United States General Accounting Office

GAO

Briefing Report to the Chairman and the Ranking Minority Member, Subcommittee on Foreign Operations, Committee on Appropriations, U.S. Senate

May 2000

OVERSEAS INVESTMENT

The Overseas Private Investment Corporation's Investment Funds Program

GAO

Accountability * Integrity * Reliability

GAO/NSIAD-00-159BR

Contents

Letter 3

Briefing Sections

Briefing Section I: Overview 8

Briefing Section II: OPIC's Fund Concept Selection Process 20

Briefing Section III: OPIC's Fund Manager Selection Process 22

Briefing Section IV: OPIC's Investment Funds Financial Standing and Performance 24

Appendixes

Appendix I: Results of GAO Review to Determine Origin of Investment Fund Concepts 34

Appendix II: Results of GAO Review to Determine Fund Manager Selection Process 35

Appendix III: Objectives, Scope, and Methodology 36

Appendix IV: Comments From the Overseas Private Investment Corporation 38

Appendix V: GAO Contact and Staff Acknowledgments 40

Abbreviations

OPIC Overseas Private Investment Corporation

United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-285132

May 9, 2000

The Honorable Mitch McConnell
Chairman
The Honorable Patrick Leahy
Ranking Minority Member
Subcommittee on Foreign Operations
Committee on Appropriations
United States Senate

The Overseas Private Investment Corporation is an independent, self-sustaining U.S. government agency[1] created in 1969 to assist U.S. investors overseas by providing political risk insurance,[2] financing, and other investment services. The Overseas Private Investment Corporation's investment funds program was created in 1987 and has committed $2.3 billion in financing (loan guaranties) since then to support 26 private equity funds currently operating in developing countries and emerging market economies.

These funds aim to promote broad U.S. foreign policy and strategic goals by investing in countries or regions that are making the transition to market economies or are otherwise of foreign policy interest to the United States, such as the Balkans, the newly independent states of the former Soviet Union, and sub-Saharan Africa. According to agency officials, investment funds also serve as a catalyst for private sector development by providing incentives for investment in countries where U.S. investors might be unwilling or unable to invest without U.S. government support.

The investment funds are managed by private sector individuals or groups selected by the Overseas Private Investment Corporation. The fund managers establish the fund as a limited partnership or limited liability company and are responsible for raising the capital for the fund from private sector equity investors. The Overseas Private Investment

[1]As part of the Consolidated Appropriations Act of 2000 (P.L. 106-113), the Congress authorized the agency to use its own funds for administrative expenses ($35 million) and for credit programs ($24 million).

[2]Political risk insurance covers investors for up to 20 years against losses due to currency inconvertibility, political violence, and expropriation.

Corporation's financial participation in the investment funds takes the form of loan guaranties that cover the risk of default for any reason.[3] The guarantied loans have terms of 10 to 12 years, and the guaranties are backed by the full faith and credit of the U.S. government.

As of December 31, 1999, there were 26 Overseas Private Investment Corporation-supported investment funds in operation, and the agency had committed about $2.3 billion in loan guaranties to the 26 funds. However, because these loan guaranties cover principal and interest, the maximum potential loss due to possible nonperformance by borrowers is about $3.4 billion ($2.3 billion in guarantied loan principal and about $1.1 billion of estimated interest[4] that could accrue over the life of the guaranty). In addition to Overseas Private Investment Corporation-supported financing, the funds are comprised of about $1 billion in equity from private investors, which is not guarantied by the agency.

To ensure that investment fund procedures would be more transparent (open), clearly defined, and consistently applied, the President and Chief Executive Officer of the Overseas Private Investment Corporation launched an improvement plan in 1998. However, virtually all of the investment funds were created before the improvement plan was put in place.

The Senate Committee on Appropriations directed us to review the Overseas Private Investment Corporation's progress in improving the management of the investment funds program.[5] In conducting this work, we examined how the agency (1) identifies and approves investment fund concepts and (2) selects fund managers. In addition, we are providing information on the funds' performance to date and risk levels assigned to the funds.

[3]The investment funds program includes one fund supported through a $20 million loan. All other funds were supported through Overseas Private Investment Corporation loan guaranties.

[4]In the agency's 1999 Annual Report, the Overseas Private Investment Corporation estimated the potential interest to be $1.1 billion as of September 30, 1999.

[5]Senate Committee on Appropriations, Foreign Operations, Export Financing, and Related Programs Appropriation Bill, 2000, Senate Report 106-81 (June 17, 1999).

Results in Brief

The Overseas Private Investment Corporation has identified and approved investment fund concepts through three different mechanisms. First, the agency has identified the need for funds in specific regions or sectors. Second, funds have been created in response to administration or congressional foreign policy initiatives. Third, prior to its investment fund improvement plan implemented in 1998, the agency created several (10) funds based on unsolicited proposals received from the private sector.

Under revised procedures adopted as part of its 1998 improvement plan, the agency publicly solicits proposals from prospective private sector fund managers. The prospective managers submit business plans in response to a "call for proposals" posted on the agency's website and advertised in business and trade publications. Agency officials stated that all of the fund managers, past and present, were selected on the basis of experience and proven success with investment funds or in a related industry. The four fund managers that we interviewed all indicated that the Overseas Private Investment Corporation completed a rigorous background examination of their experience and qualifications. However, we reviewed the Overseas Private Investment Corporation's internal reports, correspondence, and other relevant documents for the 26 operating investment funds and determined that 14 fund managers were not selected through a competitive process; the remaining 12 fund managers were selected after the agency had solicited or considered other proposals. Overseas Private Investment Corporation officials acknowledged that, prior to 1998, it was not the agency's policy to solicit competing fund manager proposals for each fund.

Measuring the financial performance of the funds is difficult, as the funds typically have 10- to 12-year life spans and, thus, long maturity periods for their investments to reach their goals. The agency indicated that fund managers generally expect to achieve a final return of at least 20 percent. However, it is especially difficult to draw meaningful conclusions about fund performance to date because the investment funds have been in operation for about 5 years on average—about one-half of the projected life span. The Overseas Private Investment Corporation provided us with the fund managers' estimates of fund performance, which show that 13 funds presently have a positive return on investment while 10 funds currently show either a zero or negative annual average return (3 funds have not started investing). These estimates cannot be used to predict the future performance of the funds, as they are only a snapshot of current performance. According to the agency, the one fund that is now close to fully liquidating its investments is expected to repay the Overseas Private

Investment Corporation guarantied loan even though the final return of the fund cannot yet be determined.

The Overseas Private Investment Corporation uses financial performance data and several other criteria in assigning an overall risk rating to each fund. As of September 30, 1999, 16 of 23 funds with investments had passing ratings, indicating that the funds at least had a minimum ability to repay the loan. The seven remaining funds had risk ratings that reflected concerns about the repayment prospects of the loan. Agency officials indicated that most of these concerns were related to the potential impact of host-country macroeconomic factors on the funds' investments. However, no funds are currently rated as a loss. To hedge against the possibility of future losses, the agency has established reserves that are based on risk ratings for the investment funds. These reserves totaled $269 million in fiscal year 1999.

Agency Comments and Our Response

We received written comments on a draft of this report from the Overseas Private Investment Corporation (OPIC), which are reprinted in appendix IV. In addition to their overall comments, the agency provided us with technical comments, which we incorporated as appropriate.

The agency characterized the report as a careful and complete review of a complex program. OPIC also used the letter as an opportunity to assert that the investment funds portfolio is sound and that the agency has made several important improvements to the program since 1998. The points that OPIC highlighted regarding the financial standing of the portfolio are their own interpretation of our analysis. We noted that the financial performance of the funds has been mixed, and drew no conclusions about the overall health of the investment funds portfolio. Further, while we agree that OPIC has taken steps to improve the operation of the program, we did not assess the effectiveness of these changes since only one fund has been approved under the new procedures.

Briefing Section I provides an overview of the Overseas Private Investment Corporation's investment funds program. Briefing Section II discusses the investment funds selection process. Briefing Section III discusses the investment fund manager selection process. Briefing Section IV discusses the financial standing and performance of the investment funds. Appendix III contains a detailed description of our scope and methodology.

