take to phase out OPIC if it is not reauthorized.

In conducting this review, we analyzed private investment trends and surveyed a judgmental sample of 34 U.S. firms that had made investments overseas within the last 5 years in the power and telecommunications sectors—two of the four largest investment sectors in emerging markets. (See app. I for a list of companies surveyed.) We also analyzed OPIC's risk assessment policies and financial reports and discussed risk mitigation strategies with private and public providers of project finance. Project financing involves lending for major projects where the assurance of repayment is provided through the project's structure and anticipated future revenues rather than through sovereign (that is, national government) or other forms of guarantees. In some cases, the public sector provides investment support to investors in these projects. Further, we reviewed and discussed laws and regulations governing an agency shutdown with cognizant government officials.

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## Background

OPIC was established by the Foreign Assistance Act of 1969 (P.L. 91-175, Dec. 30, 1969) to pursue the U.S. foreign policy of mobilizing and facilitating the participation of U.S. private capital and skills in the economic and social advancement of developing countries. In carrying out this responsibility, OPIC took over the investment guarantee and promotion functions of the U.S. Agency for International Development. In the early 1970s, the U.S. approach to foreign assistance began to shift from one of providing government aid for infrastructure building and large capital projects to providing assistance to meet basic human needs. OPIC's role was to support market-oriented private investment in various sectors.

More recently, the World Bank has estimated that \$200 billion would be needed annually over the next 10 years to meet the infrastructure needs of developing countries. Obtaining this level of private investment will be a major challenge given the economic and political characteristics of emerging markets and the unique risks inherent in each project. Project financing is emerging as an important component in infrastructure development.

OPIC's programs are designed to promote overseas investment and assume some of the associated risks for investors. Specifically, OPIC offers direct loans and loan guarantees to U.S.-sponsored joint ventures abroad, supports private investment funds that provide equity for projects abroad, and provides political risk insurance to U.S. investors. The political risk insurance covers investors for up to 20 years against losses due to currency inconvertibility, political violence, and expropriation.<sup>1</sup> OPIC collects premiums and fees from the private sector for insurance and financing services. OPIC finance and insurance activities are backed by the full faith and credit of the U. S. government and are limited to a total exposure of \$23 billion in fiscal year 1997. OPIC services are available in some 140 developing countries, although OPIC does not operate in some countries, largely for U.S. foreign policy reasons.

Projects eligible for OPIC assistance include new investments, privatizations, and expansions or modernization of existing plants. The sectors OPIC supports include power, financial services, telecommunications, and oil and gas. To obtain OPIC support, investors must meet specific criteria, including U.S. ownership requirements.

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<sup>1</sup>Currency inconvertibility is the deterioration in the ability to convert profits, debt service, and other remittances from local currency into U.S. dollars. Loss due to political violence results from damage to assets caused by war, revolution, insurrection, or politically motivated civil strife. Expropriation is the loss of an investment due to expropriation, nationalization, or confiscation by a foreign government.

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Over the years, Congress has placed various requirements on OPIC's authority to support U.S. investment. For example, in carrying out its activities, OPIC is to

- administer its entire portfolio (financing, insurance, and reinsurance operations) on a self-sustaining basis and in a manner that ensures that the projects it supports are economically and financially sound;
- refuse support for any investment in countries that are not taking steps to adopt and implement internationally recognized worker rights; and
- decline participation in investments that are likely to significantly reduce U.S. domestic employment levels or pose an unreasonable or major environmental, health, or safety hazard.

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## Results in Brief

Improvements in economic and political conditions in many developing countries—markets where OPIC services have traditionally been sought—have led to a reduction in investors' perception of risk and a dramatic increase in private investment in these markets since the late 1980s. However, according to most of the 34 firms we surveyed, risky markets still exist where the private sector (investors, bankers, and insurers) stated they are reluctant to invest or operate without public (government or multilateral) guarantees or insurance. For example, four of the firms that we spoke to that invested in Russia or Ukraine said that private insurance was unavailable for their projects and financiers were reluctant to invest without public involvement. In high-risk markets such as these, U.S. investors we spoke with have sought public finance or insurance from OPIC, the U.S. Export-Import Bank (Eximbank), or other public institutions such as Japan's Ministry of Trade and Industry. In risky markets where OPIC services are not available, such as Vietnam, China, and Mexico, U.S. investors that we surveyed tended to use other public support.<sup>2</sup> For example, the two investors in Vietnam used public providers of investment support, and two investors in China used public support while two investors there partnered with the Chinese government. In Mexico, some investors we spoke to used public support; however, two investors self-insured. If foreign export credit agencies provide the support, U.S. suppliers could be excluded.

OPIC has historically been self-sustaining by generating revenues from its insurance and finance programs to cover actual losses. OPIC's risk mitigation strategy includes maintaining reserves (\$2.7 billion in reserves

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<sup>2</sup>Of the 34 firms that we interviewed, 2 operated in Vietnam, 5 in China, and 5 in Mexico. Some of these firms had operations in more than one country.

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held largely in Treasury securities), limiting its exposure in any one country, requiring pre-approval reviews, and establishing underwriting guidelines. Nonetheless, the private sector's willingness to have greater involvement in some emerging markets has created opportunities for OPIC to further reduce portfolio risks, while continuing to pursue U.S. foreign policy objectives. Possible ways for OPIC to minimize the risks associated with its insurance portfolio include obtaining to a greater extent reinsurance from or coinsuring with other insurance providers, insuring less than 90 percent of the value of each investment, and offering insurance at less than a 20-year term. While OPIC officials agree that reinsurance and coinsurance are good risk mitigation techniques, they cautioned that these strategies should be employed on a case-by-case basis so as to enable OPIC to continue to meet U.S. foreign policy objectives and the needs of its customers.

If Congress decides not to reauthorize OPIC, an orderly phaseout of the agency would require specific legislative action. An important issue that would need to be addressed is who would manage the existing portfolio. Also, given that OPIC issues insurance policies with 20 year coverage, and that OPIC had \$5.3 billion in insurance contracts with 19-20 years remaining as of September 30, 1996, it could take up to 20 years for OPIC's existing obligations to expire. OPIC's past experience, however, shows that most insurance policies are canceled by clients before the end of the 20-year term. Thus, OPIC projects that less than 36 percent of its existing portfolio would remain active after 10 years. The government has the option to sell OPIC's portfolio to the private sector before its expiration. However, a recent study suggests that immediate disposal of OPIC's assets could only be accomplished at a discounted price.<sup>3</sup> If the risk of the remaining portfolio decreases over time, opportunities for asset disposal may arise.

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## Global Changes Have Reduced the Private Sector's Perception of Risk, Yet Public Support Still Sought in Some Markets

A changing global environment has reduced the perception of risk for the investors we spoke with in emerging markets. Economic growth and liberalization have created investment opportunities in sectors that were previously dominated by government-owned companies or were simply off limits to foreign investors. Many countries, for example, have privatized their power and telecommunication sectors and enacted laws that permit foreign ownership, resulting in dramatic increases in foreign investment. More recently, private providers of project finance and political risk insurance are increasingly available to assist investors. However,

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<sup>3</sup>Overseas Private Investment Corporation: Final Report on the Feasibility of Privatization (New York: J.P. Morgan Securities, Inc., Feb. 7, 1996).

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according to many of the firms we surveyed, markets still exist where they are unable to obtain private finance or insurance services. As a consequence, they seek public support. Public support includes direct loans, loan guarantees, and political risk insurance from OPIC and the U.S. Eximbank; foreign agencies that provide such services (often called export credit agencies); or multilateral financial institutions, such as the World Bank.

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### Private Investment in Transition Markets Has Increased Considerably

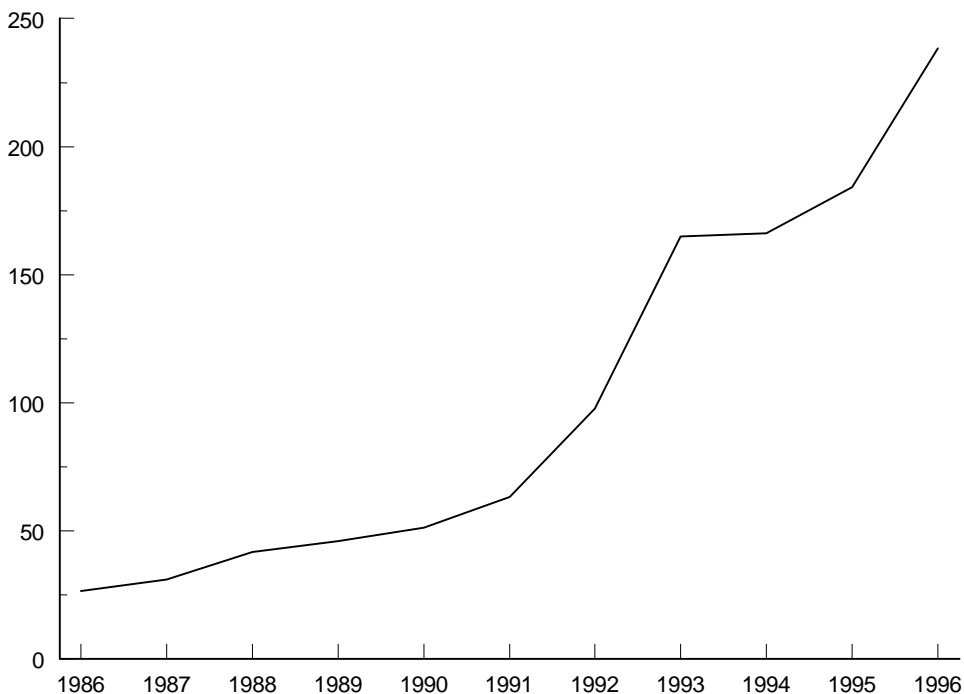
The privatization of public enterprises, legal and regulatory reforms, and a more stabilized political and economic environment in developing countries, among other changes, have led to an increase in total private capital flows. As shown in figure 1, private capital flows to finance infrastructure projects and other private investments overseas have increased from \$26 billion in 1986 to \$246 billion in 1996.<sup>4</sup>

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<sup>4</sup>Total private capital flows are calculated by the World Bank on a net basis (net of repayments) and include portfolio bonds and equity, foreign direct investment, commercial bank loans, and other private flows. Other private flows include credits from manufacturers, exporters, and other suppliers of goods, as well as bank credits covered by a guarantee of an export credit agency.

**Figure 1: Net Private Capital Flows to Developing Countries, 1986-96**

In billions of 1995 dollars



Source: World Bank.

During the 1990s, private sector finance has increased dramatically, especially to Asian and Latin American developing countries, despite setbacks associated with the Mexican peso crisis.<sup>5</sup> Private flows going to infrastructure reflect these overall increases, particularly in commercial lending devoted to project finance. According to a 1996 International Finance Corporation report,<sup>6</sup> these private infrastructure investments would not have seemed possible 10 years ago. Today, more and more countries are introducing competition and private participation in infrastructure ownership and management.

<sup>5</sup>The Mexican peso crisis in 1995 led to a temporary decline in private flows to Latin America.

