Appendix A
OPIC Reserves

Is OPIC Adequately Reserved to Support Its Commitments?

In assessing whether OPIC has an adequate level of reserves we must start by first considering the nature of OPIC's programs. As an institution with a mission to promote development in emerging markets by supporting US private investment, while maintaining a self-sustaining status, OPIC must balance the individual risk associated with each of the projects supported, in the context of its aggregate portfolio and its contribution to OPIC's mission. By design and purpose OPIC operates in geographic regions where economies tend to have greater volatility, political systems are less predictable, financial markets often lack depth, and legal systems may be less sophisticated than those where capital and financial services are readily available. Each product line is designed to fill a void that will encourage the investor to assume the risk of entering those markets; thus each product line calls for a different reserve assessment methodology.

In insurance, OPIC has its longest history, over 30 years, and thus a long enough track record of claims paid over time, as a percentage of the amount of insurance coverage issued. While the claims history yields an appropriate staffing point for the reserve process, it does not acknowledge changes in the portfolio due to entrance into a new geographical region, where OPIC has not issued contracts in the past and thus has no claim history associated with the region. Likewise, the current portfolio may no longer have exposures to areas of the world where OPIC has incurred significant claims in the past. Nor does the formula address the concentration of risk in a specific geographic sector, industry or size of transactions.

In order to address the limitations of a purely historical formula to assess whether reserves are adequate, OPIC also establishes an incremental reserve (to the historical formula) based on the likelihood of a specific claim being paid. The reserve is then further adjusted by an assessment of the ability to absorb a large unanticipated claim and the ability to absorb a reasonable percentage of all known or identified potential claims, without regard to the individual merits of those claims. As a further test of "reasonableness," OPIC performs several independent "stress tests." One of the tests is designed to measure the changes in the political risk profile of the countries where OPIC has the ten largest concentrations of insurance coverage against the required change in reserve levels to keep pace with a changing risk mix. The portfolio is also tested to assess the ability to absorb claims based on three factors: country concentration, industrial sector within a country and type of coverage. Each type of insurance coverage implies a different level of risk depending on the country as well as the industrial sector. For example, the duration of an inconvertibility event in Brazil would be weighed in the context of the average remaining life of the exposure and level of aggregate contracts written for that type of coverage. Likewise, when considering expropriation coverage risks, certain industrial sectors are more susceptible to expropriatory actions, within the current political framework of a specific country. The level of reserves and for political risk insurance at fiscal 2000 was $220 million.

Since OPIC has a remarkable recovery history for its claims paid, 90 percent of the original principal balance of any claim paid, sufficient liquidity is key to OPIC's ability to meet its commitments under its insurance coverage. Necessary to preserving its self-sustaining mandate, OPIC has built up over the years of successful operation, a large level of liquidity. With close to $4 billion in liquid assets at fiscal 2000, OPIC supported an insurance portfolio (maximum contingent liability) of $9.96 billion.

The finance product, although in existence since the inception of OPIC, has dramatically changed over the last ten years in terms of size, geographic distribution, and industrial sectors. The portfolio had its most radical transition in the mid-nineties, when OPIC began addressing the increasing demand for investment in large infrastructure projects in emerging markets. In order to support US investment in these sectors OPIC modified its policy to allow investment guaranties (as well as insurance coverage) up to $200 million. The shift from relatively smaller deal size to transactions in the $100 million to $200 million range called for a more refined assessment of risk and likewise, in support of its self-sustaining mandate, more focus on maintaining a prudent risk profile for the corporation as a whole. To address the change in the risk profile of the portfolio, the methodology used to assess loss reserve adequacy was changed in 1998.

Starting in 1998, OPIC has based its reserve assessment on the analysis of: (1) risk implied by each transaction in the portfolio, (2) risk implied by industrial sector concentrations, and (3) risk implied by country and regional concentrations. The portfolio is stratified based on a ten-grade risk rating system to identify the risk implied by each transaction. Each risk category implies an incremental level of risk and has well-defined parameters and drivers permitting consistent classification of each transaction in the appropriate category. Five of these categories constitute "pass" credits in terms of risk and five constitute "criticized" categories, i.e., transactions in these categories command a higher level of attention from management to minimize risk of loss in the event of default. Each "pass" risk category is assigned a commensurate level of implied reserves based on historical experience and best industry practices. For transactions falling in the "criticized" categories, each individual transaction is reviewed and assigned a specific reserve based on an assessment of the risk of loss in the event of default. The implied and recommended reserves generated by the stratified portfolio form the basis for the reserve, which is then adjusted for industrial-sector concentrations in the portfolio and country and regional concentrations.

The reserve level is refined by analyzing concentrations in particular industrial sectors, within a country or on a global basis, if appropriate, such as in the case of commodity price–sensitive projects. The objective of the analysis is to assess whether the deterioration of a whole sector will pose undue risk for OPIC and if there are sufficient reserves to absorb such a shock. The size, number of projects and financial strength of individual projects are factored into the reserve assessment. While individual transactions may not be exhibiting signs of financial stress, in aggregate the sector may be undergoing macroeconomic pressures that could result in rapid deterioration, thus the need to insure high levels of concentration within a sector is recognized and appropriately reserved for.

Country and regional concentrations constitute the third adjustment to the reserves. OPIC, by nature of its mission, must focus on the inherent risk of doing business in countries with weaker economies and more political volatility. For the reserve process, we classify the countries in terms of perceived risk by using an eleven-grade system. Several public and government rating sources are used to establish the grade system, updated on an on-going basis. The riskier-rated countries are assigned the reserve percentage implied by the risk profile. The portfolio is then classified by geographic domicile and aggregate exposures in the riskiest countries are assigned a reserve, based on the percentage assigned to that rating. As with industrial-sector concentrations, while individual transactions may not be exhibiting signs of financial stress, macroeconomic pressure may result in rapid deterioration of the financial viability of the project, thus the need to insure undue concentrations of risk in any one country has been recognized and provided for.

The country risk reserve adjustment is not in addition to the base reserve generated by the individual risk rating classification, since it is one of the factors in assessing the individual risk rating, but is used to adjust the reserve to the level of risk implied by the country in which the project operates. On occasion certain transactions, either by nature of the business or by credit structure, command a better risk profile than the country in which they operate. In these cases the reserve is not adjusted upwards for the country risk.

For the funds product, the youngest of the OPIC programs, the assessment of the level of reserves also starts with the classification of the portfolio by risk rating. The same ten-grade risk rating system and country risk tiers and implied reserves used for the Finance product is used with the Funds product. However, due to the nature of the Funds product, additional refinements are incorporated in assessing the reserve levels. Country and regional concentrations carry a larger impact on individual funds and the risk of repayment is best addressed by assessing the asset value of the portfolio rather than the current cash flow generated by the fund.

Using the individual valuations of the investments disclosed in the annual reports of each OPIC-financed fund, a loan-to-asset coverage is calculated to refine the risk-rating category of the fund as a whole. The stage in the "investment life" of the fund also plays a factor in appropriately risk rating and creating reserves for the funds. Further refinements are also done based on an assessment of each individual fund's exit strategy.

The reserve is calculated quarterly and constitutes part of the general reserves available to absorb losses related to OPIC's Finance and Funds portfolio. At the fiscal year ending (FYE) 2000 OPIC had reserves and allowances for uncollectible loans of $504 million supporting a portfolio of direct loans and investment guaranties with outstanding balances of $3.3 billion and total commitments of $6.9 billion (see table A.1).