We recently briefed your staff on the results of this analysis; this report summarizes the content of those briefings.

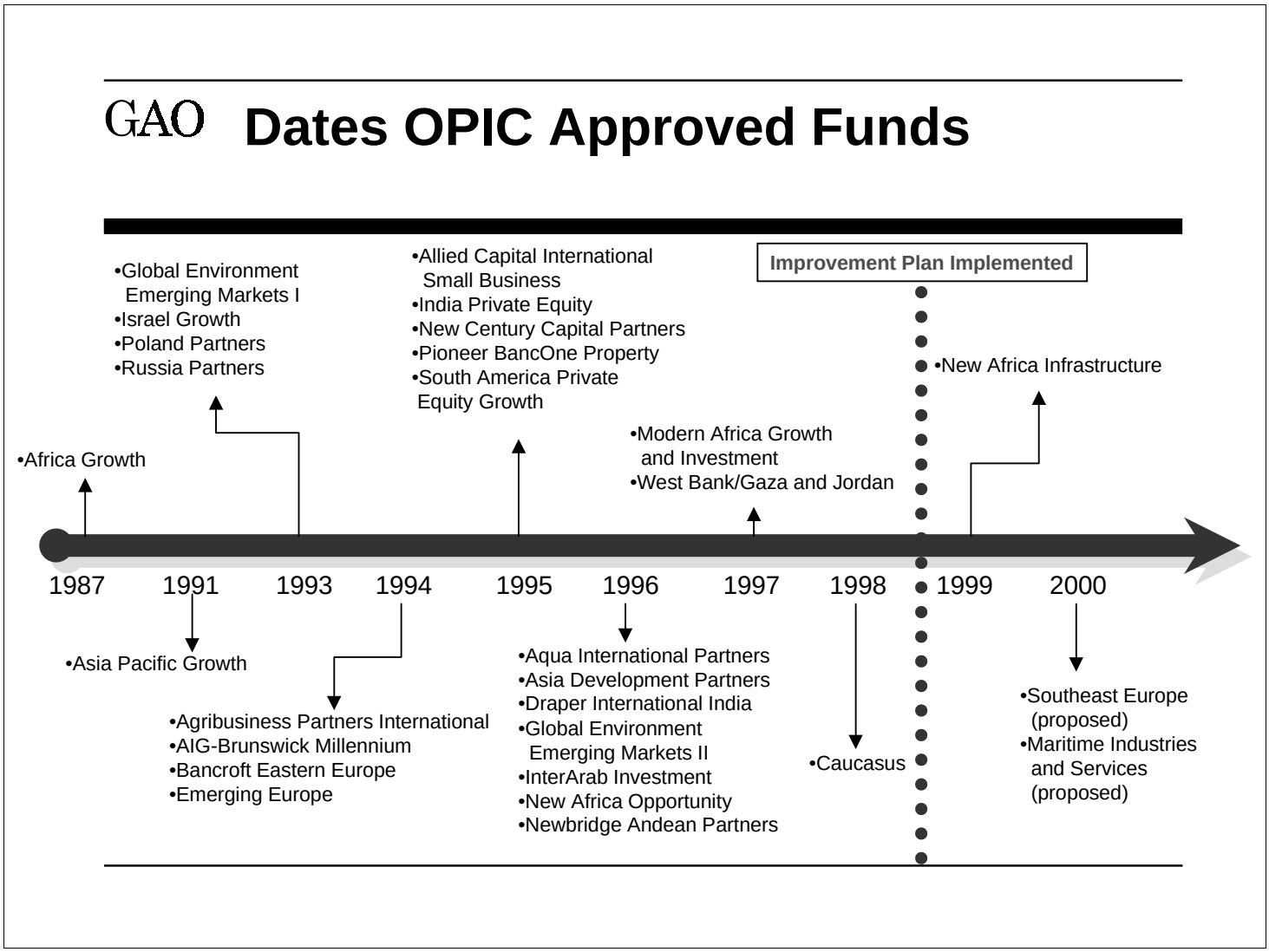
We are sending copies of this report to Mr. George Munoz, President and Chief Executive Officer, OPIC; and interested congressional committees. Copies will be made to other interested parties upon request.

If you or your staff have any questions about this report, please contact me at (202) 512-4128. An additional GAO contact and staff acknowledgments are listed in appendix V.

Susan S. Westin

Susan S. Westin, Associate Director
International Relations and Trade Issues

Overview



Source: GAO from Overseas Private Investment Corporation data.

The Overseas Private Investment Corporation (OPIC) approved the first investment fund in 1987. Sixteen of the 26 funds currently in operation were approved during 1994-96.[1] Agency officials said that the proliferation of funds during this period was directly related to global events. For example, the dissolution of the Soviet Union created a demand for private capital in economies transitioning from a state-led economy to a free market economy. Other agencies and organizations that support investment funds, such as the U.S. Agency for International Development, the European Bank for Reconstruction and Development, and the International Finance Corporation, experienced a similar increase in the number of funds approved during approximately the same time period.

In early 1998, OPIC began to implement a plan for improving the investment funds program to ensure that investment fund procedures were more clearly defined and consistently applied. One fund has been approved under these new procedures, and two funds have been proposed and are in the process of being approved.

[1] One fund, the First Newly Independent States Regional Fund, repaid its OPIC-guarantied loan in 1999 and is no longer operating as an OPIC-supported fund.

GAO

Regions and Fund Size (Dollars in millions)

Global- $445
- Aqua International Partners ($238)
- Global Environment Emerging Markets II ($120)
- Global Environment Emerging Markets I ($67)
- Allied International Capital Small Business ($20)
- Maritime Industries and Services (proposed)

Central/Eastern/SE Europe- $459
- Pioneer BancOne Property ($240)
- Bancroft Eastern Europe ($95)
- Poland Partners ($64)
- Emerging Europe ($60)
- Southeast Europe (proposed)

NIS/Russia- $881
- AIG-Brunswick Millenium ($289)
- New Century Capital Partners ($250)
- Russia Partners ($155)
- Agribusiness Partners International ($95)
- Caucasus ($92)

South America- $340
- South America Private Equity Growth ($180)
- Newbridge Andean Partners ($160)

Asia- $225
- Asia Development Partners ($150)
- Asia Pacific Growth ($75)

Africa- $611
- New Africa Infrastructure ($350)
- Modern Africa Growth ($116)
- New Africa Opportunity ($120)
- Africa Growth ($25)

Middle East- $145
- West Bank/Gaza & Jordan ($60)
- InterArab Investment ($45)
- Israel Growth ($40)

India- $195
- India Private Equity ($140)
- Draper International ($55)

Legend
NIS = Newly independent states of the former Soviet Union
SE = Southeastern

Source: GAO from Overseas Private Investment Corporation data.

The agency reported that OPIC-supported funds have invested in over 40 countries. Most funds invest in several countries within a designated region in order to limit exposure in any single country. However, OPIC has approved five country-specific funds that invest in single countries where the agency has determined there is sufficient need for capital and an acceptable level of risk. These include Draper International, India Private Equity, Israel Growth, Poland Partners, and Russia Partners. Additionally, OPIC has approved four global funds (that is, funds that can invest in any country eligible for OPIC programs) that invest in specific sectors such as water treatment and environment-related projects.

The average size of the 26 operating funds is about $127 million. The smallest fund is the $20 million Allied Capital International Small Business fund, and the largest is the $350 million New Africa Infrastructure fund. OPIC's greatest exposure, based on total capital committed to any one region, is in Russia and the newly independent states of the former Soviet Union where the total size of all funds operating in the region is $881 million.