<sup>6</sup>Lessons of Experience: Financing Private Infrastructure (Washington, D.C.: International Finance Corporation, Sept. 1996), p. 1. The International Finance Corporation is a part of the World Bank group that promotes investment by the private sector.



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The 34 power and telecommunications companies that we surveyed indicated that their investment decisions have been significantly influenced by the recent developments in emerging markets. In general, 30 of the companies stated that changes in the legal and regulatory environment in emerging markets have led them to seek investments in countries where they had not invested in the past. At the same time, the U.S. power market matured, and U.S. power companies began seeking investment opportunities in emerging markets.

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### Availability of Private and Public Investment Services Increasing

The rise in overseas private investment has been accompanied by increases in investment support by public providers of finance and insurance as well as increases in private insurance coverage in some markets. Three countries—Japan, the United States, and Germany—are the largest public providers of political risk insurance. (See app. II, which identifies features of the services provided by the major public providers of political risk insurance.) Lloyd's of London, the American Insurance Group, and Exporters Insurance Corporation—three major private insurers—have recently increased their insurance coverage.

Globally, public providers have increased investor coverage. According to the Berne Union,<sup>7</sup> new investments insured by its members rose annually between 1991 and 1996, going from \$7.1 billion to \$15.2 billion. As of the end of 1996, the cumulative amount of investment covered by Berne Union members was \$43.4 billion. According to data collected directly from the major public providers of political risk insurance, Japan led all public providers with \$13.9 billion in cumulative exposure. OPIC was second with \$13.4 billion in exposure, and the German public provider was third with \$7.8 billion in exposure. These public insurers have traditionally dominated the public risk insurance market. Although the major public providers generally offer investment services in the same countries, each of the major providers' business tends to concentrate in different markets. OPIC, for example, concentrates in Latin America, the Japanese in Asia, and the Germans in Asia/Pacific and Central and Eastern Europe. (See app. III for available information on the regional concentration of major public insurance providers.) Investors are also assisted by other Berne Union members, including the Multilateral Investment Guarantee Agency, a multilateral institution affiliated with the World Bank Group, with about \$3.9 billion in exposure reported in 1997.

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<sup>7</sup>The Berne Union is an international union of credit and investment insurers that represent private and public political risk insurers from 38 countries and locations.

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The level of coverage of privately provided political risk insurance has increased considerably over the past 2 years, according to the private insurers we spoke with. Although the volume of coverage provided by private insurers is difficult to determine, a political risk insurance expert estimated that several billion dollars of private political insurance coverage was provided in 1996.<sup>8</sup> According to the American Insurance Group, one of the largest private providers of political risk insurance, it increased the length of its coverage from a maximum of 3 years to a cap of 7 years in 1996. Additionally, ACE, Inc., a private insurance provider, recently entered into a reinsurance contract with the Multilateral Investment Guarantee Agency, providing up to 15 years of risk coverage on the same terms as that agency. However, according to officials of a large commercial bank and a private political risk insurer, in some risky markets private insurers are only willing to provide insurance when a public sector entity is involved in the project. A private insurer we spoke to said his company had not provided coverage in Russia and most of the other newly independent states of the former Soviet Union.

Public and private sources also provide financing in developing countries. Public providers include OPIC; the International Finance Corporation, a multilateral institution affiliated with the World Bank Group; the U.S. Eximbank; and other bilateral credit agencies, such as the Japanese Export-Import bank. Private sector financing to developing countries is available through commercial banks and other private financial institutions. According to the World Bank, this source of financing has increased significantly during the 1990s, with about one-half of these resources directed toward project financing for infrastructure development.

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## Risk Determines Whether Investors Seek Public or Private Finance and Insurance

Investors', private lenders', and insurers' perception of risk frames how projects are structured and financed. The risks assumed and the type of support sought by investors can differ by project and by sector.<sup>9</sup> For example, based on the projects identified in our survey, more telecommunications projects were completed without public support and with investor self-insurance than were power projects. Power plants are costly and can take 10 years or longer to recoup the investment costs, according to an energy firm official we interviewed, making plant assets

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<sup>8</sup>Private insurers generally regard the existence and amount of their insurance as a confidential matter.

<sup>9</sup>Country political and economic conditions, project size, the ability of the investor to remove or dispose of the assets, if necessary, the financial strength of the investors, and many other factors are also considered by project financiers and insurers.

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and income subject to long-term political risks. Telecommunications projects, on the other hand, may generate enough income to cover investment costs in just a few years.

Investors we surveyed told us that over the past decade, several Latin American, East Asian, and East European countries have taken steps to create environments attractive to investors. Specifically, 22 of the 34 firms we spoke to were comfortable with assuming investment risks after they had been successful in a country for a period of time. For example, one telecommunications company that is developing cellular telephone operations in Hungary told us that the availability of OPIC political risk insurance was a critical factor in its initial decision to invest \$200 million when privatization allowed the company to enter the market. After 2 years, however, the company reassessed the political and economic risks of this investment and decided to drop its OPIC insurance in favor of self-insurance.<sup>10</sup> A company with 10 projects in Poland told us that it developed 9 cable projects with private investment after completing 1 successful project in Poland that was financed by OPIC 5 years ago when private financing was not available. In another example, a power company that has used OPIC in other high-risk markets has made acquisitions of privatized public utilities in Argentina and Chile without official support by obtaining financing from European financial markets and locally syndicated money. Officials of the International Finance Corporation confirmed that investors are increasingly likely to cancel International Finance Corporation loans as lower-priced private financing becomes more available in lower-risk markets.

Despite these trends, some markets are still considered high risk by investors, lenders, and private insurance companies. Thus, obtaining commercial finance and insurance in these markets remains difficult, according to private firms we surveyed. Several of the power and telecommunications companies we surveyed concurred with the assessment that in several regions of the world, including Africa, Russia, the other newly independent states of the former Soviet Union, and Central America, the perception of risk remains high. Some companies told us that they are generally unable to raise the necessary financing for transactions in high-risk countries without public support. For example, four firms that we spoke to that invested in Russia or Ukraine said that private finance was unavailable for their projects. One telecommunications company with investments in Russia and Ukraine

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<sup>10</sup>Some firms still seek public support in Hungary. OPIC officials said that in Hungary they have recently insured a large telecommunications project and anticipate insuring a power project within the year.

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stated that without OPIC political risk insurance, it would have avoided these high-risk markets.<sup>11</sup> A power company with a \$150-million equity investment in El Salvador covered by OPIC political risk insurance told us that the availability of OPIC services was a key factor in the company's decision to invest in the country. According to an official from this company, although it considers Guatemala to have great potential for the industry, private financial institutions and insurance companies still consider Guatemala to be high risk, and the company will not go forward with projects in Guatemala without OPIC or other public support. Additionally, private lenders and insurance companies we spoke with told us that they offer limited, if any, services in higher-risk markets such as the newly independent states of the former Soviet Union. Officials at the major international banks we visited noted that they are reluctant to lend in high-risk markets without some form of political risk insurance and that the private insurance companies often cannot provide the kind of insurance lenders need in these markets.

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### U.S. Investors Obtain Public Support in Some Non-OPIC Markets

In countries where OPIC services are not available due to U.S. foreign policy or operational reasons, such as Mexico, China, Pakistan, and Vietnam, we found that most of the U.S. investors we interviewed often seek other forms of public support to facilitate investment.<sup>12</sup> As is the case in other emerging markets, investors' decisions to invest in a project were predicated on their perceived risk. Our survey of U.S. investors showed that when U.S. firms believed they needed public investment support in a non-OPIC country, they sought investment support from the U.S. Eximbank or other foreign export credit agencies or multilateral financial institutions. Although such support facilitates the original investment, subsequent equipment and service procurements are often tied to the countries providing the support. Thus, if foreign export credit agencies provide the support, U.S. suppliers could be excluded.

In some non-OPIC markets, such as Mexico, U.S. investors may not always seek public support. According to a telecommunications company official, several risk mitigation factors enabled the company to make a \$1-billion investment in Mexico without political risk insurance or other official participation in the project. Mexico's historical and geographical relationship to the United States, trends in Mexico's economic

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<sup>11</sup>It is difficult to independently discern whether an investment in high-risk markets would have occurred without public support.

<sup>12</sup>OPIC does not operate in a developing country unless it has a bilateral investment agreement. Further, U.S. statutes specify that certain in-country conditions, such as inadequate protection of internationally recognized workers' rights, preclude OPIC from supporting private investment.

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performance, the potential for free trade, and the contractual commitment of high-level government officials and the Mexican Central Bank, along with the company's confidence in its Mexican partner, all helped lower the company's perception of risk. In contrast, a \$644-million power project in Mexico is being undertaken by U.S. investors facilitated by a \$477-million U.S. Eximbank loan, \$28 million in U.S. Eximbank political risk insurance during construction, and a \$75-million Inter-American Development Bank loan.

In China, companies have entered into joint ventures with local companies that are affiliated with provincial governments, which lowers investor perception of risk. Depending on the size of the project, these companies were more likely to obtain a portion of their financing from multilateral institutions or foreign official sources. For example, one power company with several recent joint ventures in China financed smaller-sized projects (under \$30 million) without public support. However, the same company is finalizing a \$1.6-billion project and is obtaining support from the U.S. Eximbank and Hermes, Germany's export credit agency. The opportunities presented by China's large market potential may increase investors' willingness to do business there despite the perceived risk.

In other markets where OPIC is not available, the U.S. firms we surveyed have used the services of multilateral agencies or export credit agencies.<sup>13</sup> One telecommunications company mitigated its risk in Pakistan by obtaining guarantees and political risk insurance from the International Finance Corporation and the Multilateral Investment Guarantee Agency. Because OPIC was not available in Vietnam, a U.S. power firm used the Asian Development Bank and Coface (the French export credit agency) to finance a \$160-million power plant.

U.S. investors' use of investment support from sources other than OPIC may affect the source of procurements. Multilateral institutions generally do not tie their support to buying equipment from a particular country. However, some U.S. firms told us that they were unable to use U.S. suppliers when they obtained support from foreign export credit agencies. In testimony before Congress, an official of a large U.S. company testified that her company utilized or planned to use German, Japanese, or French equipment for projects in China, Pakistan, and Vietnam because the

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<sup>13</sup>Some foreign export credit agencies extend support to foreign-owned entities that are domiciled within their borders.

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company obtained investment support from German, Japanese, and French export credit agencies.<sup>14</sup>

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## OPIC's Revenues Have Exceeded Its Losses, but Global Changes May Present Opportunities for OPIC to Further Reduce Portfolio Risk

Historically, OPIC has been self-sustaining, generating substantial revenues from its finance and insurance programs and its investments that together have been sufficient to cover actual losses. As of September, 1996, OPIC had accumulated \$2.7 billion in reserves.<sup>15</sup> According to a February 1996 J.P. Morgan Securities, Inc., report, OPIC's reserves are more than adequate to cover any losses that OPIC might experience, excluding an unprecedented disaster.<sup>16</sup> OPIC's risk management strategies, which include maintaining reserves, setting exposure limits, performing pre-approval reviews, and applying underwriting guidelines, help limit U.S. taxpayers' exposure to undue risk and prevent project losses. In 1994, OPIC raised the maximum amount of insurance and finance coverage it offers on a given project, a step that increases the government's exposure to loss but may not negatively affect the quality of OPIC's portfolio. Notwithstanding OPIC's track record, the private sector's willingness to have greater involvement in some developing countries has created opportunities for OPIC to take steps to further reduce the risk associated with its portfolio through greater risk-sharing. Some possible options to explore include obtaining reinsurance from other providers, utilizing coinsurance, and insuring less than 90 percent of the value of each investment. Adoption of any of these options, however, should be carried out with due consideration of U.S. foreign policy objectives.