Loss Reserves: Peer Comparison

Several multilateral and bilateral agencies around the world engage in one, both, or variations of OPIC's lines of business: International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IDB), Asian Development Bank (ADB), and Japan Bank for International Cooperation (JIBC), to name a few. However, their target markets, clientele, products and the tools they operate with are often different, making simple direct comparisons to OPIC difficult. Nonetheless the differences do yield some insights into how different tools and

Table A.1 OPIC's portfolio distribution by geographic region and line of business as of September 30, 2000
(millions of dollars)

	Line of business		
	Loan guaranties	Direct loans	Insurance
Worldwide	510.0	20.0	0
Africa	996.1	45.0	259.6
Asia	913.2	19.0	1,890.3
Latin America	2,054.6	76.4	5,821.6
Europe	921.0	42.1	902.1
Middle East	159.3	9.6	410.2
Newly independent states	967.6	55.9	1,201.3
Stop-Loss	0	0	527.7
Total	6,522.0	268.0	9,957.5

market scope can enhance results and likewise the similarities provide a general framework for comparison.

MIGA and IFC combined provide similar products as OPIC. Both part of the World Bank Group, MIGA is the political risk insurance arm and IFC provides financing for private-sector projects in emerging markets, as well as leveraged equity and direct equity investment products. IFC has been in operation since 1956, while MIGA is a much younger institution, established in 1988. Like OPIC, they both have as part of their mission to promote foreign direct investment in support of the development of the private sector in emerging markets. Unlike OPIC, the scope of the clientele they serve is much broader. While IFC and MIGA support private-sector investment from all their member countries, which span the globe, OPIC, by statue, supports only private sector investment by US corporations.

IFC and MIGA, on a combined basis, have exposure and lines of business similar to OPIC. IFC provides loans, together with private investors, to promote the expansion of private-sector enterprises in member countries, where sufficient private capital is not otherwise available on reasonable terms. However, the EEC (European Economic Community), unlike OPIC, can also provide direct equity investment to foreign enterprises to support its stated mission. MIGA provides political risk insurance and guarantees against noncommercial risk, as well as advisory services and technical assistance to support member countries' efforts to attract foreign direct investment. With the exception of advisory and technical services, its products are similar to OPIC's.

As a separate institution, IFC has a much larger exposure in the project finance arena than OPIC; at FYE 2000 loans outstanding were 2.5 times OPIC's exposure. While OPIC also participates indirectly in the equity market, through the Funds program, comparisons with IFC's program are less clear. While OPIC is able to provide capital to equity funds investing in emerging markets, through a debt instrument, IFC is both able to do this and make direct equity investments in projects in these markets. The direct equity option enhances IFC's tools, since higher-risk projects often need equity, not debt, to start on a sounder capital structure. Investors can reap the upside of a successful business, a compensation for risk that strict debt providers do not have. By the same token, when comparing IFC's financial performance to OPIC's we have to recognize that IFC derives an important amount of income from its equity investments; capital gains and dividends contributed $260 million to IFC's fiscal 2000 revenues. IFC's net interest income and fees from loans and income from equity investments totaled $585 million for the same period.

The additional income from equity investments is reflected in a ratio of net income from loans and equity investments to loan and equity investment exposure of 5.4 percent. Since OPIC also provides political risk insurance, this ratio is not directly comparable on an aggregate basis; however, if we take the directly comparable program exposure, i.e., OPIC's financing exposure to IFC's financing exposure and the respective net interest income, the returns are closer with a 3.9 percent for IFC and 2.7 percent for OPIC.

Also available to IFC is the option to provide financing in different currencies, often a very useful and sensible alternative to dollar financing in certain geographic areas. An active treasury operation allows IFC to swap out of the multiple currency exposures and use other financial instruments to mitigate risk. From a risk mitigation standpoint, IFC is able to reduce its risk to a particular project and stimulate private sector involvement in the project by participating out risk to commercial banks. As a result of their wider scope both geographically and by product lines, IFC has been able to expand its book of business more rapidly and is able to participate in more projects and with smaller amounts, catalyzing private sector involvement.

While IFC has a much wider scope of clients, it is interesting to note that in terms of the geographic distribution of the portfolios, both OPIC's and IFC's portfolio follow similar areas of concentration. Latin America commanded the largest percentage for FYE 2000, with 39 percent for IFC and 31 percent for OPIC. OPIC differs in the Eastern European and former NIS where OPIC has 29 percent of its portfolio and IFC only 19 percent. The balance is with Asia, where IFC had 30 percent of its portfolio and OPIC 14 percent. IFC's exposure in the Middle East is 7 percent, while OPIC had a smaller presence with only 2.5 percent. In Africa, OPIC has a large presence, primarily through the Investment

Table A.2 OPIC's largest exposures by country and sector as of September 30, 2000 (millions of dollars)

	Exposure
Country	
Brazil	2,088.4
Argentina	1,237.3
Turkey	1,146.8
Venezuela	1,146.0
Colombia	929.7
Sector	
Power	5,546.7
Financial services	4,471.2
Manufacturing	2,037.8
Oil and gas	1,805.6
Communications	1,455.1

Funds product, with exposure in the 15 percent range, while IFC has 5 percent.

From a loss reserves standpoint, OPIC and IFC have comparable levels of loss reserves as a percentage of exposure, 15 percent for OPIC as of FYE 2000 and 18 percent for IFC for the same period. Considering the geographic distribution of both portfolios is weighted towards Latin America, it is not surprising the levels are comparable. However, included in IFC's revenues are provisions for direct equity investments.

While MIGA has been in operation for close to 14 years, its book of business is much smaller than OPIC's, despite the global scope of their potential clientele. OPIC although operating for 31 years as an independent agency, is limited to only US sponsors making foreign direct investments or US financial institutions providing financing. MIGA's political risk insurance product is essentially comparable to OPIC's. MIGA, however, actively reinsures its portfolio and thus carries less risk on its books, a tool currently not utilized by OPIC. MIGA is also able to participate out coverage through its "Cooperative Underwriting Program," where it acts as the insurer of record, but only keeps a portion of the risk.

As shown in table A.2, OPIC's portfolio distribution is heavily concentrated in Latin America (55.5 percent), like MIGA's (47 percent). But the balance of MIGA's portfolio has a larger exposure in Europe and Central Asia, while OPIC's exposure is small. Balancing that is OPIC's larger exposure in Asia, with 18 percent, while MIGA has only 4 percent.

OPIC's level of liquidity, i.e., liquid assets available to absorb the risk exposure in the Insurance portfolio, is substantial, representing 39 percent of the insurance portfolio, while MIGA's liquid assets only represented 17 percent of the portfolio. OPIC certainly has had a longer history to build up its capital base to support its Insurance program. Compensating the shortfall, MIGA has a higher level of loss reserves as a percentage of their insurance portfolio, 13.4 percent, while OPIC maintains 3.2 percent of reserves to its Maximum Covered Liabilities (MCL) in Insurance. OPIC's insurance loss reserve is largely for unanticipated events, since as indicated above, OPIC has a very adequate level of liquid assets (3.9 percent) to absorb claims and a remarkable recovery history for claims paid, 90 percent of the original principal balance of claims paid.

Capital adequacy ratios, which measure the level of support for the risks in which a corporation engages, are strong for all three institutions. OPIC's ratio of equity plus reserves to loan and investment exposure was 31.2 percent at FYE 2000. IFC had a ratio of 70.2 percent, more than twice that of OPIC's, reflecting very strong capitalization and an indication of the very liquid balance sheet IFC maintains, nonetheless OPIC's 31 percent ratio is quite strong. If we use total assets plus contingent liabilities to measure for capital adequacy, which would include IFC's large derivatives book at FYE 2000, the ratios are more in line. IFC's ratio was 15 percent and OPIC's was 19 percent (the ratio includes OPIC's insurance book). MIGA's equity to assets ratio was 8 percent for the same period and the ratio of equity plus reserves to Insurance portfolio was 23.9 percent, highlighting the high level of loss reserves MIGA maintains, partially compensating for the lower level of capital. Both of the ratios discussed above are useful in assessing the capital cushion available to absorb losses, the first ratio narrows the risk down to the assets where losses are most likely to occur. It is unclear from IFC's disclosure what is the nature of their derivatives portfolio, however, we assume it is largely part of their risk mitigation program, which includes a large amount of swaps.

