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Report to Congressional Requesters

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INTERNATIONAL TRADE

Commodity Credit Corporation's Refunds of Export Guarantee Fees

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National Security and
International Affairs Division

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August 19, 1987

The Honorable Pete Wilson
United States Senate

The Honorable Alan Cranston
United States Senate

The Honorable Bill Lowery
House of Representatives

This report responds to your requests that we review Commodity Credit Corporation's (CCC) decision not to refund an export credit guarantee fee of $27,988.80 to Gold Coast Investments of San Diego, California. Gold Coast's intended export sale was not consummated because the Mexican importer was unable to obtain credit from a Mexican financial institution. Using the Gold Coast case as our base, we identified procedures for obtaining a CCC export credit guarantee and analyzed guidance available to exporters. We also reviewed procedures governing requested credit guarantee fee refunds, and obtained information from CCC officials responsible for the decision; the President of Gold Coast; the Mexican importer; and officials of the Mexican bank identified on Gold Coast's guarantee application.

CCC's export credit guarantee program (GSM-102), is administered by the General Sales Manager, Foreign Agricultural Service (FAS), U.S. Department of Agriculture. Under the program, CCC enters into guarantee agreements with U.S. exporters that sell agricultural commodities on credit terms for periods up to 3 years. Guarantees provided by CCC protect exporters or their assignees against losses from defaults in payments by foreign banks. For this protection, an exporter pays CCC a fee at the time of application for a guarantee. CCC officials told us that guarantee fees were intended to pay for risk insurance. The fees, along with CCC's refund policy, are also intended to deter exporters from speculating by requiring that exporters make a sales commitment.

The program regulations state that the fee will not be refunded after application unless the Assistant General Sales Manager, Export Credits, FAS, deems it to be in CCC's interest. Requests for refunds are not a major program issue. Less than 1.25 percent of the over 18,000 fees paid, have resulted in refund requests, and 75 percent of the decisions by the Assistant General Sales Manager have resulted in refund approvals. The Assistant General Sales Manager's denial of Gold Coast's refund request is consistent with CCC Operations Division's refund policy that guarantee fees are retained in the event exporters do not have a firm sale at the time they obtain GSM-102 coverage in order to deter exporters from using the program to speculate. CCC concluded that Gold Coast had obtained GSM-102 coverage in anticipation of a later sale because Gold Coast could not demonstrate that it had a firm export sale. CCC officials said that the Mexican importer did not mislead Gold Coast because the importer and exporter agreement noted that the sale was contingent upon the importer obtaining credit approval from the Mexican bank.

Gold Coast's President claimed that CCC never informed him that the fee was non-refundable unless a firm sale existed at the time of application, but the CCC official that provided the application guidance to Gold Coast's President said that she did tell the exporter that a firm sale was required and that fees were non-refundable. She said that she could not assure that the exporter understood these policies and had no evidence to support that this information was provided.

Our review showed that CCC could better serve GSM-102 program users by clarifying the circumstances that must exist to obtain credit guarantees. For example, communicating the need for and definition of a firm sale in the program regulations would clarify guarantee application requirements that must be met for exporters to be considered for a refund. In this connection, the circumstances surrounding the Gold Coast case are instructive. First, it is not clear that CCC provided Gold Coast adequate information on the circumstances that must exist to support a firm sale. Second, CCC incurred no financial risk because Gold Coast's guarantee never became effective. Third, our review of some approved refunds did not disclose a clear basis for distinguishing those cases from the Gold Coast case. Last, CCC was unable to identify that Gold Coast's actions tied up any other potential credit guarantees for Mexico.

We recommend that the Secretary of Agriculture direct the General Sales Manager, FAS, to amend the credit guarantee program regulations to (1) clarify the circumstances that must exist for users to obtain credit guarantee application approvals, including the need for and definition of a firm sale; (2) provide that users must have a firm sale to be considered for a guarantee fee refund should an export sale not be consummated; and (3) require that program users acknowledge their understanding of the application requirements and refund policy on the guarantee applications. In clarifying the application requirements, the Secretary of

Agriculture may conclude there is some basis for reassessing CCC's decisions to deny refunds because of a lack of a firm sale.

We met with CCC officials responsible for refund decisions and obtained their oral comments on our draft report. Their views were considered and incorporated where appropriate. These officials agreed with the need to better communicate CCC policies, but said they would rather have the option to communicate the substance of our recommended regulation revisions by other means. They questioned the need to add an acknowledgement of CCC's application and refund policies on the credit guarantee application because it would add another entry on the application. The CCC official that took the telephone application from Gold Coast, however, said that the only way to assure that exporters were aware of the policies would be to have an acknowledgement statement on the application. We believe these proposed changes would better serve program users if accessible in the program regulations, and acknowledgment on the application would assure that users understand that they are responsible for meeting CCC's application and refund policy requirements.