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## OPIC Has Generated Sufficient Revenue to Cover Its Losses

Historically, OPIC has generated sufficient revenues from its insurance and finance programs to cover its operating costs and the losses associated with its portfolio.

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<sup>14</sup>Testimony of Linda F. Powers, Senior Vice President of Global Finance at Enron International, before the Subcommittee on International Economic Policy and Trade, House Committee on International Relations, March 18, 1997.

<sup>15</sup>OPIC's reserves are primarily held in Treasury securities.

<sup>16</sup>Overseas Private Investment Corporation: Final Report on the Feasibility of Privatization (Feb. 7, 1996).

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## OPIC's Insurance Program

Since its inception through 1996, OPIC had about \$500 million in insurance claims and recovered all but \$11 million of this amount from the disposal of assets and recoveries from foreign governments.<sup>17</sup> During the same period, OPIC has received over \$922 million in premiums from its insurance activities. OPIC's insurance revenues have exceeded its gross claims payments in all but 3 fiscal years, excluding recoveries that OPIC obtained after the claims were paid and liabilities were incurred but not reported. Also excluded is interest from Treasury securities.

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## OPIC's Finance Program

According to J.P. Morgan Securities, Inc., OPIC's finance program has operated at a small loss or close to breaking even. Although OPIC's cash revenues from its finance program have exceeded all cash losses from loans or loan guarantees since 1984, when operating costs and loan loss provisions are included, OPIC's finance program shows a net operating loss for each year since 1993. If income from Treasury securities were allocated for each of these years, the finance program would show a net income.<sup>18</sup>

Under OPIC's finance program, its direct loans, which by statute are only available to small businesses, have experienced higher rates of delinquencies<sup>19</sup> and loan losses than its loan guarantees. Between 1984 and 1996, OPIC's average direct loan loss rate was 4.4 percent; the loss rate was at its highest, at 11.7 percent, in fiscal year 1984. In the same time period, OPIC's loan guarantee portfolio had an average loan loss rate of 0.56 percent for a combined rate (direct loans and loan guarantees) of 0.93 percent on average outstandings.

OPIC's finance program has been subject to the Federal Credit Reform Act of 1990, which became effective in fiscal year 1992.<sup>20</sup> The act requires that government agencies, including OPIC, estimate and budget for the total

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<sup>17</sup>OPIC officials noted that the recoveries may not fully take into account the time value of money.

<sup>18</sup>The allocation of Treasury security interest income is relevant for financial statement purposes. With regard to OPIC's statement about its interest earnings, only those earnings properly allocable to its credit program are relevant to the discussion of its credit subsidy estimates; under credit reform requirements, interest earned on credit-related reserves is required to be included in estimating the subsidy cost.

<sup>19</sup>Late payments on loans.

<sup>20</sup>The finance program is subject to the Federal Credit Reform Act of 1990 (Public Law 101-508, Nov. 5, 1990) for budgetary treatment.

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long-term costs of their credit programs on a present value basis.<sup>21</sup> Based on the required estimation of subsidy costs under credit reform, OPIC's finance program will cost the government \$72 million in fiscal year 1997 and total about \$135 million between fiscal years 1992 and 1996.<sup>22</sup>

Historically, OPIC's combined finance and insurance programs have been profitable and self-sustaining, including costs due to credit reform and administration. The J.P. Morgan Securities, Inc., report<sup>23</sup> stated that OPIC's finance program has operated at a small loss or close to breaking even and that much of OPIC's profitability has come from interest earned on Treasury securities. This interest has accounted for over 60 percent of OPIC's total revenue over the past 6 years. In fiscal year 1996, OPIC's net income was \$209 million, of which \$166 million was interest on Treasury securities. From a governmentwide perspective, interest on Treasury securities held by OPIC represents transfers between two government agencies (that is, OPIC's income from Treasury securities is a Treasury expense) that cancel each other out. From that perspective, OPIC's net income from transactions with the private sector, that is, fees and premiums, amounted to about \$43 million in fiscal year 1996.

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## OPIC Has Established a Risk Management Strategy

OPIC's risk management strategy focuses on limiting OPIC's maximum exposure to loss in any one country or sector. No single country accounts for more than 15 percent of OPIC's portfolio, effectively protecting OPIC against the adverse consequences of catastrophic events in any one country. The purpose of risk diversification is to spread the risk of one transaction across a number of different transactions, thereby isolating OPIC against the risk of one "catastrophic event." As shown in figure 2, OPIC's portfolio is diversified across different regions of the world.

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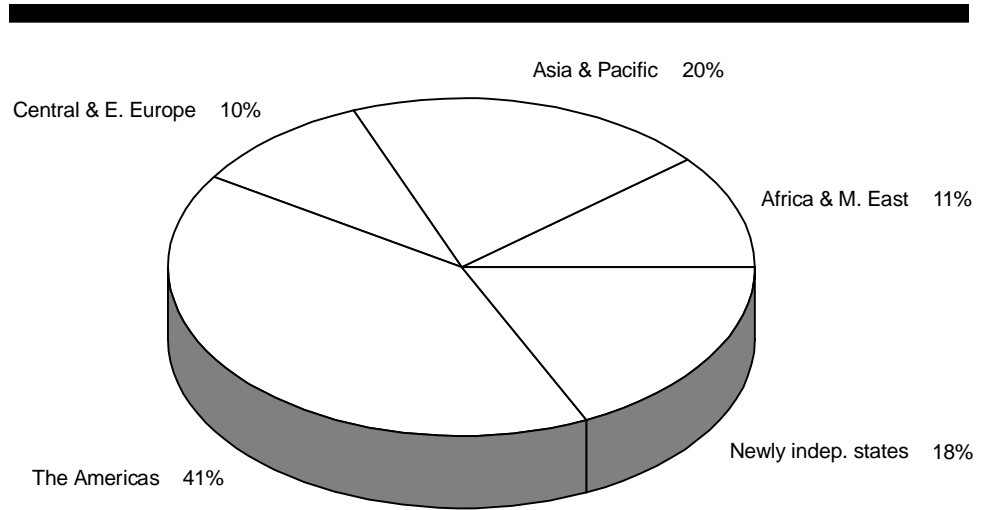
<sup>21</sup>Present value analysis calculates the value today of a future stream of payments/cash flows at the appropriate discount (interest) rate.

<sup>22</sup>Subsidy costs arise when the estimated program disbursements by the government exceed the estimated payments to the government on a present value basis over the term of the credit. Since fiscal year 1992 (except for fiscal year 1995), OPIC has obtained appropriations to cover the costs of its finance program. At the end of each fiscal year that appropriations have been received, OPIC paid dividends to the Treasury equivalent to the finance program costs for the given year. The President's 1996, 1997, and 1998 budget requests asked that Congress grant OPIC the authority to use its insurance program resources to fund its finance program instead of receiving appropriations.

<sup>23</sup>Overseas Private Investment Corporation: Final Report on the Feasibility of Privatization (Feb. 7, 1996).



**Figure 2: Regional Diversification of OPIC's Portfolio of Insurance and Finance Programs, as of September 30, 1996 (insurance and finance combined)**

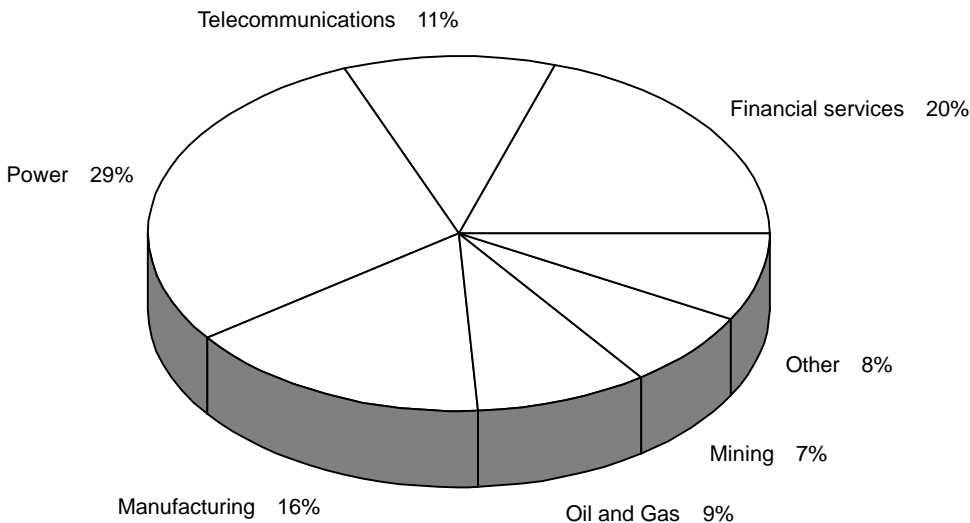


Note: Maximum worldwide exposure: \$19.8 billion.

Source: OPIC.

Although OPIC seeks to diversify its portfolio, figure 2 shows that the countries of the Americas account for more than 40 percent of OPIC's portfolio. This trend is explained by the fact that U.S. firms choose to use OPIC support in these markets. In general, OPIC's portfolio is consistent with U.S. foreign direct investment in emerging markets. Figure 3 displays OPIC's portfolio diversification by investment sector.

**Figure 3: Diversification of OPIC's Portfolio of Insurance and Finance Programs by Sector, as of September 30, 1996 (insurance and finance combined)**



Note: Maximum worldwide exposure: \$19.8 billion.

Source: OPIC.

OPIC's risk management strategy also includes pre-approval review and underwriting guidelines that take into account some of the same factors other private and multilateral insurers use in evaluating projects. For example, a risk analysis is performed as part of OPIC's insurance approval process, and a credit analysis is included in the finance approval process. OPIC officials said they consider the same factors that any commercial bank or insurance company would concerning the economics of a project under consideration for financing or insurance.

Additionally, as of September 30, 1996, OPIC had accumulated over \$2.7 billion in reserves as part of its risk management strategy.<sup>24</sup> These reserves were raised from fees or premiums paid by users of OPIC's services and from the investment of these funds in Treasury securities. OPIC's reserves as a percentage of the total current exposure to claims have declined somewhat in recent years due to the rapid increase in the size of OPIC's portfolio since 1994. The reserves as a percent of OPIC's total outstanding exposure have declined from 41 percent in 1992 to 34 percent

<sup>24</sup>If OPIC were to draw down its reserves that are comprised of Treasury securities to pay for losses, the losses would be reflected in budget outlays.

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in fiscal year 1995. Despite this decline, J.P. Morgan Securities, Inc.'s, 1996 report on OPIC privatization concluded that these reserves are extremely large relative to exposure by private sector standards and compared to OPIC's historical losses. Further, analysts at J.P. Morgan Securities, Inc., see the reserves as adequate to cover OPIC's losses in all cases but an unprecedented disaster.