From a cost-efficiency basis, it is interesting to compare OPIC to a combined IFC and MIGA pro forma income statement (table A.3). OPIC certainly compares well with administrative expenses of $44 million supporting exposure of $13.3 billion (insurance and finance) compared with a combined IFC/MIGA administrative expense level of $293 million supporting a similar $13.8 billion combined exposure.

While these two arms of the World Bank provide interesting comparisons from a ratio analysis perspective, it may be equally fruitful to compare OPIC against other bilateral agencies with similar missions. The multilateral agencies provide an interesting and convenient yardstick for a number of historical reasons, including size, mission, business plans derivative of the OPIC model and product offerings. However, as noted above, these agencies have certain client and mission scope differences

Table A.3 Pro forma consolidation of IFC and MIGA compared with OPIC as of June 30, 2000

Aspect	IFC	MIGA	IFC and MIGA	OPIC
Balance sheet highlights (millions of dollars)				
Liquid assets	13,719	473	14,192	3,897
Insurance exposure: Maximum covered liabilities	—	2,816	2,816	9,958
Loans and investment guaranties (disbursed)	8,340	—	8,340	3,310
Equity investments	2,636	—	2,636	—
Total	10,976	2,816	13,792	13,268
Total assets	38,719	723	39,442	4,141
Loss reserves (insurance and finance)	—	—	2,349	818
Finance	1,973	—	—	496
Insurance	—	376	—	322
Shareholders' equity	5,733	298	6,031	3,321
Income statement (millions of dollars)				
Insurance revenue	—	30	—	84
Interest income	694	—	—	88
Interest expense	–371	—	—	—
Capital gains and dividends on investments	262	—	—	—
Income from loans and investments net of interest expense	585	30	615	172
Total administrative and general expense	275	18	293	44
Operating income before reserves	310	12	322	128
Less provisions for loan losses	215	27	242	171
Income after provisions	95	–15	80	–43
Interest on US Treasury bonds	—	—	—	224
Income from investments	634	—	—	—
Charge on borrowings pro rata	–441	—	—	—
Other income	127	0	—	—
Income from investments and other income	282	26	308	224
Net operating income	377	11	388	181
Translation adjustment	3	0	3	—
Net income	380	11	391	181
Profitability ratios (percent)				
Net interest income from loans/loan exposure	3.87	—	—	2.66
Net income from loans and investment/loans and equity exposure	5.33	—	—	—
Net income from insurance/insurance exposure	—	1.07	—	0.84
Net income from loans, investments and insurance/loans, equity, and insurance exposure	—	—	4.46	1.30
Operating income before reserves/exposure	2.82	0.43	2.33	0.96
Net operating income/exposure	3.43	0.39	2.81	1.36
Net income/equity	6.63	3.69	6.48	5.45

(*table continues next page*)

Table A.3 Pro forma consolidation of IFC and MIGA compared with OPIC as of June 30, 2000 (*continued*)

Aspect	IFC	MIGA	IFC and MIGA	OPIC
Liquidity ratios (percent)				
Liquid assets/insurance exposure	—	16.80	—	39.13
Liquid assets/loan and equity investments	164.50	—	—	117.73
Loss reserves/loan and equity investments	23.66	—	—	14.98
Loss reserves/insurance	—	13.35	—	3.23
Capital adequacy ratios (percent)				
Equity + reserves/loans, investments, and insurance exposure	68.74	23.93	75.12	31.20
Equity/loans, investments, and insurance exposure net of reserves	52.23	12.21	52.70	26.67
Equity/total assets plus contingent liabilities	14.81	8.42	14.27	15.96
Efficiency ratios (percent)				
Administrative expenses/insurance, loan, and equity book value	3.30	0.64	2.63	0.44

— = nonapplicable
IFC = International Finance Corporation of the World Bank Group
MIGA = Multilateral Investment Guarantee Agency of the World Bank Group

that tend to distort the comparison against OPIC and thus reduce its validity.

A more direct comparison against a variety of national agencies may prove equally illuminating in the assessment of business models, mission objectives, budgetary constraints and product offerings. While none of the agencies of the OECD countries is directly comparable to OPIC from a size or product perspective, analysis of their operations might provide insight into certain challenges and opportunities currently facing OPIC. Agencies that might be examined and some of the challenges they face include:

- Commonwealth Development Corporation, UK—currently being privatized with a business focus on equity investment.
- Export Credits Guarantee Department, UK—currently being forced to prove sustainability from own resources and without reliance on UK government budgetary allocations.
- Development Finance Company, Netherlands—similar product range as OPIC's finance products, but with a significantly stronger focus on equity investment and strategic stakes in partners in developing markets.

- Deutsche Investitions und Entwicklungsgesellschaft, Germany—being challenged to reach further down its market despite its already significant support for smaller German industry.
- Nippon Export and Investment Insurance, Japan—a spin-off of JEXIM [Japan Export-Import Bank] and MITI's [Japan Ministry of International Trade and Industry] political risk insurance program, they have dealt with the issue of granting political risk insurance to investors who are not controlled by Japanese corporations.

Appendix B
Evaluating the Potential Impact of Investments

The Economic Analysis and Project Monitoring Unit, located within the Office of Investment Policy, has responsibility for evaluating the potential impact of each proposed investment on the US economy and on the host country.

Effects on US Economy

OPIC analyzes all projects for their expected positive effects and identifies any potential negative effects on the US economy. OPIC's analysis is based on conservative estimates of these potential effects. This approach minimizes the potential for overestimating positive or underestimating negative impacts of prospective investment projects.

Balance of Payments Effects

OPIC considers the potential effects of a proposed investment on the US balance of payments, based on the trade and financial flows expected to result from the project.

Employment Effects

Calculating Employment Creation. Another focus of OPIC's analysis regards the potential positive US employment effects resulting from project-related procurement of US goods and services. For each project, OPIC details each type of procured good or service and calculates the employment effect within the project's industrial sector as well as in sectors supplying necessary components or inputs. The employment effects incorporate the direct employment necessary to produce the procured goods and services, as well as the indirect employment required for the production of the associated intermediate inputs. By using this methodology, OPIC is able to ascertain employment-generation levels with greater precision than if it used an across-the-board average for all US exports. By including indirect effects, OPIC's employment figures present a more accurate picture of the benefits accruing to US workers from the procurement of US goods and services.

Avoiding Potential Job Losses. OPIC also analyzes any potential negative impact of the proposed investment on US production via competition with US industry in both domestic and foreign markets. The Economic Analysis and Project Monitoring Unit conducts extensive research using various publicly available resources as well as project-specific information provided by the potential investor.

Net Job Creation Versus Any US Job Loss. OPIC's practice since 1992 has been to deny support to projects expected to result in any US job loss. For additional information about this issue, see OPIC Policy on "Significant Reduction" in US Jobs.

Investment Restrictions

Runaway Plants. OPIC is statutorily prohibited from assisting runaway investments that result in a reduction of the investor's US employment levels. A "runaway" is defined as a production facility established outside the United States to replace a facility in the United States for the purpose of supplying the same products to the same markets. In determining whether a proposed project represents a runaway investment, OPIC considers not only the investor's operation, but also the operations of any businesses affiliated with the investor, such as a parent company or any subsidiaries.

Performance Requirements. Host-country requirements such as local-content and export quotas may diminish the trade or investment advantages of the project for the US economy. OPIC may assist projects subject to performance requirements only if such requirements do not substantially reduce the US trade benefits of the investment.