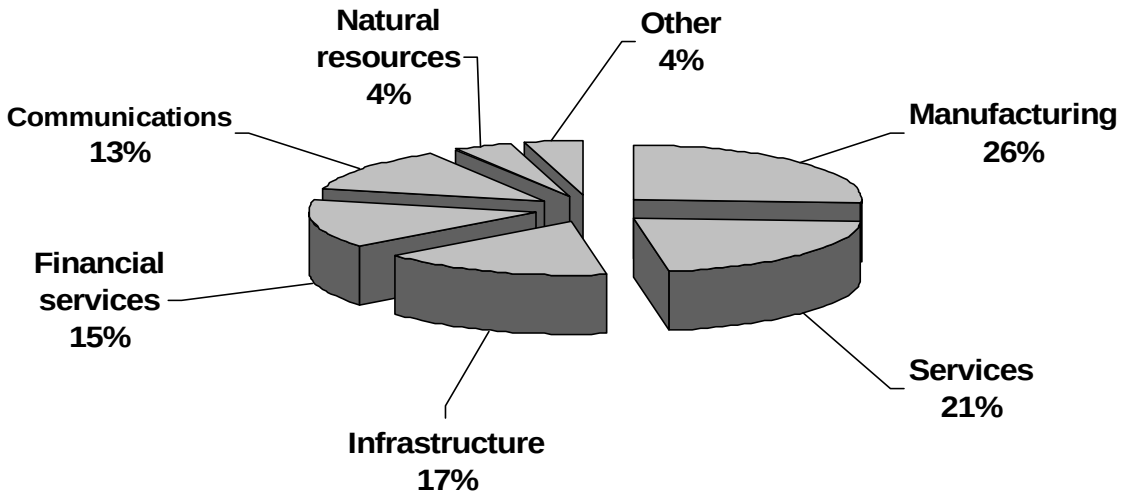
The number of funds operating in any one region ranges from two to five. Agency officials stated that because of the high demand for capital in developing countries, there is no competition for investment opportunities between investment funds operating in the same region. The fund managers and industry experts we interviewed agreed that competition between emerging market investment funds is generally not a problem.

GAO

Types of Investments

$1.6 billion invested in 317 companies

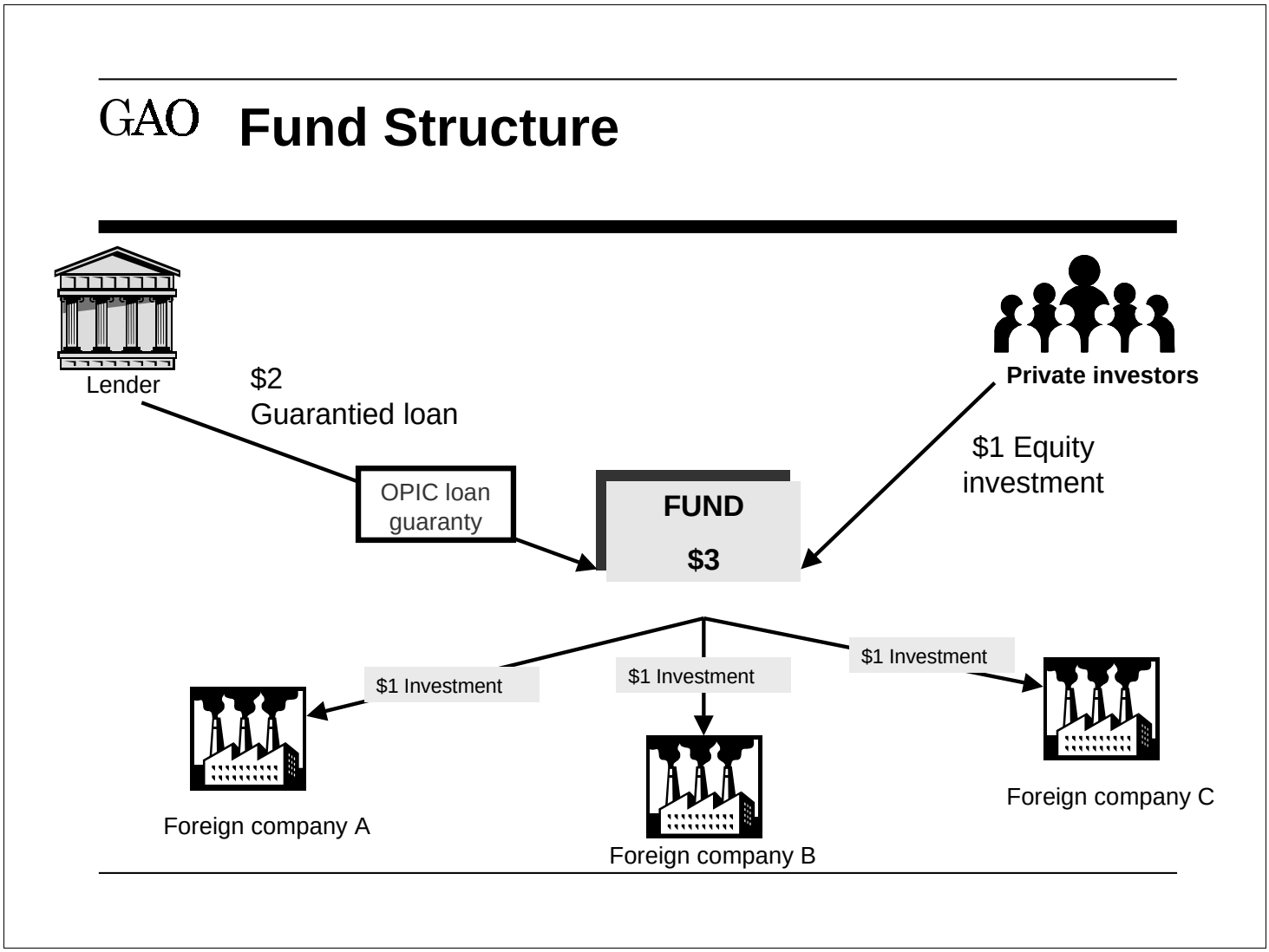
(as of December 31, 1999)



Source: GAO from Overseas Private Investment Corporation data.

OPIC-supported funds had invested about $1.6 billion in 317 overseas companies as of December 31, 1999. The funds invest in a variety of companies and sectors. For example, fund investments in the infrastructure sector include power, construction, and transportation businesses. The largest percentage of investments is in the manufacturing sector, which includes 26 percent, or about $428 million, of all investments. Examples of investments in the manufacturing sector include businesses involved in the production of high-technology electronic components, pharmaceuticals, and paper manufacturing.

OPIC requires fund managers to submit each proposed fund investment for review by the agency to ensure that the investments will not have an adverse impact on the U.S. economy, environment, workers' rights, or human rights. Further, OPIC requires fund investments to be diversified to limit risk. For example, the agency's general guidelines state that a fund may not commit more than 15 percent of available capital to any single company, nor commit more than 33 percent of available capital to any single business sector (unless the fund is created to invest in a specific sector).