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### OPIC's Overall Project Limits Have Recently Increased

In 1994, OPIC increased per project financing limits from \$50 million to \$200 million and insurance coverage from \$100 million to \$200 million per project. Although larger transactions increase the government's contingent liabilities, large loans are not necessarily more risky than small loans. For example, 13 of the 14 loans currently in technical default or in a non-performing status at the end of fiscal year 1996 were loans made to small businesses and ranged in value from \$328,000 to \$12.5 million. In addition, OPIC data show that its direct loans have historically experienced more problems than its loan guarantees, which are mostly for high-value loans to large companies. However, for insurance transactions, higher project limits may or may not raise the overall level of risk for the portfolio. On the one hand, OPIC could be subject to larger claims if a foreign government, for example, were to expropriate an insured project. On the other hand, if OPIC's past experience with claims were to continue, the government's potential liability may be small. Since 1971, OPIC has recovered over 98 percent of the claims it has paid.

We caution that OPIC's past experience may not reflect future performance because OPIC has new exposure to losses in the newly independent states of the former Soviet Union, where it has had no previous experience. Furthermore, some countries in the region are considered to be very risky by the private insurers and bankers we spoke with.

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### Possible Options to Reduce the Risks Associated With OPIC's Insurance Portfolio

The private sector's willingness to have greater involvement in some emerging markets has created opportunities for OPIC to further reduce risks in its insurance program. OPIC could share the risk of losses with the private sector, which has shown an interest in emerging markets. For example, OPIC could lower the risks associated with its portfolio through reinsurance, coinsurance, and by decreasing project coverage or terms. However, OPIC's efforts to support U.S. foreign policy objectives, which promote investment in risky markets, present challenges for OPIC when considering ways to reduce the risks associated with its insurance portfolio.

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## Reinsurance

Under the reinsurance scenario, OPIC could consider insuring part of its high- and medium-risk portfolio with private sector insurance companies at premium rates that are mutually acceptable. For example, OPIC could enter into a contract with a large private insurer that would pay a specified percentage of any claims to OPIC. Care must be taken to ensure that the private insurer is not providing support exclusively for the lower-risk transactions and that OPIC retains enough of the reinsured premiums to cover its administrative costs. According to OPIC officials, OPIC had used portfolio re-insurance by the private sector as a mechanism for managing risk and stimulating U.S. private sector interest in providing risk insurance until the mid-1980s. The Grace Commission concluded that given OPIC's low claims experience, there was no justification for the U.S. government to pay reinsurance premiums that exceeded claims payments collected from the reinsurers. After the Grace Commission's study<sup>25</sup> of OPIC's reinsurance practices, the Office of Management and Budget directed OPIC to stop this practice because it was not cost-effective. OPIC officials told us that OPIC is currently in discussions with the Office of Management and Budget about the feasibility of once again pursuing portfolio reinsurance. As noted earlier, private political risk insurance companies are showing greater interest in emerging markets. This trend presents OPIC with opportunities to negotiate fee or premium arrangements that it would not have been able to negotiate in the past.

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## Coinsurance

Another risk mitigation strategy that OPIC may use is providing more coinsurance. It could coinsure a project with other private or public insurers in order to share the associated risks and premiums. In this case, the coinsurer would provide insurance that might or might not be identical to the type provided by OPIC that would permit both parties to provide a higher level and scope of coverage. For example, OPIC could provide \$100 million of coverage on a \$200-million project, while a private entity or a number of entities could provide the other \$100 million of coverage. An insurance industry official has publicly stated that OPIC could leverage its resources by inviting the private sector to provide 50 percent of the insurance required on a project. However, OPIC officials said that the private sector's reluctance to take long-term risk in risky markets limits its opportunity to pursue coinsurance. OPIC has documented only 12 of 1,392 contracts that it has coinsured with the private sector since 1988.

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<sup>25</sup>The Grace Commission was established in 1982 to identify opportunities for (1) efficiency enhancement and cost reduction and (2) greater managerial accountability to provide information on governmental expenditures and indebtedness. The Commission recommended that OPIC phase out reinsurance on its expropriation and inconvertibility policies and seek reinsurance for its political violence policies on a temporary basis.

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## Risk Sharing

A third risk mitigation strategy may be to reduce the coverage and terms of OPIC's insurance program. OPIC currently offers standard 20-year insurance with 90 percent coverage of the value of the insured assets.<sup>26</sup> One potential option would be that OPIC could insure less than 90 percent of the value of each investment. OPIC's rationale for insuring 90 percent, rather than 100 percent, of the value of the assets is to ensure that the investor or project sponsor has an incentive to manage its assets prudently. Another option would be for OPIC to offer less than 20-year coverage. For example, rather than providing its current 20-year standard policy, OPIC could offer a standard 15-year term, as is the practice with other public insurers, and provide 20-year cover only in certain cases. Lastly, OPIC could require that the insured hold OPIC coverage for a minimum of 3 years. These measures would lower the value of assets covered, the length of coverage, and potentially the cost of coverage.

Regarding the risk-sharing option, OPIC officials said that reducing the coverage level below 90 percent would have an adverse impact on small businesses and might lead U.S. investors to seek insurance support from foreign or multilateral sources that provide 90-percent coverage. They also noted that it might not be practical to make a project sponsor hold the coverage longer than he or she thinks is necessary or prevent him or her from seeking alternative sources of insurance. However, since a reduction in coverage is likely to come with a reduction in price, U.S. investors might continue to seek OPIC coverage.

OPIC officials acknowledged that reinsurance, coinsurance, and greater risk sharing may be sound risk management options, but are not without trade-offs. For example, reinsurance may reduce OPIC's income from premiums because OPIC would have to pay premiums to the reinsurer. Furthermore, OPIC takes on the credit risks of the reinsurer. The officials also stated that OPIC would need to maintain flexibility as to how and when to utilize these risk mitigation alternatives.

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## U.S. Foreign Policy Encourages OPIC to Invest in More Risky Markets

The U.S. foreign policy objective of promoting private investment in developing countries encourages OPIC to take risks that the private sector may not take without public support. OPIC, the State Department, and other U.S. government officials consider OPIC to be a major tool for pursuing U.S. foreign policy goals. One major U.S. foreign policy goal is to assist Russia in its transition toward a free market economy. According to OPIC officials,

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<sup>26</sup>When the insured asset is a loan, the term is usually for the life of the loan. Thus, an 8-year loan would be insured for 8 years. Further, lenders are insured for 100 percent of the value of their loans.

by entering into OPIC's bilateral agreement in 1992, Russia began to establish the conditions necessary for attracting private investment. Further, OPIC operates to promote development strategies that are consistent with internationally recognized worker rights. For example, OPIC ceased operations in the Republic of Korea in 1991, due to concerns over worker rights, including the arrest and imprisonment of labor union leaders.

OPIC's involvement in Russia was initially quite cautious, as it offered only coverage for expropriation and political violence. OPIC officials noted that as conditions improved in Russia, OPIC began offering coverage for currency inconvertibility risk. Since 1992, OPIC has accumulated a finance and insurance portfolio in Russia of \$880 million and \$1.6 billion, respectively. OPIC justifies its involvement in the high-risk markets of the former Soviet Union<sup>27</sup>—currently 18 percent of its portfolio—by noting its central role in furthering the U.S. foreign policy objective of facilitating private investment in these markets.

The private sector has tended to perceive the markets that OPIC operates in as risky, and private investors have often sought support from official sources when investing in these markets. According to OPIC officials, OPIC's goal is to support deals that would not be made without its support, and OPIC as an agency of the U.S. government has access to risk mitigation tools, including advocacy and intervention to avert claims, that are not available to the private sector. This implies that OPIC would seek transactions that the private sector believes would be too risky without public support. If OPIC is to continue pursuing its mission, its portfolio will always be considered more risky than the portfolios of private sector insurers.

## If OPIC Is Not Reauthorized, Any Shutdown Legislation Should Address Future Management of OPIC's Portfolio

OPIC's authorizing legislation makes no provision for a phaseout process in the event the agency is closed. Any legislation shutting down OPIC should make clear whether OPIC's portfolio should be moved to another agency or managed by a temporary organization until the portfolio expires. It could take as long as 20 years for OPIC's portfolio to expire because many of OPIC's insurance contracts run for 20 years, and OPIC had more than \$5 billion in such contracts with 19-20 years remaining as of the end of fiscal year 1996. According to OPIC's projections, about one-third of the

<sup>27</sup>The countries that comprise the bulk of the former Soviet Union (also known as the newly independent states) are Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Ukraine, Uzbekistan, Tajikistan, and Turkmenistan.

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portfolio would remain after 10 years. If the portfolio risk diminishes, Congress' option to dispose of these assets is more viable.

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### Legislation Should Establish Who Would Manage OPIC's Portfolio

If Congress decides not to reauthorize OPIC, any shutdown legislation would need to address whether OPIC would continue to manage the portfolio during a phaseout period or whether the portfolio should be moved to another agency. If the portfolio is moved to another agency, Congress would need to decide if any OPIC employees would be moved with it to ensure an adequate and knowledgeable work force. According to Office of Management and Budget officials responsible for overseeing OPIC and related agencies, OPIC staff may be best suited to managing the portfolio because they are familiar with the portfolio.<sup>28</sup>

According to OPIC and private sector financial officials, OPIC's portfolio could suffer losses if it is not properly managed, thereby increasing the cost of closing the agency. For example, a successor entity would need to monitor the construction of power and other projects, as well as political developments in host countries and the portfolio's financial performance, to help prevent claims and/or defaults. Additionally, such an entity would need to perform OPIC's administrative and legislatively mandated functions, including fee collection, repayment, environmental oversight, compliance with worker rights, and other monitoring to ensure that clients comply with their contractual agreements. According to OPIC officials, if finance projects encountered payment difficulties, an entity would also be needed to restructure the project and make collections where necessary.

If a decision were made to move OPIC's portfolio to another agency, the U.S. Eximbank would be the closest fit, according to Office of Management and Budget officials who are also responsible for overseeing the U.S. Eximbank. U.S. Eximbank officials also stated that their agency has many of the appropriate skills to do the job.<sup>29</sup> The Eximbank officials cautioned, however, that their employees would not be familiar with the various monitoring requirements that OPIC carries out. They noted that OPIC is a foreign policy agency that provides development assistance while the U.S. Eximbank is an export promotion agency whose emphasis is on expanding U.S. exports.

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<sup>28</sup>OPIC's process for providing U.S. firms with financial and insurance services involves (1) an application and approval phase and (2) a period in which approved projects are monitored (see flowcharts in apps. IV and V).

<sup>29</sup>The qualifications for OPIC professionals are similar to those for professionals at the Eximbank. Many employees at both agencies have the same Office of Personnel Management job classifications. These classifications include code 110 (economists), code 905 (general attorneys), code 1101 (general business and industry specialists), and code 1160 (financial analysts).

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The U.S. Eximbank's lack of familiarity with OPIC's monitoring requirements would be less of an issue if OPIC staff were transferred to the U.S. Eximbank.