Sensitive Sectors. From the perspective of US effects, products in sensitive industry sectors have a high potential to negatively impact the US economy and employment. Products in sensitive sectors are not automatically precluded from receiving OPIC assistance; however, such projects require more detailed evaluation to determine eligibility for OPIC assistance. OPIC's Sensitive Products List is comprised of products involving sensitive sectors including steel, minerals, automobiles, electronics and certain other categories of manufactured products. In addition to the general guidance provided in the Sensitive Products List, the following sector-specific policies have been adopted:

> *Textiles:* Unless there is a bilateral treaty limiting exports of the product from the host count, OPIC does not assist projects exporting more than *5 percent* of production to the United States. Projects for local use or for export to third markets may be assisted. US equity participation in a textile project must be at least *25 percent* in order for OPIC to provide financial assistance. In connection with each request for assistance, a case-by-case review will take carefully into account US developmental objectives, the effect on the US textile industry, the effect on the US balance of payments, and the experience of the sponsor with maintaining its US workforce. (OPIC Directive 94-22, 2(B)(J))
>
> *Agriculture:* Agricultural projects primarily involving production for domestic use may receive OPIC assistance subject to normal developmental and other criteria. However, projects do not receive OPIC assistance to the extent that the crops involved are in US surplus and more than 20 percent of food crops or more than 10 percent of feed crops are for export to the United States. For projects involving production of crops currently in US surplus for export to third country markets, OPIC notifies and takes into consideration the views of the Department of Agriculture, the State Department, and the Agency for International Development. In such cases, OPIC considers supply and demand trends, alternative sources of assistance for the project, balance of payment effects, relative advantage to consumers, and the development priority of the host country. (OPIC Directive 94-22, 2(B)(2))

Project Monitoring

OPIC Directive 94-13 provides guidelines for implementing OPIC's statutory requirement to monitor the actual effects of projects assisted by the agency. To confirm project estimates, OPIC monitors the actual economic impact of every project from its inception until the conclusion of the investment. Using modem sampling theory, OPIC randomly selects the projects that staff will site-monitor during a three-year period. In addition to randomly selected projects, all investments considered to be economically or environmentally sensitive are also visited. All site-visited projects are evaluated for their effects on the US and host-country economies and employment, their environmental impact, and conformance with internationally recognized worker rights standards.

In addition to the site-monitoring program, OPIC operates a "self-monitoring" system in which each investor completes an annual questionnaire reporting project effects.

Through the monitoring program, OPIC has determined that the information used to screen potential projects represents good-faith estimates provided by project sponsors. OPIC has not observed any evidence of deliberate misrepresentations by investors. Indeed, actual monitored results tend to be more positive than projections, confirming that the original estimates were appropriately conservative. Monitoring has also consistently confirmed that OPIC-assisted projects provide substantial benefits to both the US and host-country economies.

In fiscal 2000, OPIC completed the final year of the fourth round of monitoring, the results of which were reported to Congress in 2001.

OPIC Statutory Requirements and Policy Guidance: US and Developmental Effects

US Employment: Under its primary operating statute, the Foreign Assistance Act (FAA) of 1961, as amended ("FAN"), OPIC is required to decline assistance for projects likely to cause "a significant reduction in the number of employees in the United States" (*US Code* 22, sec. 2191 (0)). As a matter of policy, OPIC does not assist projects expected to result in a *net* negative effect on US employment. Also, as a matter of policy, since 1997 OPIC has not supported projects expected to result in *any* negative employment effects. However, OPIC written policy prepared in 1993 provides the following guidance for evaluating investments that may involve minimal US job losses:

> [P]rojects with the potential for minimal employment losses may still merit OPIC assistance if they are expected to result in other extraordinary US benefits—such as overwhelmingly positive employment gains in another sector. Therefore, OPIC will still consider providing assistance to certain exceptional projects even if they are expected to result in minimal employment reductions. (OPIC Directive 94-34, 2(B))

Under the FAA, OPIC is required to annually report to Congress any US job losses its projects will cause, even if the net effect of such projects on US employment is positive (*US Code* 22, sec. 2200a(b)(3)).

Runaways: There are explicit statutory restrictions on supporting a project that will cause a sponsor to reduce its US employment. According to the FAA, OPIC is required to decline assistance for runaway investments that are likely to cause the investor/sponsor "significantly to reduce" its US employment (*US Code* 22, sec. 2191(k)(1)). In addition, since 1992 the annual Foreign Operations Appropriations Act (FOAA) has prohibited US agencies that receive appropriations, including OPIC, from supporting runaway investments if there would be *any* reduction in the investor's US operations.

Sensitive Sectors: OPIC must analyze the relevant industry sector(s) of the US market in order to predict the project's US effects. OPIC considers the economic health of the industry, the degree of sensitivity to foreign competitors, and industry production and employment trends. OPIC's Office of Investment Policy (IP) maintains a (nonexhaustive) list of sensitive sectors. "While OPIC assistance to projects in these sectors is not prohibited, far more in-depth analysis of the industry may be required in order to determine that the US effects in a sensitive sector will be positive" (OPIC Directive 94-34, 2(B); OPIC Directive 94-22, 2(B)).

***Performance Requirements**:* OPIC is required to decline assistance for projects that are subject to performance requirements that substantially reduce US trade benefits (*US Code* 22, sec. 2191 (in)). OPIC will not support projects subject to performance requirements that will reduce US trade benefits by 50 percent or greater, and does not generally support projects for which trade benefits will be reduced by 25 to 49 percent. However, OPIC is allowed to assist projects for which US trade benefits will be reduced by less than 25 percent (OPIC Directive 94-34, 2(D)).

***Balance of Payments**:* OPIC must analyze the volume and destination of project sales and examine whether projects will displace sales by US producers in the United States, in the host country, or in third markets (OPIC Directive 94-34, 2(B)). OPIC is required to take into consideration balance of payments effects of projects that it may assist (*US Code* 22, sec. 2197(k)). OPIC determines the effect based on trade and financial flows expected to result from the project (OPIC Directive 94-34, 2(B)).

***Host-Country Development**:* A Development Impact Profile must be prepared and maintained for each project (*US Code* 22, sec. 2199(h)) and must address local employment, local production of inputs, technology transfer, transfer of business knowledge and skills, local tax and duty revenues, and foreign exchange effects resulting from the project (OPIC Directive 94-33, 2(B)). The project evaluation criteria are developed in consultation with the Agency for International Development (*US Code* 22, sec. 2199(h)).

***Monitoring**:* In order to monitor conformance with investor representations regarding runaway investments, as well as to measure the projected and actual effects of projects on host-country development, OPIC monitors the actual economic impact of every project (*US Code* 22, sec. 2191 (k)(2) and sec. 2199(h)).

***Annual Reporting Requirements**:* OPIC is required to report annually to Congress the following with respect to the projects receiving OPIC support:

- an assessment, based upon the Development Impact Profiles, of the economic and social development impact and benefits of the projects, and of the extent to which such projects complement or are compatible with the development assistance programs of the United States and other donors (*US Code* 22, sec. 2200a(a)(1));
- projected US exports to be generated over next five years;
- destination of project production;
- impact of project production on US producers' sales (*US Code* 22, sec. 2200a(b) (1));

- any US job losses a project will cause, even if the net effect of the project on US employment is positive;
- any US jobs the project will create; and
- the host country and sector of the project (*US Code* 22, sec. 2200a(b)(3)).

OPIC Policy on "Significant Reduction" in US Jobs

Since the 1970s, OPIC's statutory guidance has addressed runaway investments as well as reduction of US employment in general.

Regarding runaway investments, OPIC is statutorily prohibited from supporting projects likely to cause the US investor "significantly to reduce" its US employment.

Regarding US employment in general, OPIC is statutorily prohibited from supporting projects likely to cause a "significant reduction" in employment.

Prior to 1985, OPIC assisted some projects resulting in insignificant net job loss. However, in that year Congress added a statutory reporting requirement obligating OPIC to report separately projects resulting in net job loss.

In 1992, Congress added a requirement to report each project resulting in any job loss, regardless of whether the same project created other jobs.

Also in 1992, Congress prohibited any government agency receiving appropriations under the Foreign Operations Appropriations Act (FOAA), including OPIC, from supporting runaway investments if there would be *any* reduction in the investor's US operations. This prohibition has been included in annual appropriations legislation ever since.