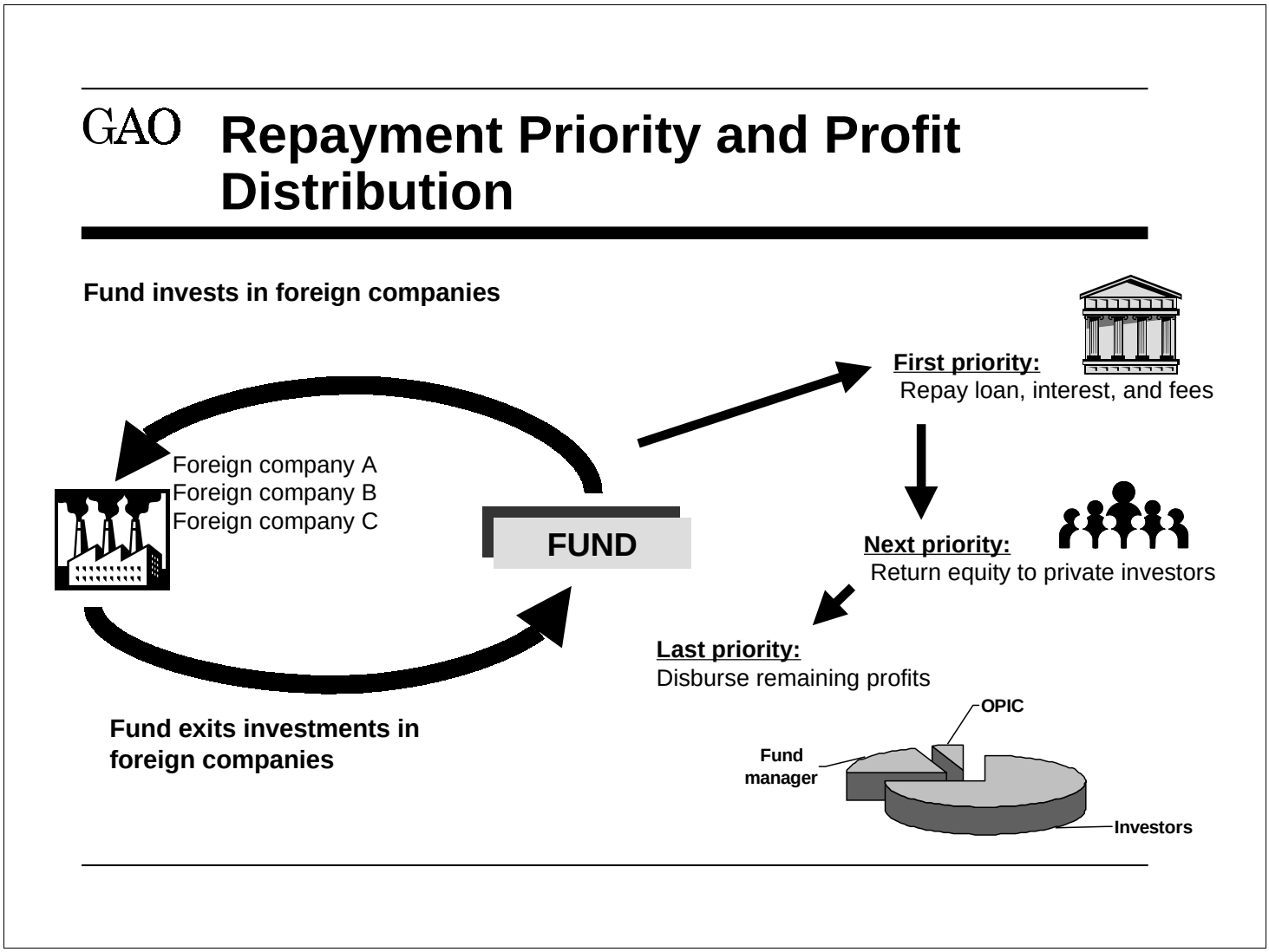


Source: GAO from Overseas Private Investment Corporation data.

OPIC-supported investment funds combine OPIC-guarantied loans and private investor equity. OPIC stated that the loan guaranties are necessary to encourage private sector investment in developing countries. The fund managers we interviewed said that the OPIC guaranty was an important factor in their decision to establish an investment fund.

Although the amount of the loan guaranty varies among funds, the agency's general policy is that OPIC's commitment shall not exceed two-thirds of the fund's total capital. In other words, a fund should have no more than $2 of OPIC debt for every $1 of private equity. According to OPIC, funds operating in countries or sectors with a relatively higher level of risk may require a higher level of OPIC commitment to provide sufficient incentive for private sector investment. Conversely, OPIC officials noted that some funds require a lower amount of OPIC loan guaranty in cases where country or sector risk is lower, or where there is a higher amount of private investor capital for the fund. The average ratio of OPIC debt to investor equity for the 26 operating investment funds is $2.40 of OPIC debt to $1 of private investor equity.

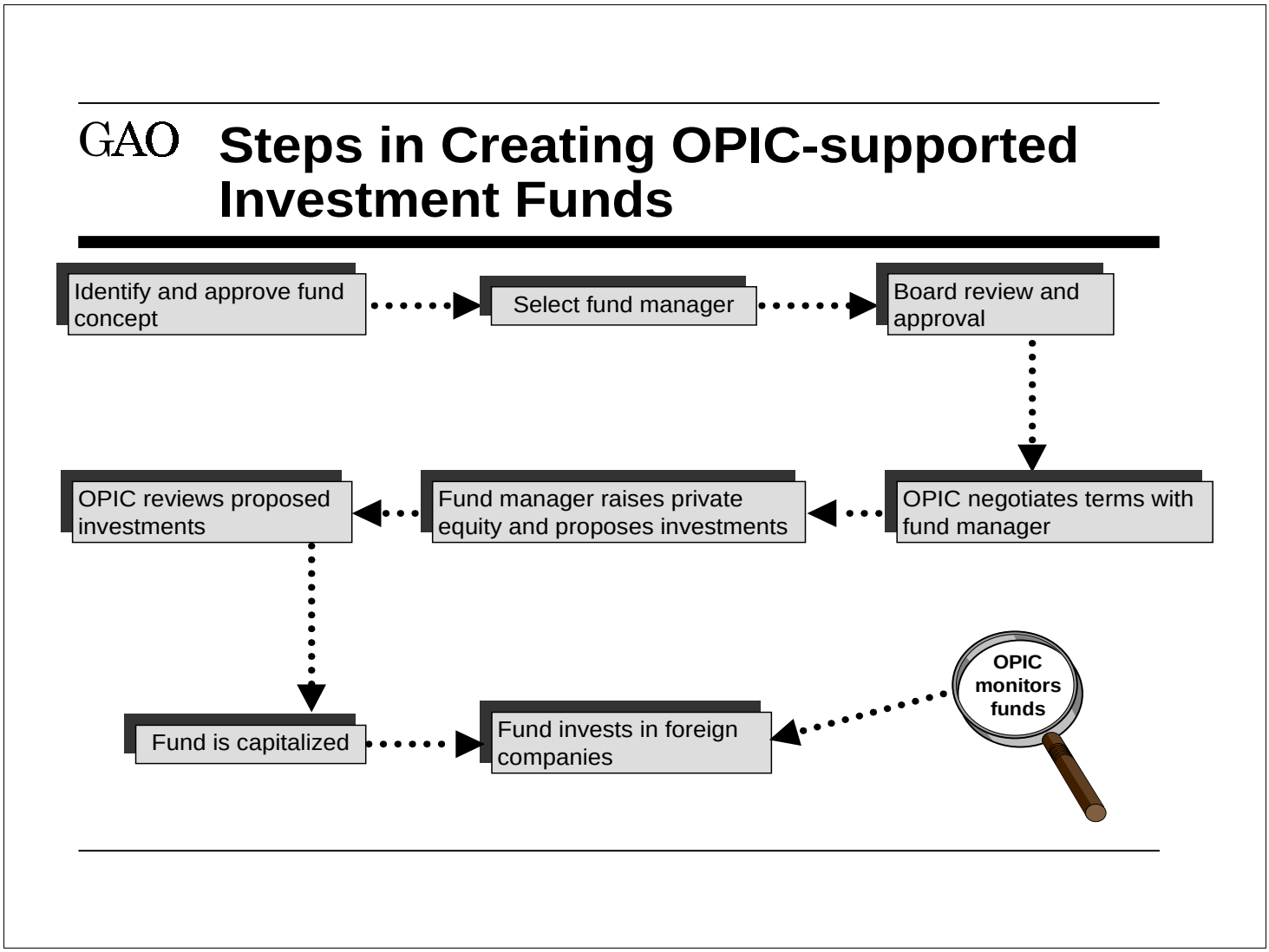
In this simplified example, a $3 investment fund consists of $2 of OPIC-guarantied debt and $1 of private investor equity. Once the fund has been capitalized, it makes investments in foreign companies, subject to OPIC review and approval.



Source: GAO from Overseas Private Investment Corporation data.

The terms for repayment of OPIC-guarantied debt and disbursement of profits are defined by a formal contractual agreement between OPIC and the fund manager. Although the specific terms of the contract vary among funds, the contract generally requires the fund to repay all principal, interest, and fees associated with the OPIC loan guaranty before returning equity to private investors or disbursing profits. OPIC asserts that this payment priority limits OPIC's risk because private investor equity is at risk before the OPIC guaranty. For example, if a fund were comprised of two-thirds OPIC debt and one-third private equity, it would have to lose more than one-third of its total capital before OPIC would be required to make payments on the guaranty. OPIC noted that, to date, the agency has not incurred a loss on an investment fund.

After the fund has repaid all principal, interest, and fees and has returned equity to its private investors, the fund may distribute any remaining profits. The contract between OPIC and the fund manager also defines how any profits will be distributed among OPIC, investors, and the fund manager. Although the percentages vary for each fund, OPIC generally receives between 4 and 6 percent of the profits, the fund manager receives about 20 percent, and the remaining portion is distributed to the private investors.