CCC officials said that they felt strongly that their decision to deny Gold Coast's refund request was correct. They said that Gold Coast's application was fabricated because it indicated that a firm sale existed by identifying credit terms, which they contend could not have been known if the importer had not obtained financing approval from its bank. It is not clear, however, that credit terms need to be firm or that Gold Coast understood CCC's criteria and requirement for a firm sale. Gold Coast's application was completed with CCC guidance and identifies credit terms in the requested estimated payment schedule as "3 years semi-annual basis." The CCC official that provided guidance to Gold Coast said that the credit terms are estimates because at times banks do change the terms and exporters change banks. She said that Gold Coast may not have originally given the credit terms in the application, but that she would have interpreted Gold Coast's explained terms as one of the six possible choices (i.e., 1, 2 or 3 years with annual or semi-annual payments).

As requested by your representatives, we did not obtain official Department of Agriculture comments on this report. More detailed information on our work is in the appendix. As arranged with your representatives, unless you plan to publicly announce its contents earlier, we do not plan to distribute this report until 30 days from its issue date. At that time, we will send copies to the Secretary of Agriculture and the Director of the Office of Management and Budget. Copies will also be made available to other interested parties upon request.

Frank C. Conahan
Assistant Comptroller General

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Abbreviations

CCC	Commodity Credit Corporation
FAS	Foreign Agricultural Service

CCC's Refunds of Export Credit Guarantee Fees

CCC is a government owned corporation established in 1933. Its purpose is to stabilize, support, and protect farm income and prices; assist in the maintenance of balanced and adequate supplies of agricultural commodities; and facilitate the orderly distribution of agricultural commodities. The broad powers contained in CCC's charter (P.L. 80-806) enable it to adapt its operations to changing conditions in the execution of the policies of the U.S. Government. Its commodity export programs are designed to aid in the development of export markets for U.S. agricultural commodities and products. These programs are carried out through such operations as financing, sales, barter, and credit guarantees.

CCC's GSM-102 program,[1] is administered by the General Sales Manager, FAS, U.S. Department of Agriculture. Under the program, CCC enters into guarantee agreements with U.S. exporters that sell agricultural commodities on credit terms for periods up to 3 years. Guarantees provided by CCC protect exporters or their assignees against losses from defaults in payments by foreign banks. For this protection, an exporter pays CCC a fee at the time of application for a guarantee agreement.

The operations of CCC are financed under a statutory borrowing authority of $25 billion; capital stock; an annual appropriation for realized loss incurred; annual appropriations and advances for costs of foreign assistance programs and special activities; and receipts from sales of commodities, loan repayments, interest income, guarantee fees, and foreign currencies used. CCC officials told us that guarantee fees were intended to provide risk insurance. Current GSM-102 fees range from 0.153 percent to 0.670 percent,[2] but the Administration has proposed increasing the fees to 5 percent. The Office of Management and Budget official responsible for the Administration's proposal said that the 5 percent origination fee was an arbitrary amount based on recovering some of the program costs created by claims and country debt reschedulings. Congress rejected the 5 percent origination fee proposed in the President's Fiscal Year 1986 Budget and established a 1 percent ceiling on GSM-102 fees in the 1985 Food Security Act. The 5 percent origination fee is again proposed in the President's Fiscal Year 1988 Budget, but some program users are concerned that an increase in the fee would decrease program

[1] CCC also administers an intermediate credit guarantee program (GSM-103) for credit terms in excess of 3 years but not more than 10 years.

[2] The GSM-103 rates are higher than those of the GSM-102 program. For example, GSM-103 guarantees in February 1987 were made available to Thailand for rates ranging from 1.17 percent for 4 years semi-annual payments to 3 percent for 7 years annual payments

usage and exports of agricultural commodities by effectively increasing prices.

CCC established the GSM-102 program in September 1980 to provide protection to U.S. exporters or their assignees (usually U.S. banks) against default by foreign banks when purchases of U.S. agricultural commodities are made using deferred payments. In every transaction the foreign buyer's bank must issue an irrevocable letter of credit covering the port value of the commodity exported. The CCC guarantee covers most of the amount owed to the U.S. financial institution in case the foreign bank defaults.

The GSM-102 program is intended to increase or maintain exports of U.S. agricultural commodities to foreign buyers by making available federal guarantees for commercial bank financing with credit terms up to 3 years. This program, which provides a 98 percent guarantee to U.S. banks for all credit risks, replaced CCC's earlier GSM-101 program that offered a 100 percent guarantee, but only against political risk.[3]

The program permits countries with improved financial positions that have developed beyond the need for full dependence on concessionary food aid programs to buy U.S. commodities when the guarantee is needed to get private financing for U.S. agricultural exports. Exporters that make sales to foreign buyers under the program register sales with CCC and pay guarantee fees. When exporters register a sale, CCC requires that the following information be submitted.