Officials from three other agencies with responsibilities for overseeing loans or insurance obligations, or for encouraging and tracking U.S. investment in key overseas markets, all said that their agencies lack the business skills and resources necessary to manage OPIC's portfolio. These agencies include the Departments of Commerce, State, and the Treasury. Office of Management and Budget officials concurred that their agency also lacks these skills and resources. In addition, officials from the Agency for International Development, the agency from which OPIC was created, said that their agency would not be well suited to managing OPIC's portfolio because the agency (1) does not provide political risk insurance, (2) provides mostly grants, and (3) lends primarily to public entities (OPIC lends to the private sector).

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### Other Issues to Be Considered If OPIC Is Not Reauthorized

Regardless of whether OPIC's portfolio is turned over to another agency, certain Office of Personnel Management rules would affect OPIC employee entitlements as he or she is separated from government service.<sup>30</sup> These entitlements may include (1) retirement or severance pay, (2) unemployment compensation, (3) the dollar equivalent of unused annual leave, and (4) settlement from any pending equal employment opportunity or other labor-related litigation.<sup>31</sup> According to officials of the Office of Personnel Management, if OPIC's portfolio is moved to another agency, Congress would have to decide if any OPIC employees are to be moved with the portfolio. These officials said that reassignment of OPIC employees to another agency, under current Office of Personnel Management rules, would be temporary, lasting only until OPIC's portfolio expires or the government disposes of the portfolio.

If OPIC's portfolio is moved to another agency, other issues might be considered for easing the transition. For example, a timetable could be

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<sup>30</sup>Previous agency phaseout experience indicates that personnel issues are the most difficult. According to the Federal Deposit Insurance Corporation official responsible for managing the phaseout of the Resolution Trust Corporation, there are lessons that can be learned from the Resolution Trust's termination. Although these lessons may not require specific legislative action, there are steps that may be taken to mitigate personnel problems in the event of a phaseout. They include (1) setting up a joint task force with representatives from both OPIC and the portfolio monitoring entity so that the OPIC participants feel they have some say in how matters are resolved and (2) establishing a mechanism for employee communications to reduce uncertainty and anxiety.

<sup>31</sup>Severance pay can be up to an employee's current gross annual salary, depending on the employee's age and length of government service. Unemployment compensation would begin only if the employee has not yet found a new job once the severance pay is exhausted.



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established for transferring OPIC functions to the designated agency. In the absence of specific congressional direction, General Services Administration regulations would apply governing the disposal of OPIC's property including the transfer of office furniture and equipment. In addition, OPIC said it has a commercial real estate lease that runs to June 30, 2007.<sup>32</sup>

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## OPIC's Portfolio May Take 20 Years to Expire

A phaseout of OPIC would require ceasing new business as of a certain date.<sup>33</sup> Also, a phaseout could take as long as 20 years. OPIC's investment funds run for 10 years; its loans and guarantees, a maximum of 15 years; and its insurance policies, a maximum of 20 years.

According to OPIC estimates, which assume a 10-percent annual drop in the declining remainder of the insurance portfolio due to both cancellations and policies ending at term, the agency's potential exposure of \$23 billion for all services would fall by 64 percent, to \$8.2 billion, after 10 years. During the same period, OPIC estimates that its current staff of 200 would decrease by more than 70 percent to about 60 people as the portfolio diminishes. We compared OPIC's assumptions concerning insurance cancellations and contracts ending at term to historical data and found these assumptions to be generally consistent with these data.<sup>34</sup> According to OPIC, just under 10 percent of the original exposure would remain in the 20th year, with less than 8 percent of the staff needed to monitor it. The decline in OPIC's portfolio is shown graphically in figure 4. The insurance portion of the portfolio is by far the largest, currently at just under \$16 billion. This portion is about 3 times the value of the finance portion and almost 8 times that of the investment fund portion. In the 20th year, just the insurance portion would be left, having dropped by 86 percent to just over \$2 billion (see fig. 4).

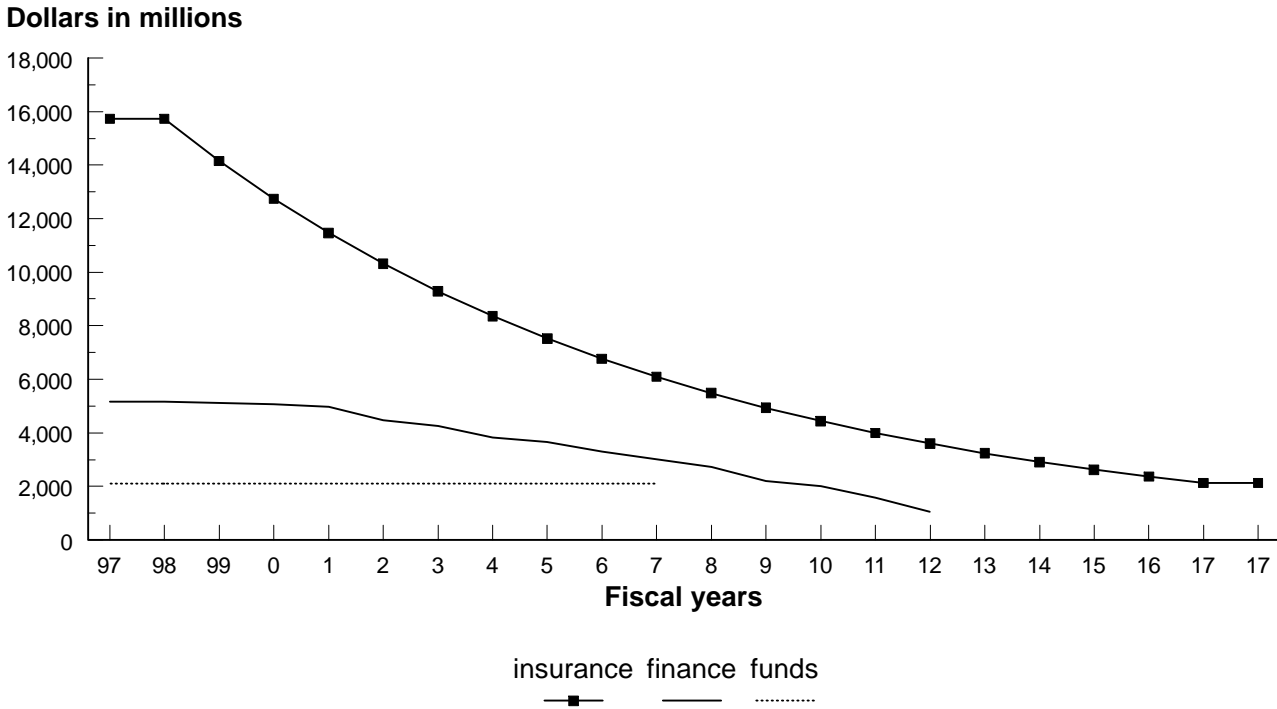
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<sup>32</sup>According to OPIC officials, if OPIC terminates this lease without finding a suitable sublessee, it would be liable for the payment of 1 year's rent (about \$4 million) as liquidated damages.

<sup>33</sup>OPIC issues a "commitment letter" when it approves a project. As of the end of fiscal year 1996, OPIC's insurance commitment letters covered \$3.4 billion, 25 percent of its total insurance portfolio; its finance commitments stood at \$1.6 billion, or 38 percent of its total finance portfolio (excluding investment funds). Any legislation phasing out the agency should recognize the existence of the commitment letters. According to OPIC officials, legislation that does not give effect to these commitments would result in a U.S. government liability.

<sup>34</sup>Our analysis compared OPIC's assumed 10-percent rate of decline to past experience regarding OPIC's insurance cancellation rates. We also subjected OPIC's calculations to a 15-percent annual decline and compared this to the previous results to determine the sensitivity of OPIC's assumption. Using OPIC's 10-percent assumption, 35 percent of the insurance portfolio would remain after 10 years, versus 20 percent if the 15-percent assumption is used.

Figure 4: Projected Phaseout of OPIC's Portfolio



Disposal of Portfolio Assets Could Be Revisited in the Future

Although the government may wish to divest OPIC's portfolio before its expiration by selling it to the private sector, such a decision would need to account for the relative riskiness of OPIC's portfolio and any discounts such a disposal would necessitate. According to a recent study, a privatization of OPIC's current assets could only be accomplished at a discount.<sup>35</sup> As OPIC's portfolio matures during a phaseout, external factors may affect the riskiness of the portfolio, either negatively or positively, and thus any potential privatization discount.

If existing economic and political trends continue in the markets where OPIC currently operates, OPIC's portfolio may become less risky. With each year that passes, the length of the government's obligation decreases and the insured as well as the government becomes more familiar with the risks and issues inherent in a given transaction. As stated earlier, OPIC's clients tend to cancel their insurance coverage after a few years as they

<sup>35</sup>Overseas Private Investment Corporation: Final Report on the Feasibility of Privatization (Feb. 7, 1996).

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feel more comfortable with the political risks. On the other hand, OPIC's portfolio may experience greater risk. In general, long-term transactions are riskier than similarly situated short-term loans, guarantees, or insurance transactions. Also, according to OPIC officials, cancellations are more likely to occur in the lower-risk segment of OPIC's portfolio, thus making the portfolio riskier in the future than it is today. Either situation—less risk in the portfolio or greater risk—may occur.

Regardless of the risk characteristics of the portfolio over time, OPIC's portfolio will decrease. As the portfolio decreases, the amount of the discount will decrease for a given risk in the portfolio. If the quality of the portfolio improves as a result of improvements in OPIC markets, then the rate of discount will likely be much lower or even disappear. If, on the other hand, the portfolio becomes more risky over time, the rate of discount is likely to increase. Since the condition of this portfolio a decade or more from now is unclear, the government has the option of revisiting its choice to sell the portfolio if the risk is reduced.

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## Agency Comments

OPIC provided written comments on a draft of this report. OPIC generally agreed with the information and analyses in the report. In commenting on the draft, OPIC provided additional information to further clarify its view of (1) the role of the private sector, (2) risk mitigation opportunities, and (3) phaseout issues. OPIC also orally provided technical corrections and updated information that were incorporated throughout the report where appropriate. OPIC's comments are reprinted in appendix VI, along with our evaluation of them.

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## Scope and Methodology

To identify trends in private sector investment in developing markets and the public sector's role in these markets, we focused on various characteristics. Specifically, we obtained and analyzed World Bank data on the extent and types of private capital flows going to finance infrastructure and the trend of these flows over time. To identify the recent developments in the volume and types of investment support provided by the public and private sectors for investments overseas, we obtained and compared information from (1) five large private providers of political risk insurance; and (2) the largest public providers of investment support representing France, Germany, Japan, Canada, Italy, the United Kingdom, and the United States. (see app. II) and the Multilateral Investment Guarantee Agency. We also discussed with the Berne Union information on the nature of political risk insurance and the

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role and capability of the public and private sectors. We obtained total insurance exposure data directly from the Group of Seven (G-7)<sup>36</sup> insurance providers. Regarding financing, we obtained information from major financial institutions that provide financing to U.S. investors, including the Chase Manhattan Bank and Citibank, and the International Finance Corporation. We also discussed the international finance environment with Standard & Poor's Ratings Services and Moody's Investors Service, two large financial rating agencies. An important component of our analysis of private sector investment was the identification of the kinds of investment services U.S. investors have utilized in various developing countries or economies in transition as well as countries in which OPIC is not open for business (for example, China and Mexico). To obtain this information, we surveyed a judgmental sample of 34 U.S. investors that had made major investments within the last 5 years in the power and telecommunications sectors.<sup>37</sup> We selected the power and telecommunications sectors because they (1) are listed as the major sectors of growth in emerging markets<sup>38</sup> and (2) represented two of the four largest sectors supported by OPIC.<sup>39</sup> Since these sectors have considerably different resource requirements and risks, their inclusion allowed us to make several important distinctions regarding the investment environments in which they operate.