As a result of the reporting requirements of 1985 and 1992, as well as the stricter standard applied to runaway plants in 1992, OPIC Executive Vice President James Berg issued a policy in November 1992 that the Corporation would not support projects expected to result in any loss of US employment, regardless of the number of jobs to be created. During the 1993 confirmation hearings of Ruth Harkin as OPIC President and CEO, Senator Paul Sarbanes referred to the policy implemented by James Berg at the end of the prior OPIC administration, and stated that Mrs. Harkin should "put a policy [continuing the Berg guideline] into place right at the beginning and that it be very carefully developed." He also noted that "many people or perhaps most people in Congress would want to see it."

At the end of 1993, OPIC adopted a policy directive allowing for "netting out" positive and negative employment effects. However, the corporation has not supported projects resulting in any US job loss since this time.

Under OPIC President George Mufioz, the policy directive was not modified. However, management determined not to support projects that would result in any US job loss regardless of the number of jobs to be created.

In practice, OPIC has not turned down any project in recent history on the determination that the investment would have resulted in single-digit job loss. On the contrary, projects turned down by OPIC due to potential job loss have involved significantly higher numbers of jobs. For applications submitted during the past three years, OPIC has formally turned down only five projects (including two fund subprojects) on account of potential job loss. Over the same period, there were approximately an equal number of projects for which complete applications were not formally submitted to OPIC but which OPIC determined had a strong potential for significant loss of US jobs. In those cases, sponsors were notified of OPIC's preliminary assessment and they decided not to complete the application process. Finally, OPIC receives numerous verbal inquiries from investors regarding projects that may not meet OPIC's statutory criteria. Such inquiries are usually handled informally by officers in the Insurance, Finance and Funds or Investment Development departments with consultation from FMSR as needed.

Appendix C
OPIC Worker Rights Policies and Procedures

OPIC's worker rights policies are statutorily directed and apply to program eligibility at the country level as well as project-specific worker rights conditionality.

Country Level Eligibility

Statutory Requirements

Under the Foreign Assistance Act (FAA), OPIC has been authorized since 1985 to "insure, reinsure, guarantee or finance" a project only if the country in which the project is to be undertaken is "taking steps to adopt and implement laws that extend internationally recognized worker rights (as defined under the Trade Act of 1974) to workers in that country." The Trade Act defines "internationally recognized worker" rights to include the following:

- the right of association;
- the right to organize and bargain collectively;
- prohibition of forced or compulsory labor;
- minimum age for employment; and

- acceptable conditions of work with respect to wages, hours of work and occupational safety and health.

It is USG (US government) policy to operationally define these rights as they are defined in corresponding international conventions administered by the tripartite committees (representing government, labor and employers) of the International Labor Organization (ILO). The committee language accompanying the OPIC legislation directed OPIC to assess the extent to which a country meets the "taking steps" criteria by reference to its membership in the ILO, ratification and implementation of the relevant ILO conventions.

OPIC is also directed by the FAA to use the State Department's annual Country Reports on Human Rights Practices and by committee report language, to consult with the Department of State and the Department of Labor, in making its eligibility determinations. The eligibility provision is subject to Presidential waiver on grounds of US "national economic interest." The waiver provision has been used only once, to permit OPIC to reopen its programs in Nicaragua after the restoration of an elected government in 1990.

Implementation

For practical purposes, OPIC relies on the annual recommendations and made by the Trade Policy Review Group (TPRG), an interagency committee (that does not include OPIC) at the subcabinet level chaired by the Office of the US Trade Representative (USTR), with respect to worker rights eligibility under the Generalized System of Preferences (GSP) for the majority of its country eligibility determinations. The vast majority of OPIC-eligible countries are also designated beneficiaries under the GSP program and are thereby subject to GSP worker rights eligibility criteria that are virtually identical to those required of OPIC under the FAA.

The GSP process is petition-driven. Petitions are normally filed annually by interested parties such as labor or human rights organizations seeking a formal review of a country's eligibility or foreign governments or businesses seeking to maintain or restore a country's eligibility for GSP. Upon a determination by USTR that a country is no longer eligible for GSP on worker rights grounds, OPIC immediately suspends its programs in that country until such time as GSP eligibility is restored. Examples of countries that have been suspended from eligibility for GSP and OPIC programs and since restored to eligibility since the requirement went into effect in the mid-1980s include Chile, Paraguay, Romania, Central African Republic, and Ethiopia. Countries that have been and remain suspended from GSP and OPIC programs on worker rights grounds include Liberia, Belarus and Swaziland.

The fact that the GSP process is petition-driven leaves room for anomalies whereby a country with a very poor worker rights record may remain eligible while a country with a "better" record may be liable to suspension on account of its failure to meet the "taking steps" criterion. In response to this, there have been one or two occasions when OPIC's Board has rejected or deferred approval of a project in an otherwise GSP-eligible country (e.g., Indonesia under Suharto and Equatorial Guinea, respectively) which in the Board's view, did not meet the "taking steps criteria" but had remained eligible for GSP essentially "by default."

For OPIC-eligible countries that are not designated as GSP beneficiaries (typically due to per capita income limitations) OPIC has instituted a parallel petition-driven process at its annual public hearing, usually held in December. As a result of this process OPIC has made a number of determinations, in close consultation with the Department of State and the Department of Labor, to suspend, restore and in one case, to initiate its programs in a country on worker rights grounds. Since 1995 OPIC programs were and remain suspended in Saudi Arabia, the United Arab Emirates and Qatar on worker rights grounds. (The worker rights section of the most recent State Department Country Report on Human Rights Practices in Saudi Arabia is appended.)

OPIC programs were suspended in South Korea in 1991 (South Korea "graduated" from GSP eligibility on per capita income grounds in 1988) and were restored there in 1998. OPIC programs were initiated in Vietnam in 1998 after an extensive review of worker rights conditions in that country including two visits by OPIC-State-Labor delegations, including representatives from US organized labor. OPIC's finding that Vietnam, despite having a trade union federation closely affiliated with the ruling Communist Party, meets the "taking steps" criterion, continues to be questioned by some US labor and human rights organizations whose petitions triggered the OPIC review.

Project Level Conditionality

OPIC is also statutorily required (by annual Foreign Assistance Appropriations legislation) "ensure that no funds authorized . . . contribute to violations of worker rights." To implement this provision OPIC's authorizing legislation was amended in 1992 to require that the following language be included in each OPIC contract of insurance or finance:

> The investor agrees to not take actions to prevent employees of the foreign enterprise from lawfully exercising their rights of association and their right to organize and bargain collectively. The investor further agrees to observe applicable laws with respect to minimum age for employment of children, acceptable conditions of work with respect to minimum wages, hours of work and occupational health and safety and not to use forced labor. The investor is not responsible under this paragraph for the actions of a local government.

Implementation

Since 1993 OPIC has included the above language or some slight variation of it in every insurance contract and finance agreement. Amendments to the statutory language have been made to accommodate the liability concerns of investors (particularly on the insurance side) that do not have a controlling interest in the foreign enterprise such that they can guarantee that the foreign enterprise will refrain from certain actions or observe applicable laws. Such investors are held to "best efforts" or "commercially reasonable efforts."

Because the statutory language makes reference to "applicable laws," and the laws in some countries are not consistent with ILO conventions that set a threshold for worker rights protection, OPIC has determined that in some cases, an investor's agreement to "observe applicable laws" is not sufficient to meet the statutory requirement that projects "not contribute to violations of worker rights."