Source: GAO from Overseas Private Investment Corporation data.

OPIC's policy is to identify and approve fund concepts that support the agency's U.S. foreign policy and free market development objectives. According to OPIC, specific fund concepts originate from various sources, including OPIC staff, foreign policy initiatives, and the private sector.

After a fund concept is approved, OPIC evaluates and selects a private sector fund manager. In general, OPIC evaluates potential fund managers on the basis of experience and proven success within the investment fund or related industry.

Pending approval of the fund concept and fund manager from the agency's 15-member, Senate-approved Board of Directors, OPIC negotiates a contract with the fund manager. The contract includes terms and conditions such as the amount of OPIC financing available to the fund, financial reporting requirements, and repayment and profit distribution guidelines. The fund manager then obtains equity commitments from private investors and proposes investments to OPIC, which the agency reviews to ensure compliance with the terms of the contract.

Lastly, the fund is capitalized with private investor equity and OPIC-supported debt and begins to invest. The agency monitors ongoing fund operations to determine financial performance and to ensure that the fund's investments do not adversely impact the U.S. economy, environment, workers' rights, or human rights. OPIC's monitoring activities include periodic financial analyses of a fund's investments, site visits to the foreign companies in which the fund has invested, and serving as a nonvoting member of the fund's governing bodies.

OPIC's Fund Concept Selection Process

GAO

OPIC's Past and Present Fund Concept Selection Process

Pre-1998 process

- Three main sources of fund concepts:
  - -OPIC identifies need
  - -Foreign policy initiative
  - -Unsolicited proposal from prospective fund manager
- Reviewed fund concept to determine if proposed fund is consistent with OPIC objectives
- Validated need and support for fund concept through feasibility studies, site visits, and consultation with the private sector

Post-1998 process

- OPIC will not approve fund concepts based on unsolicited proposals without soliciting competing proposals from prospective fund managers
- Other elements of the process remain the same

Source: GAO from Overseas Private Investment Corporation data.

OPIC has identified and approved investment fund concepts through three different mechanisms. First, the agency has identified the need for funds in specific regions or sectors. Second, funds have been created in response to administration or congressional foreign policy initiatives. For example, the Caucasus Fund was created in response to 1996 legislation (P.L. 104-107) mandating the establishment of a Trans-Caucasus Enterprise Fund. Third, prior to its investment fund improvement plan implemented in 1998, the agency created several funds based on unsolicited proposals received from prospective fund managers seeking to establish an OPIC-supported investment fund. We reviewed OPIC internal reports, correspondence, and other relevant documents for the 26 operating investment funds. We determined that 5 fund concepts were identified by OPIC, 10 fund concepts were created in response to foreign policy initiatives, and 10 fund concepts were originated based on unsolicited proposals. We were unable to identify the origin of one fund concept. See appendix I for the detailed results of our review.

Once a fund concept is identified, OPIC executive staff review the concept to determine if the proposed fund is consistent with OPIC program objectives. Additionally, OPIC conducts inquiries with the private sector to ascertain investor support for a given fund concept and may conduct feasibility studies and site visits to validate the need for a fund.

As part of the improvement plan implemented in 1998, OPIC resolved to no longer approve fund concepts originating from unsolicited proposals without soliciting competing proposals from prospective fund managers. The policy change was intended to ensure that the opportunity to manage an OPIC-supported investment fund was made available to a wide range of candidates.

OPIC's Fund Manager Selection Process

GAO

OPIC's Past and Present Fund Manager Selection Process

Pre-1998 process

- Solicited competing fund manager proposals or reviewed and approved unsolicited proposals
- Evaluated fund manager qualifications based on
  - -Prior experience and performance
  - -Ability to raise capital
  - -Geographic and sector knowledge
  - -Ability to assemble host-country management teams

Post-1998 process

- Solicit competing proposals for all funds by issuing a public call for proposals
- Established an interdepartmental Evaluation Committee to review all proposals and recommend a prospective fund manager for approval by OPIC's Board of Directors
- OPIC uses same criteria to evaluate fund manager qualifications

Source: GAO from Overseas Private Investment Corporation data.

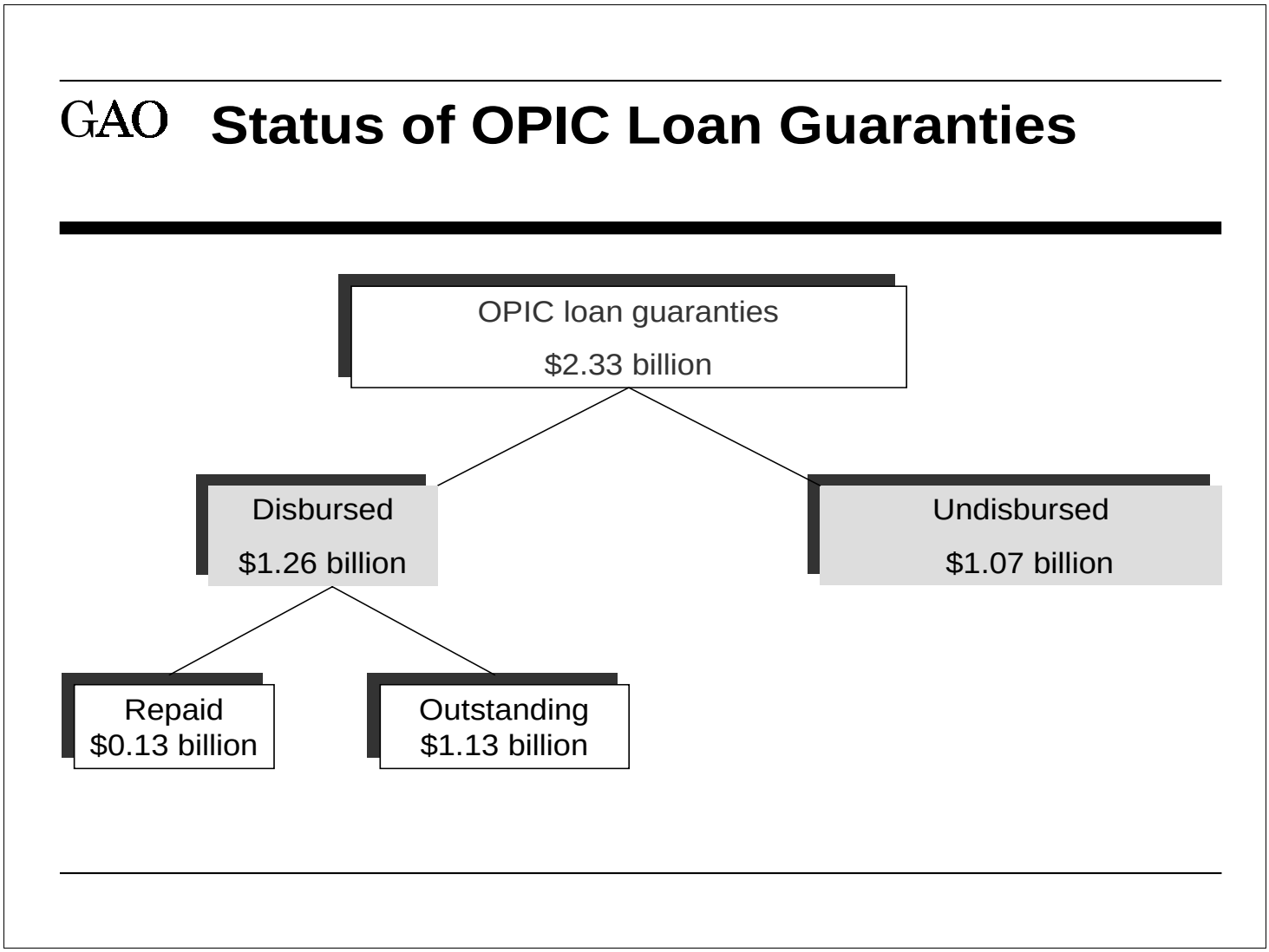
Since the inception of the investment funds program, OPIC's policy has been to evaluate potential fund managers based on (1) previous private equity investment experience, (2) ability to raise capital from investors, (3) geographic and industry knowledge of the areas targeted in the fund concept, and (4) ability to assemble management teams in the host countries where the proposed fund will invest. OPIC's evaluation of fund managers' qualifications includes a review of credit references, personal history, and performance record managing other private equity funds or related investment projects.