To survey firms in the power and telecommunications sectors operating overseas, we (1) reviewed relevant literature including the Directory of American Firms Operating in Foreign Countries and U.S. Security and Exchange Commission data, (2) contacted appropriate Department of Commerce officials, (3) reviewed OPIC's annual reports that list overseas investors, and (4) asked the firms contacted to identify their major competitors. We attempted to contact the 54 firms identified and successfully interviewed 34. We asked each firm to identify the projects it was involved in over the past 5 years, how these projects were structured,

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<sup>36</sup>Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

<sup>37</sup>We characterize our sample as judgmental due to the difficulties associated with identifying the universe of firms with overseas investments in these sectors. As a result, we did not randomly select the firms chosen.

<sup>38</sup>According to International Finance Corporation data, the power and telecommunication sectors represented about 67 percent of all private investment in developing countries between 1990 and 1995.

<sup>39</sup>The financial services and manufacturing sectors are larger than the telecommunications sector. We did not include the financial sector in our sample because it is an intermediary activity that combines investments in various sectors, including power and telecommunications. We did not include the manufacturing sector because, although this sector has received a considerable amount of OPIC support in the past, only a small amount of OPIC's business in the last 5 years has been in this sector.

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their views on the nature of the risks involved, and how it mitigated the risks.<sup>40</sup>

To determine OPIC's risk management strategy and the steps that OPIC may take, if it is reauthorized, to further reduce portfolio risks while pursuing its objectives, we obtained and reviewed documents on OPIC's risk assessment policies and financial reports that detailed the condition of OPIC's portfolio. We also gathered and reviewed information on the risk assessment policies of two World Bank institutions (the Multilateral Investment Guarantee Agency and the International Finance Corporation), organizations that have programs comparable to OPIC's insurance and finance programs. To support our analysis of these policies, we interviewed OPIC, Treasury, and State Department officials. Furthermore, we interviewed officers of private banks, investment institutions, and political risk insurance companies about steps that OPIC could pursue in reducing the risks associated with its portfolio.

To determine the issues that would need to be addressed and the time it would take to phase out OPIC if it is not reauthorized, we reviewed laws and regulations and discussed applicable policies and practices with officials from the Office of Personnel Management, the General Services Administration, and the Office of Management and Budget. In addition, we reviewed our past work on the closure of the Resolution Trust Corporation and interviewed the Federal Deposit Insurance Corporation official responsible for managing the phaseout of the Resolution Trust Corporation. To determine how long it would take for OPIC's obligations to expire, we obtained documents from OPIC on (1) its current financing and insurance obligations, (2) its insurance policy cancellation rates, and (3) its projections on the duration of its existing portfolio and the resources it would require to manage the portfolio. To assess the reasonableness of these projections, we reestimated OPIC's analysis using a higher projected phaseout rate. With regard to which agency might be best suited to manage OPIC's existing portfolio until the obligations expire, we interviewed officials from the Agency for International Development, the Commerce Department, the U.S. Eximbank, the National Economic Council, the Office of Management and Budget, OPIC, the State Department, and the Treasury Department. We also obtained Office of Personnel Management documents showing job classifications at OPIC and two other agencies—the Agency for International Development and the U.S. Eximbank.

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<sup>40</sup>Our analysis did not consider the implications closing OPIC would have on the private sector. Such an analysis would be highly speculative; and as we discuss in the report, there are many public and private sector alternatives to OPIC available to private investors.

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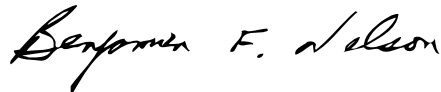
We conducted our review from January 1997 to July 1997 in accordance with generally accepted government auditing standards.

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We are sending copies of this report to appropriate congressional committees and the President and Chief Executive Officer of the Overseas Private Investment Corporation. We will also make copies available to other interested parties upon request.

This review was done under the direction of JayEtta Z. Hecker, Associate Director. If you or your staff have any questions concerning this report, please contact Ms. Hecker at (202) 512-8984. Major contributors to this report are listed in appendix VII.

Sincerely yours,

A handwritten signature in cursive script that reads "Benjamin F. Nelson".

Benjamin F. Nelson  
Director, International Relations  
and Trade Issues

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Abbreviations

Eximbank	U.S. Export-Import Bank
OPIC	Overseas Private Investment Corporation

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# Firms Contacted During the Review

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## Firms Surveyed

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### Power Companies

AES Corporation  
Coastal Power Energy  
CalEnergy Company, Inc.  
CMS Energy Corporation  
Constellation Power, Inc.  
Dominion Resources, Inc.  
Duke Energy International, Inc.  
Enron International  
GE Capital Corporation  
GPU International, Inc.  
Houston Industries Energy, Inc.  
Edison Mission Energy  
Ogden Energy Group, Inc.  
TECO Power Services Corporation  
El Paso Energy International  
The Wing Group Ltd. Co.

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### Telecommunications Companies

Adelphia Communications International  
African Communications Group, Inc.  
Ameritech Corporation  
Andrew Corporation  
BellSouth Corporation  
Comcast Corporation  
Chase Enterprises  
D & E Communications, Inc.  
GTE Service Corporation  
Hungarian Telephone & Cable Corporation  
Lucent Technologies, Inc.  
MCT of Russia, L.P.  
Millicom International Cellular, S.A.  
Motorola, Inc.  
Radiomovil Digital Americas, Inc.  
Telecel International, Inc.  
SBC Communications Inc.  
US WEST International Holdings, Inc.

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**Appendix I**  
**Firms Contacted During the Review**

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**Other Public and Private  
Entities Contacted**

American International Group, Inc.  
AT&T  
Bechtel Corporation, Inc.  
Berne Union  
The Chase Manhattan Bank, N.A.  
Citibank, N.A.  
Citicorp International Trade and Indemnity  
Citicorp North America, Inc.  
Exporters Services  
FCIA Management Company, Inc.  
International Finance Corporation  
MCI Communications  
J.P. Morgan Securities, Inc.  
Lloyd and Thompson Insurance Co.  
Multilateral Investment Guarantee Agency  
Moody's Investors Service  
NYNEX  
Sedgewick Reinsurance Brokers Ltd.  
Standard & Poor's Ratings Services  
Taylor-DeJongh, Inc.  
Unistrat Corporation of America

# Main Features of the Group of Seven Investment Insurance Programs

<b>G-7 Country Investment</b>	<b>Eligible investors</b>	<b>Eligible enterprises</b>	<b>Coverage limits</b>	<b>Maximum duration risks covered</b>
<b>France/COFACE</b>	Legal entities registered in France.	No restrictions.	No limit.	15 years. Expropriation, war, inconvertibility, breach of government commitments.
<b>Germany/C&amp;L</b>	Domestic German entities.	No restrictions.	No limit.	15 years. <sup>a</sup> Expropriation, war, inconvertibility, breach of government contracts.
<b>Japan/EID/MITI</b>	Persons and entities existing in Japan.	No restrictions.	\$500 million per project.	15 years. <sup>b</sup> Expropriation, war, inconvertibility, bankruptcy after 2 years of operation.
<b>Canada/EDC</b>	Persons or business beneficial to Canada.	No restrictions.	No limit.	15 years. Expropriation, war, inconvertibility.
<b>Italy/SACE</b>	Persons or entities domiciled in Italy.	Developing countries only.	No limit.	15 years. Expropriation, war, inconvertibility, natural catastrophe.
<b>U.K./ECGD</b>	Persons and entities carrying on business in United Kingdom.	No restrictions.	No limit.	15 years extendable to 20. Expropriation, war, inconvertibility, breach of contract by host government.
<b>U.S./OPIC</b>	U.S. citizens and entities and foreign entities 95% owned by U.S. interests.	Developing countries only. <sup>c</sup>	\$200 million per project.	20 years. Expropriation, war, inconvertibility, breach of contract by host government.

<sup>a</sup>Twenty years if a project involves long construction period.

<sup>b</sup>Longer periods for projects with long construction periods; commercial risk for 10 years with longer periods possible.

<sup>c</sup>Bilateral agreement required; host government attitude toward human rights, worker rights considered; environmental impact considered.

Source: Overseas Private Investment Corporation (OPIC) Insurance Department.

# Regional Investment Insurance Exposure of the Major Group of Seven Providers

U.S. dollars in millions

Major insurance providers	Asia/ Pacific	Europe <sup>a</sup>	Africa <sup>b</sup>	The Americas <sup>c</sup>	Reported total
Japan MITI/EID	Unavailable	Unavailable	Unavailable	Unavailable	<b>\$13,943</b>
U.S. OPIC <sup>d</sup>	\$ 2,740	\$3,517	\$ 1,554	\$ 6,622	<b>\$13,386<sup>e</sup></b>
Germany C&L	2,751	3,826	650	608	<b>7,835</b>
France COFACE	1,050	730	1,590 <sup>f</sup>	100	<b>3,470</b>
Canada EDC	50	250	40	910	<b>1,250</b>
U.K. ECGD	380	110	48	2	<b>540</b>
Italy SACE	2	Unavailable	Unavailable	39	<b>41</b>
<b>Total</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>\$40,465</b>

Note: All data are as of 1996; exchange rates as of December 31, 1996.

<sup>a</sup>Europe includes the former Soviet Union, Eastern Europe, and Turkey.

<sup>b</sup>Africa includes the Middle East.

<sup>c</sup>The Americas includes Central America, South America, and the Caribbean.

