

APPENDIX A: MANAGEMENT RESPONSE AND OIG EVALUATION



EXPORT-IMPORT BANK
OF THE UNITED STATES

September 23, 2015

Michael McCarthy
Deputy Inspector General
Office of the Inspector General
Export-Import Bank of the United States
811 Vermont Avenue NW
Washington, DC 20571

Dear Deputy Inspector General McCarthy,

Thank you for providing the Export-Import Bank of the United States ("Ex-Im Bank" or "the Bank") Management with the Office of the Inspector General's (OIG) "Report on the Project Financing of Sasan Power Limited" (September 2015). Management continues to support the OIG's work which complements the Bank's efforts to continually improve its processes. Ex-Im Bank is proud of the strong and cooperative relationship it has with the OIG.

The Bank appreciates that the OIG noted that "the Bank pro-actively monitored and restructured the Sasan transaction, effectively shifting repayment risk to the Sponsor, Reliance Power" and that the Bank "revised the risk assessment process outlined in the Loan Manual in April 2015 and requires the Loan Officer to document the supporting rationale for evaluating specific risks". The Bank is committed to full cooperation with the OIG and will work with staff on implementing all recommendations that resulted from this audit.

Recommendation 1A: OIG recommends that Ex-Im Bank:

- Continue to apply for notification (i.e., inclusion) under the SARFAESI Act.
- Ex-Im Bank's reauthorization expired as of June 30, 2015. In the event that the Bank were to be reauthorized, OIG recommends the following:

For future transactions in India, Ex-Im Bank should ensure that the SARFAESI risks are appropriately presented in the Board Memo and reflected in the risk rating analysis when co-lending with SARFAESI lender banks on a secured basis.

Management Response: Management agrees with this recommendation, for implementation in the event the Bank is reauthorized. Ex-Im Bank recognizes the benefit of becoming a SARFAESI lender in order to have a direct vote on initiating and implementing the expedited enforcement process under SARFAESI. Since 2005, the Bank has engaged in a process, unrelated to any specific Indian transaction, to obtain recognition as a SARFAESI lender through the Indian administrative notification process. This effort continues.

Ex-Im Bank's SARFAESI efforts have been appropriately diligenced and carried out with full knowledge of senior management within the Bank. Prior to the expiration of the Bank's full authority, when an application for a project finance loan to an Indian borrower was filed with the Bank, the Country Risk and Economic Analysis Division (CREA) was notified as part of the application processing. CREA considered and analyzed SARFAESI and included the analysis as part of the country risk perspective. This analysis was also included when considering the ICRA rating for India. As with many of the factors considered, SARFAESI was not specifically named.

The Bank applies lessons learned from past transactions to future transactions. In the event the Bank is reauthorized, Management will ensure that the SARFAESI risks are specifically identified in the Board memo and the risk rating analysis when co-lending with SARFAESI lender banks on a secured basis.

As previously advised to OIG, the Bank considers the implications of SARFAESI for the Bank's secured lending to Indian borrowers as having no impact on its substantive recovery rights and remedies. This includes the right to recover proceeds from the sale of collateral and whether or not Ex-Im Bank acts as a sole lender or co-finances a loan with SARFAESI lenders. SARFAESI is solely a procedural and facilitative statute, which does not create any substantive rights in favor of SARFAESI lenders. The only effect on the Bank's ability to recover is one of timing.

The Bank has required a security sharing agreement (SSA) in every transaction with multiple lenders (both SARFAESI and non-SARFAESI). Pursuant to the SSA, the lenders agree to share recovery proceeds with each other, notwithstanding whether such recovery is obtained under SARFAESI out-of-court or outside of the SARFAESI process, in order to ensure that no secured party receives more than its pro rata share of any recovered amount. Such agreements are recognized under both SARFAESI and Indian substantive law, viz., the Transfer of Property Act, 1882. Finally an Indian Ministry of Law Opinion recognizes that inter-creditor recovery sharing arrangements would enable non-SARFAESI lenders to benefit from the expedited enforcement process under SARFAESI.