Prior to 1998, the agency selected some fund managers through a competitive process, while other fund managers were selected after OPIC evaluated and approved an unsolicited proposal. However, OPIC officials stated that the criteria for evaluating the fund managers' qualifications were the same under both processes.

OPIC revised the procedures for selecting fund managers in 1998 to establish a transparent and competitive selection process. Under the revised procedures, OPIC posts a call for proposals on the agency's website and advertises it in business and trade publications. Prospective fund managers submit a detailed business plan that is then reviewed by an interdepartmental Evaluation Committee, an Investment Committee, and OPIC's Board of Directors.

We reviewed OPIC's internal reports, correspondence, and other relevant documents for the 26 operating investment funds and determined that 14 fund managers were not selected through a competitive process; the remaining 12 fund managers were selected after the agency had solicited or considered other proposals. OPIC officials acknowledged that, prior to 1998, it was not the agency's policy to solicit competing fund manager proposals for each fund. See appendix II for the results of our review.

OPIC's Investment Funds Financial Standing and Performance



Note: Data as of December 31, 1999.

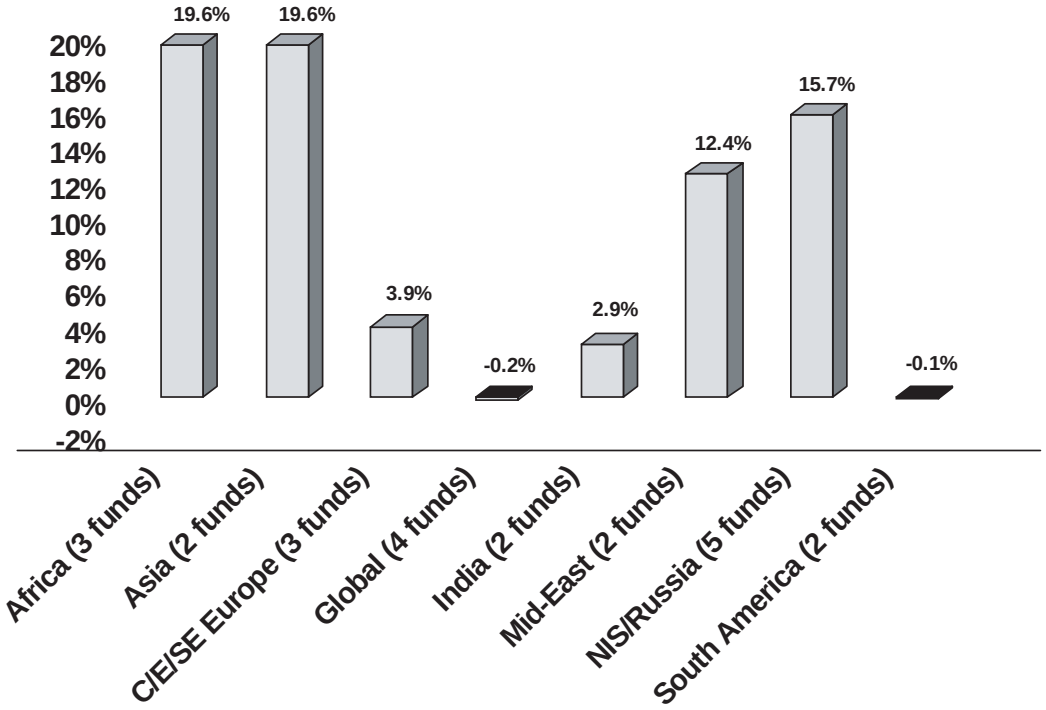
Source: GAO from Overseas Private Investment Corporation data.

OPIC has committed $2.33 billion in loan guaranties to support investment funds. However, only about one-half of these guarantied loans had been disbursed to fund managers as of December 31, 1999. Because repayment of the principal and interest on OPIC-guarantied debt is typically deferred until a fund is liquidated, only $127 million of the principal had been repaid as of that date.[1] The outstanding principal on OPIC-guarantied loans was about $1.13 billion at the end of calendar year 1999.

[1]The funds have varying maturity dates ranging from the year 2004 to the year 2011. However, about two-thirds of the funds will not mature for at least 5 years.

GAO

Estimated Average Annual Return by Region for 311 Investments



Legend
C = Central
E = Eastern
NIS = Newly independent states of the former Soviet Union
SE = Southeastern

Note: OPIC data reflect the weighted average annual rate of return for 44 liquidated and 267 unrealized investments through March 31, 2000. The weighted averages are based on the cost of a fund's individual investments relative to the total cost of OPIC-supported investments. Estimated annual returns may not predict the funds' future performance.

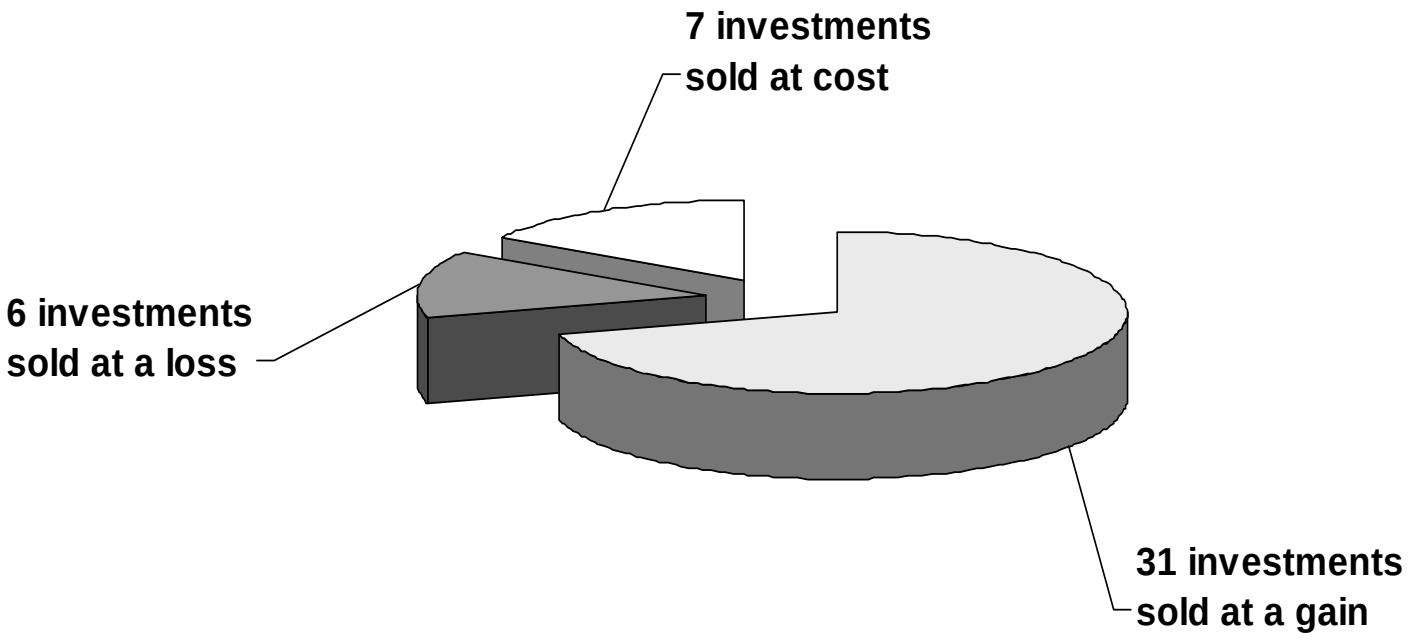
Source: GAO from Overseas Private Investment Corporation data.