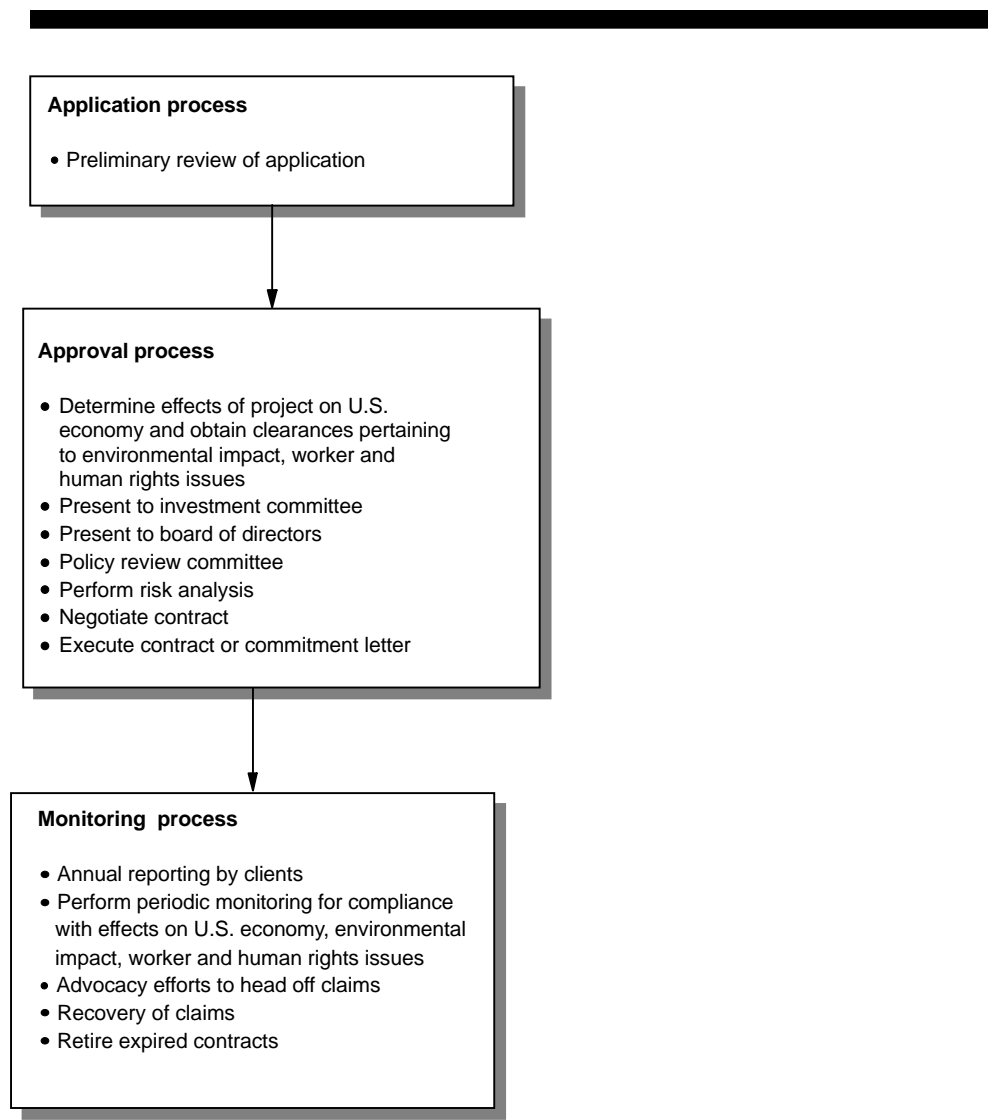
<sup>d</sup>OPIC data as of September 30, 1996.

<sup>e</sup>The sum of the geographic regions exceeds the reported total by \$1,048,133 due to a client-specific stop loss adjustment that limits OPIC's liability.

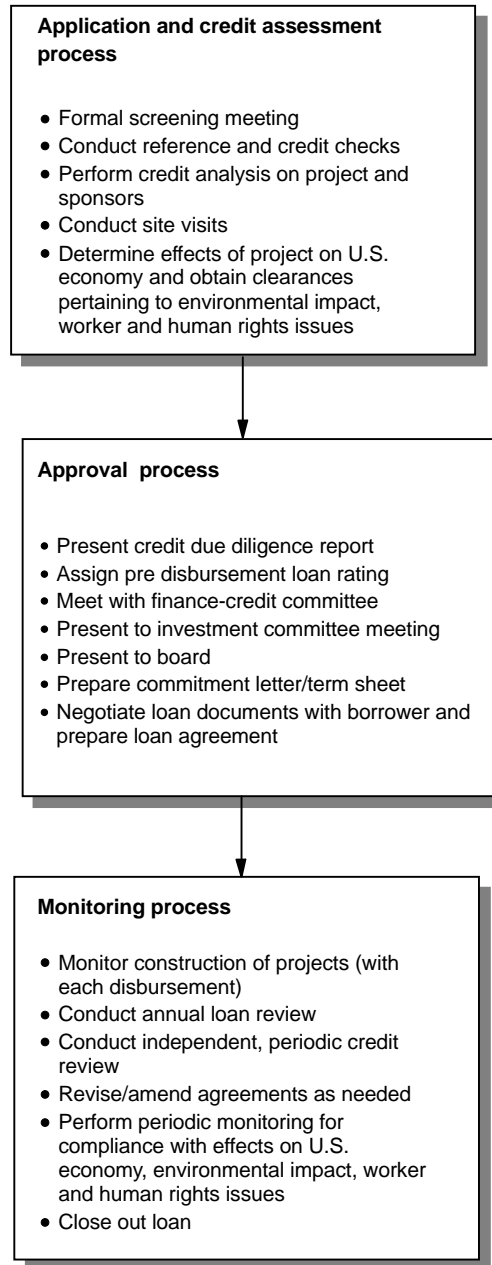
<sup>f</sup>French data for Africa include Middle East and Turkey.

Source: Group of Seven Insurance Providers.

# OPIC Insurance Process



# OPIC Finance Process



# Comments From OPIC

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

**OVERSEAS PRIVATE INVESTMENT CORPORATION**  
WASHINGTON, D.C. 20527, U.S.A.



OFFICE OF THE  
PRESIDENT

August 6, 1997

Mr. James F. Hinchman  
Acting Comptroller General  
U.S. General Accounting Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. Hinchman:

This letter responds to GAO's request for written comments on the draft report dated July 27, 1997, on issues relating to the Overseas Private Investment Corporation. I hope you find these comments helpful in finalizing the report.

## I. INTRODUCTION

GAO has reached a number of important conclusions with which OPIC fully concurs:

- **OPIC Is Profitable and Self Sustaining:** "Historically, OPIC's combined finance and insurance programs have been profitable and self-sustaining, including cost due to credit reform and administration" (p. 19).
- **OPIC Is Profitable Even Without Treasury Income:** "OPIC's net income from transactions with the private sector, that is, fees and premiums, was about \$42 million in fiscal 1996" (p. 20). When interest from its U.S. Treasury securities is added, "OPIC's net income was \$209 million" (p. 19).
- **OPIC Has Healthy Reserves:** OPIC has generated "substantial revenues from its finance and insurance programs and its investments that have been sufficient to cover actual losses" (p. 15). The GAO cited the J.P. Morgan study's conclusion that OPIC's reserves are "extremely large relative to exposure by private sector standards" (p. 23) and are "more than adequate to cover any losses that OPIC might experience" (p. 15).
- **OPIC Fills A Commercial Void:** "Markets still exist where investors are unable to obtain private finance or insurance services. As a consequence, they seek public support" (p. 6). And, "In some risky markets private insurers are only willing to provide insurance when a public sector entity is involved in the project. A number of private insurers we (the GAO) spoke to said they have not provided coverage in Russia and most of the other newly independent states of the former Soviet Union" (p. 10).

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See comment 1.

Now on p. 12

Now on p. 14

Now on p. 12.  
Now on p. 17.

Now on p. 9.



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Now on p. 20.

- **OPIC Has A Key Foreign Policy Role:** “The State Department and other U.S. government officials consider OPIC to be a major tool for pursuing U.S. foreign policy goals.... OPIC operates to promote development strategies that are consistent with internationally recognized worker rights” (p. 27).
- **OPIC Has a Well-Diversified Portfolio:** “No single country may account for more than 15 percent of OPIC’s portfolio, effectively protecting OPIC against the adverse consequences of catastrophic events in any one country” (p. 20).
- **Without OPIC, American Jobs Would Be Lost:** “Some U.S. firms told us that they were unable to use U.S. suppliers when they obtained support from foreign export credit agencies” for projects in countries where OPIC does not operate – a situation that obviously would occur more often if OPIC is not reauthorized (p. 14).

Now on p. 14.

Now on p. 10.

In addition, OPIC would like to offer the following clarifications.

**II. CLARIFICATIONS**

**A. Risk Mitigation**

1. **Insurance Portfolio:** The draft report does not make a judgment about whether OPIC’s insurance portfolio is too risky. We believe the facts – some of which are cited in the draft – firmly support a conclusion that OPIC’s insurance portfolio is not too risky. From fiscal year 1971 through the end of FY 1996, OPIC’s insurance program had earned \$922 million in premiums and fees, and paid or settled \$515 million in claims, of which it had recovered all but \$11 million. The net \$911 million earned, not counting interest on reserves, is clear evidence of a successful risk mitigation program.
2. **Risk Management Strategies:** We agree with the draft report’s finding that OPIC has managed its risk by limiting exposure in any one country or sector. But OPIC uses a number of other strategies as well. These include:
  - OPIC’s underwriting strategy begins with careful analysis of the risks associated with projects in a particular country, from investigation of the political and economic framework to analysis of legal and regulatory risk.
  - OPIC focuses on the particular risks being underwritten for the type of investment as well as the unique circumstances of each project, including its location, structure and the track record of the U.S. investor.

See comment 2.

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- OPIC's standard contract language is carefully tailored to address the specific risks for each project and to preserve OPIC's salvage rights, and each contract is priced accordingly.
- The underwriting of each project is carefully reviewed according to an internal control process beginning with review by the Underwriting Committee.
- OPIC uses a number of risk sharing techniques to manage risk, including reinsurance and coinsurance arrangements with other political risk insurers;
- OPIC uses underwriting tools such as risk sharing, stop loss agreements and higher self-insurance; requirements to pay for coverage for a minimum number of years; increased deductibles; and contractual limitations on the amount and timing of claims submissions.
- OPIC uses coverage limits that carve out specific risks from the scope of insurance, including delineation between commercial and political risks.

We appreciate the report's recognition that no risk mitigation technique should be required in every case. OPIC should retain the flexibility to apply risk mitigation techniques on a case-by-case basis as it has done in the past.

Finally, while the draft report claims that OPIC's portfolio is riskier than the portfolios of private sector insurers and financiers, it should be noted that OPIC has a mandate that private firms do not have: to support U.S. foreign policy in "emerging" markets that are inherently risky. It should also be noted, however, that OPIC's unique position as an agency of the U.S. government acts as a risk mitigant and allows OPIC to manage risk in a manner that the private sector cannot. OPIC's history demonstrates that foreign governments are much less likely to disrupt U.S. investments if the U.S. government participates through OPIC. If problems develop, OPIC, as part of the U.S. government, has leverage for resolving these disputes through diplomatic channels that is not available to private sector insurers. OPIC has had several notable successes using these techniques recently in the emerging markets of the former Soviet Union.

In addition, as part of the government-to-government agreements it negotiates with each country where it operates, OPIC obtains special arrangements for recovering salvage when it pays inconvertibility claims. Under these arrangements, OPIC makes inconvertible local currency available for other U.S. government uses, in exchange for the dollars that would have been spent, for example, by a U.S. embassy for its local currency expenses. Through this mechanism, which is not available to private sector insurers, OPIC has historically been able to obtain excellent salvage on currency inconvertibility claims.

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See comment 3.