In such cases, and where the foreign enterprise has sufficient control over employment practices to enable it to adhere to a higher standard, OPIC supplements the standard contract language with additional contractual covenants in which it specifies the relevant ILO standard. These typically address such issues as minimum age for employment, where OPIC would substitute an ILO standard of 14, 15 or 18 (depending on a country's GNP and the level of occupational hazard associated with the work) for a local law that permitted employment at age 12. Other supplemental conditions used by OPIC extend worker rights protections to employees of contractors and subcontractors, provide for non-discrimination against employees on account of their exercise of the right of association and allow workers to remove themselves from hazardous working situations without jeopardizing their employment, all of which are consistent with ILO "core conventions."

The process of identifying the appropriate supplemental conditions to include in each contract is a labor-intensive internal "clearance" process that includes a review of each country's labor laws in order to determine where there are gaps or deficiencies relative to ILO standards that are relevant to the project. OPIC is considering adopting an expanded version of the standard contract language that would obviate the need for each project to undergo a separate "clearance." However, undertaking the clearance process does provide OPIC staff with a better understanding of labor rights issues that may arise in the implementation of a project and helps to identify projects suitable for monitoring.

Monitoring

Worker rights advocates frequently remind OPIC that contractual protections of worker rights are only effective if there is an equally effective (and ideally "independent") monitoring system in place to identify worker rights violations and to remediate them. Worker rights violations are inherently difficult to identify and allegations of such violations are even more difficult to prove. A typical pre-arranged one-day site visit to a project may reveal only the most egregious violations of physical working conditions; under-age workers may not be asked to stay home that day and workers who have been denied employment or dismissed for exercising their rights of association will be inconspicuously absent.

While OPIC includes worker rights monitoring in its random and "sensitive" samples of projects to be site-monitored for US and environmental effects, it targets its in-depth monitoring efforts for countries and sectors with a high potential for worker rights violations. On such occasions, OPIC employs trained and certified labor rights auditors, usually recruited from the NGO (nongovernmental organization) community and with reputations for impartiality and credibility among both the labor and business communities, to accompany OPIC officers to the site. The auditors spend as much time as is necessary on site conducting independent and confidential interviews with employees, management, organized labor, government officials and knowledgeable NGOs. In addition, two members of OPIC's Office of Investment Policy have been trained to audit worker rights compliance against the Social Accountability 8000 standard, which closely resembles OPIC's statutory requirements and ILO conventions.

On two occasions that OPIC has engaged in such in-depth monitoring, in Central America and Africa, it has identified significant worker rights violations, primarily at the contractor and subcontractor levels during the construction phase of the projects. Both instances were identified prior to disbursement of an OPIC loan guaranty and in both cases OPIC required the borrower, as a pre-condition for disbursement, to agree to a detailed remediation plan. The remediation plans included training in occupational safety and health, informational seminars by independent legal experts to inform workers of their rights under the law, and in one case, financial compensation for workers whose employment was improperly terminated because they had formed a legally recognized union. OPIC and its auditors monitored the implementation of the remediation plans to ensure that the agreements were carried out, subject to the continuing default provisions of the loan agreements. In carrying out these highly resource-intensive monitoring and remediation programs, OPIC has treated these cases as business confidential, avoiding all publicity and requiring its auditors to sign and respect confidentiality agreements. While some of the labor conflicts associated with these projects have subsequently been reported in the press, OPIC's involvement in monitoring and resolving the conflicts has not been publicly disclosed. Although this posture has cost OPIC some credibility with labor and human rights advocates who believe that greater transparency is necessary to protect worker rights, OPIC does not believe that there is anything to be gained in this process by subjecting its clients or itself to media attention. Disclosing OPIC's (and thereby, the US government's) role in such cases would likely politicize and further aggravate a situation that is typically highly polarized to begin with, making an equitable resolution more difficult to achieve.

Appendix D
OPIC and Small Business

Background

OPIC's statute directs the agency "to the maximum degree possible consistent with its purposes to increase the proportion of projects sponsored by or significantly involving United States small business to at least 30 percent of all projects insured, reinsured, or guaranteed by the Corporation." Thus, OPIC is statutorily required to transact business with United States small businesses. Nonetheless, transacting business in the emerging markets is difficult enough without adding the constraints that small businesses present. In recent years OPIC Finance has made process adjustments to better meet the needs of US small business and to better meet its own small business statutory requirements. Discussed below are some of the challenges that extending loans to projects sponsored by small businesses in emerging markets present and how OPIC Finance has tried to improve its responsiveness to small business.

Challenges

Identifying good small business prospects that have the experience, resources, and desire to make a long-term equity investment in a project in the emerging markets is extremely difficult. The number of small businesses willing to make a long-term equity investment in the emerging markets is a small fraction of the small business companies that are exporting to these markets. Thus, finding qualified prospects is the single most challenging aspect of OPIC Finance doing projects with US small business.

Another challenge of completing transactions with US small business is their limited experience with the requirements of structured finance. Generally small businesses finance themselves with revolvers or long-term loans that are secured with local assets, which are less demanding to close than a structured credit. Although the small businesses want the benefits of the off-balance sheet structured financing, they are unprepared to deal with its demands.

Making a long-term equity investment in an emerging market requires financial and human resources. The human resources are necessary to operate the investment and to close and monitor the structured financing. Financial resources are necessary to pay the costs of closing the financing (which will include a local attorney and possibly an environmental consultant). Few small businesses have these types of resources to undertake such a venture.

Although the dollar amount of loans to projects involving small businesses is generally smaller than the loans to projects with larger businesses, the absolute risk level is larger with loans to projects with small business. Thus, the loans extended to projects with small businesses have a higher probability of not repaying than do the loans to projects with larger business. OPIC must accept a higher level of risk with transactions with small business.

Although fees (on a percentage basis) charged to projects sponsored by small business are comparable to those charged to projects sponsored by large business, the aggregate amount of earnings to OPIC for small business project loans is smaller than the aggregate amount earned for loans to large business projects. This is because the fees charged are based on a percentage of loan size and since the loan amount is generally much smaller for loans to small business projects, the earnings to OPIC are smaller. Thus, at current volume levels and at current OPIC overhead levels, loans to projects sponsored by small business are not a profitable business for OPIC

OPIC Finance Efforts

OPIC formed a working group to examine the challenges of transacting business with small business. Several suggestions were made to improve how OPIC processes transactions involving small business.

OPIC Finance developed a small business pilot program that (a) increased the amount of risk that OPIC Finance was willing to accept for loans under a certain dollar amount and (b) streamlined the Finance Department approval process for loans under a certain dollar amount.

The vast majority of the procedures established in the Small Business Pilot Program were permanently incorporated into the OPIC Finance Department's operating procedures.

OPIC Finance directed the Legal Department to draft new form loan agreements for transactions involving small business. The new form loan agreements removed certain requirements that the borrower had to perform and made it easier to close the transactions.

In an attempt to expand the pipeline of deals involving small business, OPIC Finance developed the Small Business Franchise Program. This program built around the concept of "significant involvement." The OPIC Statute allows OPIC to provide loans to projects that "are sponsored by or significantly involve United States small business." The Small Business Franchise Program created a single definition of "significant involvement" for all small business franchise deals. Furthermore, the Franchise Program established credit guidelines for deals. Thus, the program gave clarity to the concept of "significant involvement" and to OPIC's credit approval guidelines to both applicants for OPIC financing and those within OPIC working on the applications. The program allows OPIC to process transactions more quickly and increased OPIC's pipeline of small business franchise deals.

OPIC Finance has identified the challenges of providing finance to projects involving small business. The department has also adjusted procedures and documentation requirements to better meet the needs of small businesses investing in the emerging markets.

Insurance Initiatives

OPIC Insurance has implemented several initiatives over the past two years targeting small business. These initiatives include:

Small Business Application. OPIC Insurance has developed a simplified application for small businesses. In addition, small businesses get a 25 percent reduction on retainer fees.