1. Name of the destination country
2. Name and address of importer
3. Intervening purchaser, if any, and a statement that the commodity will be shipped directly to the foreign buyer in the destination country
4. Date of sale
5. Exporter's sale number
6. Delivery period
7. Kind and description of commodity
8. Quantity
9. Contract loading tolerance
10. Port value, including upward tolerance
11. Guaranteed value
12. Guarantee fee

[3]Political risk is political changes or trends often accompanied by shifts in economic policy which may affect the availability of foreign exchange to finance private and public external obligations

13. The name and address of the foreign bank issuing the letter of credit
14. Estimated payment schedule(s) for each shipment to be made under the export credit sale showing principal payment due dates and amounts due.

Program regulations state that the date of sale means the date the exporter establishes a contractual obligation with the importer under which a firm price has been established or a mechanism to establish the price has been agreed upon. No details, however, are provided or sought by CCC about any conditions or contingencies on the sale that may affect completion of the transaction (e.g., agreement needed from a third party to finance the transaction).

Financial arrangements are established and the credit periods are set within CCC limits. U.S. banks usually finance the transactions and pay exporters after the commodities are shipped and documentation is received. An exporter can then assign its payment guarantee rights to a U.S. bank. CCC's guarantee protects exporters or their assignees against losses from defaults on payments due from the foreign banks that issued the letters of credit.

Refund Decisions of Credit Guarantee Fees

Program regulations state that the guarantee fee will not be refunded after application approval unless the Assistant General Sales Manager deems it to be in CCC's interest. CCC identified that as of June 22, 1987, more than 18,000 guarantees were issued since the start of its export credit guarantee programs in 1978. CCC credit guarantee program data also indicate that through fiscal year 1986, CCC issued guarantees covering $17.9 billion in commodities for which fees totaling $115 million were paid. However, only 224 refund requests totaling $1.35 million have been sought from CCC. According to CCC, 42 refunds valued at $159,173 were denied, 126 refunds valued at $1,002,300 were approved, and 57 requests valued at $186,509 were pending, as of May 27, 1987.[4]

A CCC program official identified 9 reasons for approvals or denials. The following chart summarizes CCC's reasons for 167[5] refund decisions.

[4]In one case, CCC reported one request as an approval and denial, because of a partial refund.

[5]One denial decision file was sent to storage by CCC and not readily available.

Table I.1: Summary of CCC's Guarantee Fee Refund Decisions

	Reasons	Approved	Denied	Total
1	Shipment with payment in cash or alternative financing	87	0	87
2	Change in credit terms	12	1	13
3	Importer's inability to secure letter of credit/cancellation by importer	26	0	26
4	Loading tolerances or unused portion of guarantee[a]	0	3	3
5	Lack of firm sale at time of application/changes in contracts	0	9	9
6	Discrepancies between firm sale/registration/letter of credit	0	5	5
7	Lack of supporting documentation	0	22	22
8	Exporter error at time of application	1	0	1
9	Exporter's inability to obtain commodity	0	1	1
	Total	**126**	**41**	**167**

[a]Exporters paid guarantee fees to cover more commodities than were actually shipped and requested refunds for the differences

According to CCC program officials, exporters qualify for a refund only if they provide evidence that a firm sale existed at registration. This policy is intended to keep exporters from speculating and tying up guarantee amounts which might prevent other potential exporters from obtaining export credit guarantees. CCC officials acknowledged that Gold Coast did not tie up the allocation for credit guarantee sales to Mexico because $216.1 million in guarantees were still available to Mexico at the end of fiscal year 1986.

In denying Gold Coast a credit guarantee fee refund because it lacked a firm credit sale, CCC concluded that Gold Coast had speculated because the guarantee was obtained in anticipation of a later sale. CCC also told us that the Mexican importer did not mislead Gold Coast because the importer and exporter agreement noted that the sale was contingent upon the importer obtaining credit approval from the Mexican bank.

As the preceding chart indicates, Gold Coast was 1 of 9 requests that were denied because exporters did not have firm sales. One of the reasons, however, for approving requests for refunds—the importer's inability to secure a letter of credit—appeared to be similar to the Gold Coast situation because importer financing is an element of the foreign bank's letter of credit, which is a condition of any GSM-102 sale. CCC officials noted that although a firm sale is required at registration, an irrevocable letter of credit is not required.