Assessing the financial performance of OPIC investment funds in midstream is difficult, as the funds typically have 10- to 12-year life spans, and returns are realized mostly late in a fund's life or at final liquidation. Although OPIC indicated that fund managers generally expect to achieve a final return of at least 20 percent, it is recognized within the industry that it takes several years for investment funds with long intended life spans to realize positive returns. Given that OPIC funds are still in the early stages of investing—the average age of the investment funds is about 5 years—it is especially difficult to draw strong conclusions about future investment performance. Additionally, interim returns do not predict the future financial performance of funds, since the investment valuations apply only to a specific point in time.

OPIC provided performance data to us on the estimated value of unrealized investments and the value of liquidated investments as reported by fund managers.[2] Based on this combined data, the financial performance of OPIC-supported funds appears mixed. Overall, 13 of the funds showed a positive annual average return, while 10 showed either a zero (4 funds) or negative (6 funds) annual average return. There were disparities in the annual average returns of funds in different regions as well as funds within a region. For example, the estimated annual average return of the three operating Africa funds ranged from about negative 1 percent to a positive 533 percent. Significant disparities were also evident in the average annual returns among OPIC funds within other regions and sectors.

[2]Fund managers' estimates of the value of unrealized investments are not reported in accordance with U.S. Generally Accepted Accounting Principles. According to OPIC, under these principles, about 80 percent to 90 percent of the funds' investments would have been valued at cost.

GAO Results for 44 Liquidated Investments



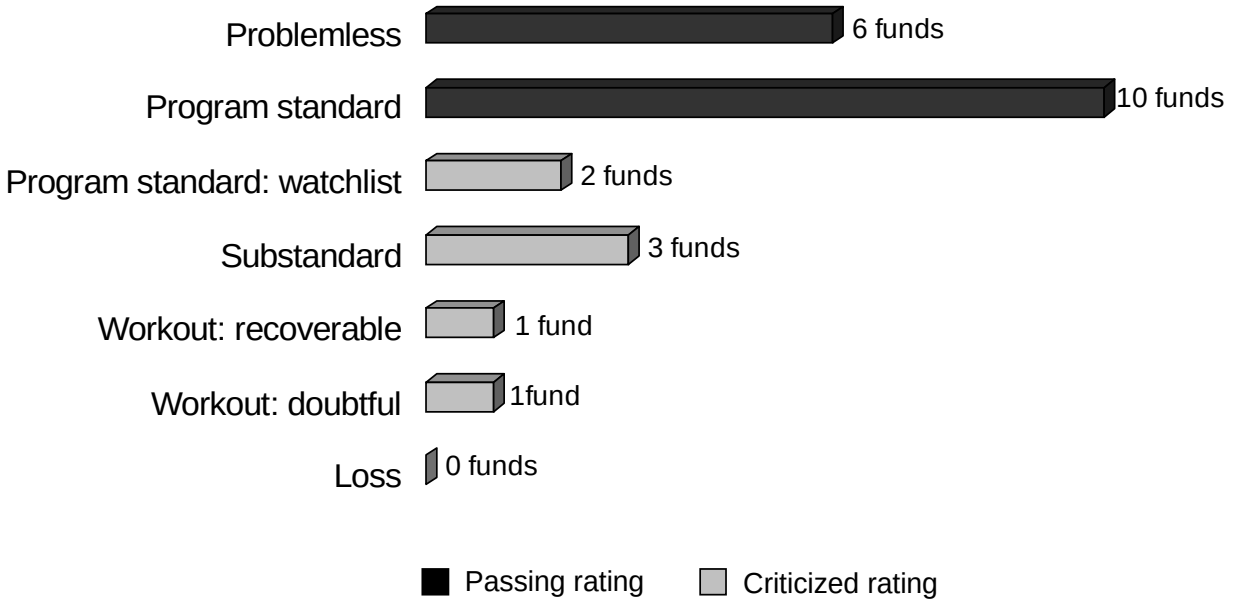
Note: OPIC data reflect the results for 44 liquidated investments through February 29, 2000. Results may not accurately predict the funds' future performance.

Source: GAO from Overseas Private Investment Corporation data.

We also separately examined the results for 44 liquidated investments, which represent about 9 percent of the funds' total investments. Returns on these 44 fully liquidated investments were mixed, as almost one-third of the investments were sold either at a loss or at cost and two-thirds were sold at a gain. Within the industry, it is generally recognized that investment failures tend to be liquidated earlier in the life cycle of a fund than potentially profitable investments would be.

GAO

Investment Fund Risk Ratings



Legend
Problemless = Fund demonstrates high degree of financial stability.
Program standard = Fund meets at least the minimum standards of creditworthiness (ability to repay the loan).
Program standard: watchlist = Fund has potential weaknesses that if left uncorrected could result in a deterioration of the repayment prospects of the loan.
Substandard = Fund exhibits weaknesses that jeopardize timely repayment of the loan.
Workout: recoverable = Fund demonstrates weaknesses that make repayment of the loan doubtful but not improbable.
Workout: doubtful = Fund has characteristics that make repayment of the loan unlikely.
Loss = Loan is considered uncollectible.

Note: OPIC had assigned risk ratings to 23 of 26 funds as of September 30, 1999. The three funds that were not rated had not drawn down any OPIC-guarantied debt.

Source: GAO from Overseas Private Investment Corporation data.

OPIC uses seven risk ratings to categorize outstanding fund loans—two representing passing ratings and five representing criticized ratings (that is, ratings that reflect concerns about the repayment prospects of the loan). To determine a risk rating for each fund, OPIC reviews its cash flow, asset coverage, investment strategy, management and financial controls, market conditions, and country risk. OPIC officials indicated that country risk—which reflects a country's macroeconomic environment, political, and social constraints; foreign debt service burden; and access to foreign exchange—is the most important factor in determining a risk rating for funds that are in the early stages of the investment cycle.

OPIC reviews fund risk ratings quarterly or more frequently as events dictate. As of September 30, 1999, 16 of 23 funds that had drawn down OPIC-guarantied loans had passing ratings, indicating that they at least had a minimum ability to repay the loan. The seven remaining funds had risk ratings that reflected concerns about the repayment prospects of the loan. Agency officials indicated that most of these concerns were related to the potential impact of host-country macroeconomic factors on the funds' investments. However, no funds were rated as "loss."

To cushion against potential future losses, OPIC establishes reserves based on a fund's risk rating. The reserves are based in part on OPIC's assessment of country and sector risks and the potential impacts of these risks on the funds' investments. For a fund with a passing rating, OPIC generally sets aside reserves equaling 1.5 percent to 3 percent of the fund's outstanding loans and accrued interest, and reserves from 6 percent through 100 percent of outstanding loans and interest for funds with criticized ratings.[3] According to OPIC officials, the average reserve level for the funds is approximately 15 percent and totaled $269 million in fiscal year 1999.

[3]OPIC sets aside an additional reserve of 0.5 percent of the undisbursed loan amount for all funds.

GAO

OPIC's Estimates of U.S. and Host-country Investment Benefits

U.S. exports generated	$2.7 billion
U.S. jobs created	8,251
Host-country revenues	$0.6 billion
Host-country jobs created	34,190

Note: Data reflect OPIC's estimates of U.S. and host-country benefits for operating OPIC-supported funds through September 30, 1999.

Source: Overseas Private Investment Corporation.

According to OPIC, the investment funds program (1) strengthens the U.S. economy and enhances the competitiveness of U.S. businesses and (2) promotes social and economic development in developing countries and regions in a manner that complements U.S. policy objectives. In terms of host-country benefits, OPIC estimates that the funds had created about 34,000 host-country jobs and generated over $600 million in host-country revenue through September 30, 1999. U.S. and host-country effects are based on estimates provided to OPIC by fund managers. Based on OPIC's in-country monitoring of selected investment projects, agency officials reported that fund managers' estimates of economic and social benefits are reasonably accurate.[4] OPIC also estimates that the operating funds had generated almost $2.7 billion in U.S. exports and over 8,200 U.S. jobs. However, as reported in our prior work, economists and policymakers recognize that U.S. employment levels are substantially influenced by macroeconomic policies, including actions of the Federal Reserve.[5] At the national level, under conditions of full employment, government export finance assistance programs may largely shift production among sectors of the economy rather than raise overall employment levels.

Additionally, OPIC notes that the investment funds program contributes to the development of emerging markets by stimulating non-OPIC supported investment. For example, OPIC fund managers are currently operating or raising private equity for 12 non-OPIC supported funds in emerging countries.