Small Business Contract. The Small Business Contract is designed to provide streamlined, yet comprehensive political risk insurance coverage to small businesses that invest equity or parent company debt in overseas projects. The contract offers coverage for up to 20 years for inconvertibility, expropriation, and political violence for both assets and business income. OPIC provides quarterly elections of coverage to small businesses so that they have the maximum flexibility to match their premium payments with their business cash flow. Premium rates for all four coverages are discounted relative to standard rates, but can vary depending upon OPIC's assessment of the project and country risks and if the investor selects fewer than all four coverages. Small businesses do not have to pay stand-by fees on the small business contract.

Insurance Interactive Training for Small Business. OPIC Insurance has designed an on-line interactive training program for small businesses accessible from OPIC's website. The training program provides an overview of OPIC Insurance coverages, the eligibility requirements, the terms and conditions of coverage, and reviews the process for obtaining coverage.

Insurance Letters of Intent. OPIC Insurance has developed a letter of interest for businesses that need an indication of OPIC's interest in a project in order to secure financing or investments. The letter of interest is available to businesses that have registered and applied for OPIC insurance and whose projects meet OPIC's eligibility and policy requirements.

Challenges and the Response of OPIC Legal Affairs

OPIC's direct loan program comprises smaller loans (as little as $100,000) as well as much larger loans for projects that are sponsored by or significantly involve US small businesses. The challenges and obstacles are different for these types of loans.

With respect to smaller loans, the challenge is to meet the demand for disbursement expeditiously while balancing the need for collateral. OPIC's loan agreement for small business loans has been streamlined and barring negotiation, could be prepared expeditiously by the in-house lawyer without cost to the borrower. Taking collateral abroad is another matter. OPIC will have to procure a local attorney who has to prepare and register the relevant local law mortgage or pledge. It takes time and the borrower is required to reimburse the costs of OPIC's local counsel. Due to these obstacles and the uncertainty of enforcement in a foreign jurisdiction, OPIC tries to satisfy its need for collateral by looking to the US sponsor and collateral located in the United States. If the US sponsor is an individual, he will often be required to give a mortgage on his real property. Even so, the time for disbursement is thus extended by the time that it would normally take for a mortgage closing. To save time, OPIC is already looking at the possibility of doing a blanket purchase agreement for the services of a national title company so that the process of retaining such title company is shortened for each transaction.

OPIC's mandate is to support small business loans especially where the projects are developmental. These projects are likely to be more risky and encounter higher losses. One suggestion is for OPIC to recognize the developmental nature of the project and its inherent risks by creating a basket for smaller loans to projects with developmental benefit and document such simply by a loan agreement with a guaranty or a pledge of shares. With minimum documentation, these high-risk but developmental projects can be closed very quickly.

The direct loan program really benefits the small businesses who are given larger size loans (in the range of $25,000,000 and over) by OPIC. As a general rule, OPIC shows greater flexibility in the evaluation and requirements for small business loans. There are also a number of cost savings. The small businesses avoid the funding costs of the investment guarantee program. Furthermore, they avoid legal costs to the tune of $100,000-$200,000 or more because the US law documents are drafted inhouse. Since small business clients normally have less sophistication, they also benefit from OPIC's technical support in structuring the transaction.

OPIC should consider expanding the group who can benefit from the direct loan program. Recent contacts with a number of commercial banks have shown that commercial banks are now mainly focused on their largest clients, a few Fortune 500 companies, to whom they can sell investment banking and other services. This presents a market opportunity for OPIC to make direct loans to middle-sized or indeed large companies for projects overseas. The definition of small business (which has not been revised since 1998) should be reviewed and revised to reflect this development and to allow OPIC to fulfill a need in the marketplace.

Appendix E
Environmental Issues

Examples of OPIC Environmental Additionality

At the time OPIC receives an application for insurance, financing or investment by a fund, many projects either to not purport to or can not substantiate a claim to meet the international environmental guidelines developed by the World Bank to which OPIC adheres. In some cases projects have been designed to meet host-country regulatory standards that are often less rigorous than World Bank guidelines. In other cases, environmental assessments have not been conducted and sponsors are waiting to take their cues from official lenders before addressing the environmental impacts of projects. In both cases, OPIC has an opportunity to provide "environmental additionality" to projects by helping to structure in them in a manner that produces more environmentally acceptable outcomes. The following brief examples illustrate some of the challenging issues OPIC has successfully resolved and the environmental benefits that resulted.

Gas-Fired Power Generation Project

OPIC provided an investment guarantee and political risk insurance to a US independent power producer for the construction and operation of a large gas-fired combined-cycle power plant.

The proposed project site was located just 800 meters southeast of an ancient city and its port. The remains of the city had been designated by the host country as a protected area. The project site did not affect the designated protected areas but the proposed route for the cooling water intake and discharge pipeline traversed the protected areas for approximately 200 meters. The proposed pipeline route had been recommended by an eminent archaeologist and received host country regulatory approval.

Given the protected status of the areas, OPIC required the commission of an independent archaeological survey. The study concluded that the pipeline routes and associated pump-house would not impact the cultural heritage protected in the area. OPIC also required that all work during construction of the pipeline be carried out under the observation of an archaeologist from the local museum and that a "Chance-Finds Procedure During Construction" document be prepared to establish the procedures to be followed during the construction. And finally, OPIC required that all pipes in protected areas be constructed above ground, with the pipes supported on racks supported on concrete footings constructed on the existing surface. As a result of these requirements, construction was adequately supervised, was completed with minimal intrusion and chance-finds were protected and given to the local museum.

Privatization of Coal-Fired Power Plant

OPIC provided an investment guarantee and political risk insurance to a major US power company for their acquisition and expansion of coal-fired electric generating plant.

As originally proposed, the project was to use coal with an annual average sulfur content of 1.25 percent. Dispersion modeling results indicated that the use of 1.25 percent sulfur coal would potentially result in exceedances of World Bank ambient air quality guidelines. To make matters worse, because the sponsors' proposal allowed for the use of coal with up to a 2.5 percent sulfur content, short-term ambient impacts were was likely to result in significant exceedances of these guidelines, affecting the air quality of communities located downwind of the plant.

In order to achieve compliance with the World Bank guidelines, OPIC negotiated an agreement whereby the sponsors committed to a reduction in full-capacity project stack emissions of sulfur dioxide (SO_2) to an equivalent of 1.12 percent sulfur content. In addition, due to the seasonal nature of local meteorology, the sponsors committed to a further reduction—equivalent to 0.87 percent sulfur content—for a period of up to five months of each year. This agreement resulted in a reduction in SO_2 of approximately l8 percent from the levels anticipated in the initial proposal and brought the project into compliance with World Bank Guidelines. OPIC has monitored the project in the field to confirm compliance with the contract conditions and World Bank Guidelines.

Clinical Laboratory

OPIC is providing a direct loan to a US small business to establish a clinical laboratory in a low-income developing country where no internationally certified laboratory exists. The laboratory will provide a wide range of medical diagnostic tests to serve the pressing health care needs of the population.

Errors in laboratory testing can result in misdiagnosis or erroneous medical treatment. To address this risk OPIC is requiring that the company put in place a rigorous quality assurance/quality control system to reduce or eliminate potential testing errors. Because workers at the laboratory run a high risk of exposure to blood-borne pathogens such as HIV and Hepatitis B, OPIC is also requiring the implementation of additional safety precautions to reduce the risk of exposure.

No rigorous host-country standards exist to address these risks and international standards are only in the early stages of development. With OPIC's encouragement, the project sponsor is working with a US not-for-profit organization that accredits US clinical laboratories to obtain the first international laboratory accreditation issued by that organization. Costs of obtaining the accreditation are being financed under the OPIC loan.

Dairy Cooperative

An OPIC-supported financial intermediary provided a loan to a large dairy cooperative to relocate their main processing and distribution facility. The original plant location was not large enough to install a sewage treatment plant and the original plant was a major contributor to water pollution in a large river.