At the start of our field work, CCC identified 11 refund approvals based on exporters not being able to obtain irrevocable letters of credit. Our review of these approvals did not disclose a clear basis to distinguish these cases from the Gold Coast case. These situations appear to be similar since export credit guarantee sales are not complete until a foreign bank's letter of credit is obtained, and the letter of credit is dependent on the importer's financing arrangements with the foreign bank. In the 11 cases where refunds were provided, CCC officials told us they determined that firm sales existed at application because documentation provided by exporters did not indicate that they contemplated any problems with obtaining the letters of credit. However, the documentation in 5 of the 11 case files did not provide a basis to determine whether financing problems existed and 1 file did not contain copies of a contract, memoranda of sale, or any confirmation from the importer to support that a sale existed without a financing contingency.[6]

Gold Coast's President told us that he understood from guidance provided by CCC staff that he first needed to obtain the guarantee to assist the importer in obtaining financing. The CCC official that provided the guidance said that she has always told new applicants (Gold Coast was a new applicant) of the need for a firm sale by telling them to assure that the importers will be able to obtain letters of credit. The intended Mexican importer for the Gold Coast sale told us that although there was a contingency in his sales agreement, he did not anticipate any problems in obtaining financing. Discussions with senior Mexican bank officials, the importer, and Gold Coast's President indicated that importer financing became a problem.

CCC Needs to Assure That Users Fully Understand Its Refund Policy

It is not clear that CCC has provided guarantee applicants with adequate information about guarantee fee refunds. CCC could take steps to better assure that guarantee applicants understand that fees are not refunded unless certain circumstances exist, such as the existence of a firm sale at the time they pay the fee. Guarantee applicants are not asked to disclose any conditions or contingencies affecting sales or transactions. Thus, CCC is not usually able to determine at the time it is reviewing an application whether the applicant meets its firm sale requirement. Also, CCC's definition of a firm sale is not mentioned in the program regulations, and although the CCC official that provided Gold Coast guidance said that

[6]We also noted that some exporters that received refunds had changed shipping dates or commodity specifications, 2 additional elements that CCC used as supporting evidence that Gold Coast did not have a firm sale.

she tells new applicants that they need to assure the importers are able to obtain the letters of credit, CCC's file on Gold Coast contains no information to indicate that the need for a firm sale was communicated to Gold Coast.

Information on refunds of guarantee fees is available in the GSM-102 program regulations, a program leaflet, and directly from correspondence with CCC Operations Division personnel. The regulations state that once an application is approved the fee is non-refundable unless in the interest of CCC, but do not specify the circumstances that must exist for exporters to be considered for a refund; the leaflet states that the fee is non-refundable even though that is not always the case; and the CCC official who provided application guidance to Gold Coast stated that because Gold Coast was a new applicant she would have told the exporter that he had to assure that the importer would be able to obtain a letter of credit. A question and answer sheet on the program that is also available to users, states that exporters can contact CCC to find out how to register a sale and pay the guarantee fee. Gold Coast's President said he received the program regulations and the question and answer sheet, but he did not receive the program leaflet prior to his guarantee application. He said that based on the question and answer sheet, he contacted CCC to obtain guidance, but CCC officials did not discuss the need for a firm sale.

CCC's notes in its Gold Coast file indicate that they contacted Gold Coast's President to clarify information on his application dated January 14, 1986. The application originally stated that the sales date was not firm and that Gold Coast and the importer intended to consummate the sale after the payment guarantee was approved. According to Gold Coast's President, in a telephone conversation with CCC officials he was given guidance and counseling to make the changes that appeared in his February 3, 1986 application, but he was never told that a firm sale was needed or that the fee might not be refundable. The CCC official who provided guidance to Gold Coast for the approved guarantee application disputed this point, but stated she could not be sure that exporters fully comprehend the information she provides. She stated that no records of the discussions with Gold Coast existed.

Gold Coast's President stated that he assumed the guarantee was needed to help get the letter of credit. CCC written notes on Gold Coast's January 14, 1986, application indicate that changes were made and that Gold Coast was submitting a revised application. The revised application, dated February 3, 1986, was approved by CCC. Gold Coast claims that

CCC officials were told that shipment would take place after the buyer's loan was approved and that officials made no mention of the potential loss of the guarantee fee. The CCC official who provided guidance disagreed with these points and said that she has always told new users that the guarantee fees were non-refundable. She also said that she recalls Gold Coast was in a hurry to get the guarantee because its President told her that the cattle were ready for shipping.

Guidance obtained by Gold Coast in conversations with CCC staff was not documented in CCC files, and CCC's Assistant General Sales Manager said he did not know what guidance Gold Coast received or whether it was informed that the guarantee fee would be non-refundable without a firm sale. He noted, however, that because of the Gold Coast case and to assure that users understand the requirements, they now provide this information when providing guidance on the telephone.

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