Recommendation 1B: Ex-Im Bank's reauthorization expired as of June 30, 2015. In the event that the Bank were to be reauthorized, OIG recommends the following:

- In an effort to improve the accuracy of its financial modeling, the Bank should evaluate and account for foreign exchange risk and attendant costs during construction as well as operation. Further, the Bank should provide guidance on the formulation of assumptions

for the financial model used in the credit risk rating and analysis and consider additional skill building in evaluating and modeling financial projections.

Management response: Management agrees with this recommendation, for implementation in the event the Bank is reauthorized. The Bank has typically focused on the operational phase of project financings due to the longer period of time represented by the operational phase and the availability of risk mitigants during the construction/completion phase in the form of guarantees from creditworthy corporate sponsors. In the event the Bank is reauthorized, in future project finance analyses, the Bank will evaluate and account for foreign exchange risk and attendant costs during construction and provide guidance on the formulation of assumptions for financial model use in the credit risk rating and analysis. The Bank will update the Loan, Guarantee and Insurance Manual to reflect enhancements in the evaluation of the construction/completion phase.

In regard to the findings cited in this report, Ex-Im Bank management notes that for project financings involving multiple currencies, Ex-Im Bank assesses and underwrites such projects to address two key considerations: (1) is there adequate matching of currencies of the sources of project capital to the uses of project capital, as and when capital expenditures are incurred and (2) is the economic currency of the project's operational cash flows which form the basis of the cash flow available for debt service (CFADS) adequately aligned with the currency or currencies of the project's debt capital.

For the Sasan transaction, Ex-Im Bank actively addressed these foreign exchange considerations, both at the time of the initial assessment of the transaction in August 2010 and in subsequent modifications to the loan structure driven by the changing circumstances of the loan. The facility as contemplated by the August 2010 Board Memorandum reflected the anticipated capital structure of matched U.S. dollar (USD) sources to USD uses (62% to 64%) and Indian rupee (INR) sources to INR uses (38% to 36%). As a result, the project was structured with a natural hedge against currency movements during the construction period.

As noted in the report, events did overtake the anticipated matched funding arrangement as a large portion of the USD-based financing was replaced by INR-sources. Although this resulted in a misaligned currency mix in the capital structure, it did result in the beneficial effect of reducing the portion of USD-denominated debt capital that would need to be hedged against the INR-denominated tariff revenue. Furthermore, in agreeing to a revised capital structure as a result of the change in circumstances, Ex-Im Bank required a significant improvement in support from Reliance Power, thus shifting the burden of the construction phase INR devaluation impacts onto Reliance Power.

Ex-Im Bank further worked to assess and structure adequate protection against unfavorable foreign exchange movements affecting the economic currency of the project's cash flow available for debt service versus the servicing requirements of the debt capital not denominated in the same economic currency (in this case the Indian rupee). The August 2010 Board Memo stated the project would be required to enter into agreed minimum interest rate and currency hedging programs for specifically this risk and Ex-Im Bank staff identified the on-going due diligence of the "vulnerability of project economics to changing inflation rates and related interest rates and INR:USD exchange rates which may result in modifications to the Model assumptions and the level of Sponsor support." An INR:USD hedging program was implemented with the first disbursement of the USD loan facilities, taking into account the resulting changes to the debt capital structure (which featured less USD-denominated debt than originally anticipated and thus less misaligned exposure to the project's INR revenues) and on-going changes to currency hedging market conditions.

Recommendation 1C: Ex-Im Bank's reauthorization expired as of June 30, 2015. In the event that the Bank were to be reauthorized, OIG recommends the following:

- To enhance transparency and to ensure the risk rating methodology, the Bank should provide written criteria or benchmarks as to what constitutes a "Low, Moderate or High" risk rating for each factor considered in developing the risk rating for a transaction.

Management Response: Management agrees with this recommendation, for implementation in the event the Bank is reauthorized. Bank staff will provide greater detail as to what constitutes a "Low, Moderate or High" risk rating for each factor considered in developing the risk rating for a transaction, and this methodology will be documented in the Loan, Guarantee and Insurance Manual.