3. **Per Project Limits:** The draft report correctly notes that larger finance projects tend to be less risky than smaller projects. But the same is true for OPIC's insurance projects. Larger projects, whether supported by insurance or finance, tend to have built-in risk mitigants, as they are sponsored by more sophisticated companies whose experience in global markets enables them to mitigate their risks. Furthermore, larger projects frequently have the participation of one or more bilateral agencies or multilateral financial institutions in addition to OPIC, whose presence and special arrangements with the host government act as an additional deterrent to interference with a project.

It is also worth noting that when the 1994 increases in OPIC's per project caps are viewed in real dollar terms, OPIC's insurance coverage actually has declined: \$100 million worth of coverage in 1971 would have been worth \$350 million in 1994. Likewise, the increase in OPIC's finance cap from \$50 million to \$200 million represents only a nominal increase in real dollars.

**B. Role of the Private Sector**

See comment 4.

1. **Private Market Instability:** The draft report states that "Lloyd's of London, the American Insurance Group and Exporters Insurance Corporation, three major private insurers, have recently increased their coverage" of the types of projects that OPIC insures. However, the report should note that the market's history to date has been one of markedly variable capacity, with insurers and reinsurers exiting as well as entering the marketplace – resulting in corresponding decreases and increases in the amount of available coverage. Capacity flows to the political risk insurance market when there is more capacity available in the property/casualty market than there is demand for coverage. But the private market capacity for political risk coverage is likely to contract in size when demand for property/casualty coverage rises relative to capacity – for example, if there are significant property/casualty claims events. In addition, historically the political risk market has contracted when faced with significant political risk claims. There is no reason to conclude that current political risk capacity will remain available as the market progresses through its inevitable cycle. OPIC, on the other hand, by virtue of its mandate to support U.S. foreign policy, has remained a steady source of political risk insurance throughout periods when the private market was unable or unwilling to meet market demands. This fact is of great importance to American companies whose investment opportunities in emerging markets do not necessarily mirror the cycles of the insurance industry.

See comment 5.

2. **Risk Sharing:** The draft report suggests that OPIC consider various forms of risk sharing, including reinsurance, coinsurance and self-insurance. As noted above, OPIC presently uses each of these options when appropriate on a project-by-project basis.

While, as the report correctly notes, OPIC ceased all portfolio-wide or treaty reinsurance activities in 1985 at the direction of OMB, OPIC currently uses project-by-project ("facultative") reinsurance when appropriate. In addition, the agency is currently in the

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process of undertaking a systematic evaluation of treaty reinsurance options for the future. Should the analysis indicate that treaty reinsurance is a feasible option, OPIC would work with private insurers to develop the most advantageous reinsurance program, in light of the current expansion of the private market and the cyclical nature of private market capacity.

The draft report suggests that OPIC has coinsured only 18 of 1,392 projects. In fact, the actual number is greater than that. The figures cited represent only those projects that involved formal documentation of coinsurance through a claims cooperation or similar agreement. As noted in the draft, many private insurers require that the issuance of their coverage remain confidential. However, OPIC has anecdotal evidence that the private market has frequently provided insurance to investments also insured by OPIC, without OPIC's knowledge or active participation. In the early 1980s OPIC attempted to collaborate with the private market on a joint underwriting program. Although the joint underwriting program was never formalized, OPIC amended its standard contract language to allow the participation of private insurers without the specific knowledge or approval of OPIC.

OPIC also has used increased self-insurance on a number of occasions. Investors have taken a greater percentage of risk themselves in order to reduce premium expense or when the project size is above OPIC's \$200 million limit. Increased self-insurance by OPIC-insured investors is the form of coinsurance most frequently used by OPIC.

**C. OPIC's Profitability and Income Issues**

- 1. Treasury Income:** The draft report states that "...much of OPIC's profitability comes from interest earned on Treasury securities." This statement is true. But the implication seems to be that these profits should not be counted in evaluating the program. The fact is, Treasury security revenue represents real revenue to OPIC and provides excellent assurance that OPIC will never require a bailout from the taxpayer. Moreover, if OPIC had invested its reserves in other types of securities, its interest earnings would surely be taken into account in assessing the agency's profitability. However, Congress limited OPIC's investments to Treasury securities for sound policy reasons: Treasury securities represent a reasonable rate of return with minimal risk and, most importantly, Treasury security investments guarantee that OPIC's significant cash reserves stay within the U.S. Government and are available for the government's cash needs. The fact that Congress has required OPIC to invest in Treasury securities should not change the analysis of OPIC's profitability.

It is interesting to note that if OPIC had invested outside the government in mutual funds or other similar investments, as private insurance companies do, its investments would have created a portfolio worth nearly \$7 billion today – much greater than OPIC's current reserves of approximately \$2.7 billion.

See comment 6

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See comment 7.

Finally, footnote 24 states that “to the extent to which OPIC were to draw down its reserves that are comprised of Treasury securities, the loss would become a liability to the U.S. Federal budget.” What the draft report footnote terms a budget “liability” would more properly be termed an “outlay.” This should then be compared to the offsetting collections that OPIC receives, which more than offset the outlays. The insurance premiums alone that OPIC collected between FY 1971 and FY 1996 totaled \$922 million, more than offsetting the \$289 million in cash claims paid during that period, even if the recoveries are not considered. As mentioned earlier, all but \$11 million of those cash claim payments had been recovered by the end of FY 1996.

2. **Finance Program Profits:** The report notes that between 1993 and 1996, when OPIC’s finance program saw unprecedented growth, the finance program appeared to operate at a slight loss. It should be noted that this occurred because of timing differences, whereby the recording of income lagged behind the recording of expenses. In particular, the provision for reserves, which is an accounting expense entry, not an actual cash expenditure, grew significantly to allow for the growth in the portfolio. As the revenues from the portfolio have increased, this trend has reversed. Indeed, OPIC’s finance program will show a profit in FY 1997.
3. **Loan Write-Offs:** The draft report also states that OPIC’s total write-offs since 1984 were \$66.9 million. It should be pointed out, however, that as a percentage of OPIC’s total finance portfolio for the same period, this write-off rate is less than one percent of average annual loans outstanding. OPIC’s write-off rate compares very favorably with that of the private sector. During the same period, finance program revenues totaled over \$250 million, resulting in \$180 million in finance revenues net of write-offs.
4. **Credit Reform Estimates:** The draft report states that “based on credit reform subsidy projections, OPIC’s finance program cost the government about \$135 million between fiscal years 1992 and 1996.” We would like to clarify that credit reform subsidy projections are not actual costs, but instead represent a conservative estimate of projected cash flows. In fact, all of OPIC’s cohorts have shown a downward trend in projected subsidy costs as actual activity progresses. Moreover, as explained above, any discussion of OPIC’s costs should take into account the revenues OPIC earns from its Treasury securities.

See comment 8.

**D. Considerations for a Phase-Out of OPIC**

1. **Advocacy Role:** The draft report concludes that a successor entity would need to monitor the construction of power and other projects, as well as political developments in host countries and the portfolio’s financial performance, to help prevent claims and/or defaults. However, such an entity would also need to engage in advocacy with foreign

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governments in order to avert potential claims and pursue salvage when claims are paid in order to maximize recoveries. Similarly, it would need to devote resources to the restructuring of finance projects that might encounter payment difficulties, as well as collection efforts in workout situations.

2. **Potential Liability:** The draft report comments that “any legislation phasing out the agency should address whether projects approved in commitment letters as of a certain cutoff date would continue as part of OPIC’s existing portfolio.” OPIC commitments to issue insurance and financing are legally binding on the agency and terminable only in accordance with their terms. Any phase-out legislation that failed to give effect to commitments outstanding on a shut-down date could result in U.S. government liability to the holders of those commitments for breach of contract. The draft report recognizes that any phase-out legislation should address whether projects that have received commitments should remain in the portfolio, but should also recognize the costs that could result if legislation were adopted requiring termination of outstanding commitments.

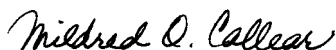
**III. CONCLUSION**

OPIC appreciates the opportunity to comment on the draft report, and we would also appreciate GAO’s consideration of these comments in preparing the final report.

I want to express OPIC’s sincere thanks for the thoughtful, balanced and professional approach your staff took in examining these complex and oft-misunderstood issues.

If you have any questions, please do not hesitate to contact me.

Sincerely,



MILDRED O. CALLEAR  
Acting President and Chief Executive Officer

See comment 9.

See comment 10.

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The following are GAO's comments on OPIC's letter dated August 6, 1997.

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## GAO Comments

1. The points that OPIC highlights are their own interpretation of our analyses. Several points discussed by OPIC, such as the health of their reserves, filling a commercial void and the impact of its activities on U.S. employment, are not our specific conclusions. Rather, the report provides factual information and our analysis of the trends in private sector investment, the public sector's role in emerging markets, OPIC's portfolio and risk management strategy, and issues to be addressed if OPIC were not reauthorized.
2. Information in the report on OPIC's risk management strategy is not restricted to a discussion of how OPIC limits exposure in any one country or sector. The report also includes a discussion of OPIC's pre-approval review process and underwriting guidelines. Appendixes IV and V contain information on the application, approval, and monitoring processes for the insurance and finance programs.
3. Although the report notes that the larger finance projects tend to be less risky than smaller projects, we do not agree that the same is necessarily true for OPIC's insurance projects. Financing involves commercial risks that well-capitalized and experienced private participants have greater influence in mitigating. However, political risk insurance only covers actions taken by governments—actions that are less within the control of the private sector.
4. The report discusses only the recent growth in privately provided political risk insurance. The extent to which the private market capacity for political risk insurance would be affected by changes in demand for property/casualty coverage is not certain.
5. We recognize that OPIC has in some cases pursued the risk mitigation options discussed in the report. However, we believe that the private sector's current high level of interest in investing in emerging markets has created opportunities for OPIC to further reduce portfolio risk through greater use of the options presented.
6. The report provides OPIC data that show 18 (now 12) cases since 1988 in which OPIC coinsured with the private sector. Although there may be other cases in which the private sector provided insurance to investors also insured by OPIC, this information is more anecdotal and these instances

would not represent cases in which OPIC formally sought to coinsure with the private sector.

7. We revised the report to reflect that any loss that was covered by a drawdown in reserves (that are comprised of Treasury securities) would become a budgetary outlay. However, we do not agree that such an outlay should then be compared to the offsetting collections that OPIC receives. If it were necessary for OPIC to redeem Treasury securities, then it would need more cash to cover losses than it would be taking in.

8. The report states that under the Federal Credit Reform Act of 1990, agencies are to estimate and budget for long-term costs of their credit programs on a present value basis. Subsidy costs arise when the estimated program disbursements by the government exceed the estimated payments to the government on a present value basis. The subsidy cost data in our report are based on OPIC's reported estimates. In order to show lower subsidy costs, the costs must be reestimated, with key factors such as the credit risk of the borrowing country showing improvement. OPIC identified \$72 million in subsidy costs for fiscal year 1997 programs.

With regard to OPIC's statement about its interest earnings, only those earnings properly allocable to its credit program are relevant to the discussion of its credit subsidy estimates. Under credit reform requirements, interest earned on credit-related reserves is required to be included in estimating the subsidy cost.

9. We modified the report to include this information.

10. We modified the report to include this information.



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