[4]OPIC staff have visited 52 investment project sites since the beginning of fiscal year 1997 and plan to visit at least 3 additional project sites during the remainder of fiscal year 2000.

[5]See *Export-Import Bank: Key Factors in Considering Eximbank Reauthorization* (GAO/T-NSIAD-97-215, July 17, 1997).

Results of GAO Review to Determine Origin of Investment Fund Concepts

Fund Concepts Identified by the Overseas Private Investment Corporation

New Africa Opportunity
New Century Capital Partners
Newbridge Andean Partners
Pioneer BancOne Property
South America Private Equity Growth

Fund Concepts Created in Response to Foreign Policy Objectives

Africa Growth
AIG-Brunswick Millenium
Asia Pacific Growth
Caucasus
InterArab Investment
Israel Growth
Modern Africa Growth
New Africa Infrastructure
Poland Partners
West Bank/Gaza & Jordan

Fund Concepts Based on Unsolicited Proposals

Allied International Capital Small Business
Aqua International Partners
Asia Development Partners
Bancroft Eastern Europe
Draper International
Emerging Europe
Global Environment Emerging Markets I
Global Environment Emerging Markets II
India Private Equity
Russia Partners

Origin of Fund Concept Unclear

Agribusiness Partners International

Results of GAO Review to Determine Fund Manager Selection Process

Evidence That OPIC Solicited or Considered Other Fund Manager Proposals

Africa Growth
AIG-Brunswick Millenium
Asia Pacific Growth
Caucasus
InterArab Investment
Israel Growth
Modern Africa Growth
New Africa Infrastructure
New Africa Opportunity
New Century Capital Partners
Pioneer BancOne Property
West Bank/Gaza & Jordan

No Evidence That OPIC Solicited or Considered Other Fund Manager Proposals

Agribusiness Partners International
Allied International Capital Small Business
Aqua International Partners
Asia Development Partners
Bancroft Eastern Europe
Draper International
Emerging Europe
Global Environment Emerging Markets I
Global Environment Emerging Markets II
India Private Equity
Poland Partners
Russia Partners
South America Private Equity Growth

Fund Manager Selection Process Unclear

Newbridge Andean Partners

Objectives, Scope, and Methodology

The Senate Committee on Appropriations directed us to review the Overseas Private Investment Corporation's progress in improving the management of the investment funds program. In conducting this work, we examined how the agency (1) identifies and approves investment fund concepts and (2) selects fund managers. In addition, we provided information on the funds' performance to date and risk levels assigned to the funds.

To identify how the Overseas Private Investment Corporation reviews and selects investment fund concepts and fund managers, we reviewed the agency's current and previous operational guidelines as well as internal reports, which examined investment fund operations and made several recommendations for improving investment fund selection procedures that OPIC subsequently adopted. We also interviewed OPIC officials, including its President and Chief Executive Officer, to discuss the series of improvements launched in 1998 to ensure that the fund concept and fund manager selection procedures were more clearly defined and consistently applied.

To determine (1) how the agency identified and selected the 26 fund concepts; (2) how many of the fund managers were selected through a competitive process; and (3) whether OPIC systematically collected information regarding these fund managers' experience and qualifications, we reviewed relevant documents included in each fund's project folder, including fund proposals, investment committee papers, board of director's papers, annual reports, fund manager qualification statements, and correspondence between OPIC and the fund manager.

To gain additional perspectives on the investment funds program and the recent operational improvements, we interviewed managers of five OPIC-supported investment funds located in New York City and Durham, North Carolina. We also interviewed several other industry experts not affiliated with the Overseas Private Investment Corporation, including officials from the U.S. Agency for International Development; the European Bank for Reconstruction and Development; and the International Finance Corporation, a member of the World Bank group.

To identify how OPIC measures fund performance, we met with OPIC officials to determine what performance data the agency maintains for its investment funds program. We also obtained the agency's most current estimated average annual return data for each fund. These data were based

on the value of liquidated investments and the current estimated value of unrealized investments as reported by the fund managers.

To gain additional insights into investment fund valuation issues, we reviewed several industry guides and reports that addressed measuring the performance of private-equity investment funds, including the European Venture Capital Association guidelines—which industry experts we interviewed consistently cited as the industry standard—and the International Finance Corporation's Investment Funds in Emerging Markets: Lessons of Experience Series (1996). We also discussed investment fund performance issues, including the availability of comparative data, with managers of OPIC-supported funds; officials from the other development agencies; and other private industry groups, including the National Venture Capital Association headquartered in Arlington, Virginia.

We also reviewed OPIC's process for assigning risk ratings and establishing reserves for its investment funds. Specifically, we interviewed senior agency officials and obtained documents detailing the fund risk rating process and defining the various risk ratings and associated reserve levels. We also obtained the risk rating and reserve level assigned to each fund as of September 30, 1999. Because agency-supported funds have economic and developmental objectives, we collected documentation regarding how the agency measures such impacts. We also obtained data that estimate the funds' impact on U.S. employment and exports as well as host-country tax and customs revenues and employment.

The fund performance data included in this report are not an accurate indicator of the future performance of the funds, because the underlying investment valuations apply only to a specific point in time. We did not independently assess the reliability of the performance data that OPIC provided.

We conducted our work from February through April 2000 in accordance with generally accepted government auditing standards.

Comments From the Overseas Private Investment Corporation

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

OFFICE OF THE PRESIDENT

April 21, 2000

Ms. Susan S. Westin
Associate Director,
International Relations and Trade Issues
US General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Westin:

Thank you for the opportunity to make some additional comments on the excellent report on OPIC's Investment Funds program by the GAO.

We are pleased that the GAO report provided the support for the fact that the Investment Funds portfolio is sound and that OPIC has made important improvements to the program since 1998. Let me highlight a few of the important points in this report:

- Prudent oversight and management have led to the sound financial standing of the total portfolio, as is reflected in the report. This is all the more impressive given the Asian and Russian financial crises, which have adversely affected many purely private sector funds.
- The improvements since 1998 have taken the funds program to a new level of care and due diligence.
- OPIC's fund manager selection process adopted in 1998 has established a higher standard of transparency and competition.
- While it is very hard to measure fairly the likely success of any individual fund until the last stages of the life of the fund, the report does show that the investments to date are doing well overall.

Since the GAO's last look at our funds, we have gotten more good news on the value of one of our India technology funds. That fund has repaid all of OPIC's interest and principal, and we expect to make a net gain of 108% of our initial loan!

1100 NEW YORK AVE., N. W. · WASHINGTON, D. C. 20527 · FAX (202) 408-9859 · (202) 336-8400

Ms. Susan S. Westin
April 21, 2000
Page Two

Let me say that everyone at OPIC has been impressed by the thorough, professional manner in which the GAO reviewed the Investment Funds program. The team was able to review any and all records that it wished to see and asked OPIC to develop a variety of measures to help make an assessment of the program. With anything as complex as OPIC's investment funds, it is critical to have the kind of careful, complete approach used by the team to analyze the strength of the program.

Finally, I want to thank the GAO for its hard work and thorough analysis. OPIC is proud of the role the funds program is playing in supporting U.S. foreign policy, expanding American free market principles around the world, and helping developing countries gain viable business that create jobs and high quality goods and services for their people.

Sincerely,

George Muñoz
President and
Chief Executive Officer

GAO Contact and Staff Acknowledgments

GAO Contact

Stephen M. Lord, (202) 512-4379

Acknowledgments

In addition to the person named above, Carlos J. Evora, Matthew E. Helm, Rona H. Mendelsohn, and Mary E. Moutsos made key contributions to this report.

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are $2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:
U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

Orders by visiting:
Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders by phone:
(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet:
For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web home page at:

http://www.gao.gov

To Report Fraud, Waste, or Abuse in Federal Programs

Contact one:

- **Web site: http://www.gao.gov/fraudnet/fraudnet.htm**
- **e-mail: fraudnet@gao.gov**
- **1-800-424-5454 (automated answering system)**

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Correction Requested

Bulk Rate
Postage & Fees Paid
GAO
Permit No. GI00