Recommendation 2A: OIG recommends that Ex-Im Bank:

- Continue to closely and proactively manage the Sasan transaction and its Sponsor, Reliance Power given Ex-Im Bank's \$650 million exposure, the on-going issues with Sasan covenant compliance, and the remaining 12-year life of the transaction. As part of the Bank's annual BCL review process, AMD should perform a full stand-alone analysis of the Reliance Power holding company including its projected cash flows and financial obligations related to Sasan and other projects under development and in operation.
- Improve its financial modeling capabilities for the purposes of ongoing scenario analysis, re-assessment of the BCL risk rating, and stress testing (e.g., individual obligor/names, occurrence of exogenous events in the market) for a transaction.

Management Response: Management agrees with this recommendation. Given the large aggregate Ex-Im Bank exposure to Reliance Power Limited sponsored credits and the existence of varying ongoing Reliance obligations to Ex-Im Bank-financed projects, the Bank decided in January 2015 to monitor Reliance both more closely and as a stand-alone entity. Staff finished its inaugural Reliance Power risk rating on July 2015.

The Bank is actively leveraging resources in support of ongoing improvement of financial modeling capabilities by tasking portfolio managers and analysts with financial modeling analysis, engaging financial consultants to develop, maintain and enhance financial models and providing ongoing training to staff for the same.

Recommendation 3A: OIG recommends that Ex-Im Bank:

- Establish an agreed upon timeline between the Borrower, Project Sponsor and independent outside consultant retained to monitor a project's compliance with environmental and social conditions pursuant to the Bank's financial support. The agreement should include specific dates for site inspections and due dates for receipt of the monitoring reports.
- Develop a strategy to take stronger actions against a project with serious or repetitive violations with respect to the Bank's environmental and social policies. This would include established formal policies and procedures for enhanced risk-based monitoring and reporting.

Management Response: Management agrees with this recommendation. Based on the experience developed in the process of monitoring Sasan, such procedures or measures established to improve the caliber and timeliness of project monitoring will be documented and formally conveyed to the project sponsor together with an explanation of potential consequences associated with any violations of environmental monitoring or other related Conditions referenced in the Credit or Common Terms Agreement. Management will evaluate the need for establishing formal policies and procedures with project sponsors to improve and enhance the caliber of risk-based monitoring and reporting to EXIM in order to manage serious or repetitive violations of the Bank's environmental and social guidelines including non-compliances and performance issues and will update the Loan, Guarantee and Insurance manual to reflect any policies and procedures developed.

Recommendation 3B: OIG recommends that Ex-Im Bank:

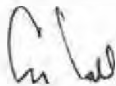
- Establish a formal process for responding to complaints. Guidelines detailing how to submit a complaint should be in writing and include what information is required, how

the submission is processed and a timeline for the process. The timeline should include registering, acknowledging, forwarding and responding to complaints. The complaint should be addressed to a specific person designated as an overall coordinator for the Bank. In the interest of transparency and ease of filing complaints, OIG suggests that the complaint process be posted on the Ex-Im Bank's website reflecting best practices outlined above.

Management Response: Management's response to this recommendation assumes that the formal complaint process referenced in Recommendation 3B relates to the Bank's environmental and social performance of projects and the Bank's handling of issues related to its environmental policies. Management agrees with this recommendation. The Bank will establish a team to work with the Office of the General Counsel and the Bank's web team to develop and launch a formal and more effective EXIM process for addressing and responding to outside complaints associated with the environmental and social performance of projects. The web site will contain formal instructions, placed at strategic and prominent locations on the various environmental pages of its web pages directing interested parties and stakeholders as to whom to contact and how to file a complaint. The Loan, Guarantee and Insurance Manual will be updated to reflect this process.

We thank the OIG for your efforts to ensure the Bank's policies and procedures continue to improve, as well as the work you do with us to protect Ex-Im funds from fraud, waste, and abuse. We look forward to strengthening our working relationship and continuing to work closely with the Office of the Inspector General.

Sincerely,



Charles J. Hall
Executive Vice President and Chief Risk Officer
Export-Import Bank of the United States