Although the country is placing an increasing emphasis on reducing pollution, an inadequate and outmoded legal framework provided little guidance to the cooperative in designing their new wastewater treatment system. OPIC worked with the cooperative over a period of months to develop a detailed design plan for a wastewater treatment system capable of achieving treated effluent levels acceptable under the World Bank Guidelines.

Hydropower Privatization

OPIC provided political risk insurance to a US firm acquiring a number of hydropower facilities owned and operated by a government utility. Although the dams associated with these facilities had been designed to meet industry best practices at the time of their construction, the age of some of the dams as well as advances in dam engineering raised a number of safety concerns.

OPIC required a detailed study of the structural integrity of the dams and their ability to safely pass large floods. As a result of this analysis, the project sponsor identified a number of vulnerabilities in the assets and was able to develop corrective action plans to protect downstream communities.

Cement Packaging Plant

The project involves the packaging 2 million metric tons of cement for distribution and sale in a city with over 8 million people. The packaging plant has fully enclosed pneumatic conveyors that transfer cement from the silos to the bagging machines without the release of dust into the ambient air.

Based on discussions with OPIC, the project sponsor, a small business, agreed to the following measures to bring the project into compliance with the World Bank Group's Guidelines on Environment and General Health and Safety:

- Minimize the release of dust by using fully enclosed equipment (conveyors, packaging machines, etc.) for handling cement. This minimizes the health impacts on employees of the plant.
- Provide all plant personnel with personal protective equipment such as helmets, industrial boots, etc., to minimize the hazard of an industrial accident.
- Provide all plant personnel with adequate training on environment and on occupational health and safety.
- The facility will be regularly monitored to detect problems and take corrective action.

Barge-Mounted Oil-Fired Power Generation Project

This project involves the quick start-up of a power generation plant designed to reduce blackouts and severe power shortages. This engine-driven power plant uses imported fuel oil stored in tanks with appropriate spill containment dikes.

Based on discussions with OPIC, the project sponsor agreed to:

- Maintain fuel quality at a level such that the air emissions from the plant complied with the World Bank's Environmental Guidelines. This will reduce the associated environmental impacts to acceptable levels.
- Prepare a Spill Prevention and Control Countermeasures Plan. This will reduce the likelihood of oil spills and in the event of a spill, lists the actions that will be taken to minimize the environmental risk.

- Prepare an Environmental Management and Monitoring Plan to ensure that the releases from the plant are adequately monitored and corrective actions taken when needed.

Oil Refinery

OPIC provided financing for the first oil refinery in an oil-exporting country. Although the sponsor's application stated that the project would meet World Bank Guidelines (WBG), OPIC's detailed assessment of the possible impact on the environment, supplemented by a review by an independent consultant, suggested otherwise.

As a result of the deficiencies pointed out by OPIC, the client reengineered the facility to meet WBG, and also eliminated some of the processes and additives that were most detrimental to the environment. Engineering modifications included:

- Elimination of sea water cooling in favor of a more conventional evaporative cooling tower. This removes the stream of heated seawater effluent (estimated at 100,000 cubic meters per day).
- Switch from flash evaporation to reverse osmosis desalination and reduced requirement for desalinated water resulting from increased bore supply. This reduced brine volume as well as boiler load atmospheric emissions.
- A revised wastewater treatment system including corrugated plate interceptors, flotation, biological filtration, and sand filtration stages, which replaced the open oxidation pond originally proposed. This change provided a significant improvement in both quantities and quality of liquid wastes compared with the originally proposed model.
- Zero production of leaded gasoline eliminated the need for handling tetraethyl lead.
- The final design and location of the jetty offered some environmental advantages in terms of reduced length of earthen causeway and reduced impact to the marine ecosystem.
- Use of gas turbines instead of diesel generators to reduce net stack emissions.

Environmental Issues for Discussion

General Issues

What are the appropriate objectives for OPIC's environmental policies given OPIC's primary development mandate and other important objectives with respect to US foreign policy and promotion of US exports and employment?

Should OPIC's development mandate be further refined to focus on "sustainable development" that incorporates environmental and related social values?

Public Disclosure and Comment

Does OPIC's statutory requirement for a 60-day public comment period on the environmental aspects of Category A projects interfere with the timely processing of applications for insurance and financing? Does it preclude OPIC Funds and other financial intermediaries from making timely decisions on investment opportunities in companies engaged in Category A activities?

Does OPIC do enough to ensure that locally affected people and not just Washington-based NGOs (nongovernmental organizations) are made aware of pending projects? Should OPIC allow a longer comment period in order to solicit more comments from locally affected people? Are there other ways that OPIC could engage in more direct communications with locally affected people as part of its environmental assessment and monitoring procedures? How can OPIC determine whether NGOs are accurately representing the views of locally affected people?

Are OPIC applicants exposed to a greater degree of outside scrutiny and risk of public opposition as a result of OPIC's disclosure requirements?

Do companies derive a degree of "insulation" from public controversy by virtue of OPIC's "seal of approval" and the fact that OPIC responds directly to public inquiries and comments?

Does the legislative requirement to hold a public hearing prior to each Board meeting achieve the desired objective of providing the public with an opportunity to directly inform the Board of their concerns?

Is OPIC's 1985 statutory requirement to provide prior notification of "environmentally sensitive projects" to appropriate host government authorities made redundant by the 1999 amendments requiring broad public disclosure of EIAs? Applicants are understandably reluctant to have a project rejected by OPIC on environmental grounds out of concern that, if this information were somehow to be disclosed, it could jeopardize other potential sources of financing and insurance. Therefore, most of OPIC's negative decisions are made prior to the formal application process, without the benefit of public disclosure of comment. Among other things, this lack of transparency leads to the perception that OPIC is not selective with respect to its support of projects on environmental grounds. Does this also undermine the intent of the public disclosure process? Should OPIC make informal decisions about projects outside of the formal application and disclosure process?

Screening

Does OPIC's early screening of projects into A, B and C categories according to their environmental sensitivity provide investors and the public with clear and consistent guidance regarding requirements for public disclosure and environmental assessment?

Environmental Standards

Are World Bank/IFC standards appropriate for US companies operating in developing and emerging markets? Why isn't it sufficient that companies comply with host-country standards? Would US standards be more appropriate than World Bank/IFC Guidelines.

Categorical Prohibitions

Are OPIC's categorical prohibitions reasonable given OPIC's statutory requirements to avoid projects "posing a major or unreasonable hazard to the environment, health or safety"?

Do the categorical prohibitions achieve the objective of providing applicants with clear, timely and transparent guidance on the likelihood of OPIC support?

Do the categorical prohibitions have the effect of discouraging potentially eligible companies from approaching OPIC?

Does OPIC act consistently in its application of the categorical prohibitions?

Should OPIC's categorical prohibitions be made statutory?

Conditionality

Are OPIC's reporting and auditing requirements unduly burdensome for investors?

What is the risk that OPIC users face in agreeing to contractual provisions with respect to environmental performance? Has OPIC unilaterally terminated insurance or finance commitments on environmental grounds? Are investors given a chance to "cure" environmental defaults as an alternative to losing coverage?

Application of Environmental Policies to Small Business, Financial Institutions, and Capital Markets Transactions

Are there ways to streamline OPIC's environmental requirements for small businesses that invest in large, environmentally sensitive projects?

How should OPIC's policies best be applied when the investor is a lending institution or passive investor without any ownership or managerial role in the project?

OPIC's environmental policies and procedures are designed for application to a project-finance structure. How can they be applied in a meaningful way to capital markets and other non-project finance structured transactions?

Competitiveness

Do OPIC's environmental requirements diminish or enhance the competitiveness of US companies that use OPIC services? The additional costs that may be required to meet OPIC's requirements could make OPIC-supported projects appear less attractive to countries or joint venture partners looking for lower-cost solutions to the supply of energy or lower-cost manufacturing. On the other hand, OPIC's careful assessment and monitoring of projects on environmental grounds can make the project more attractive to other investors and lenders by reducing environmental risk.

How do OPIC's environmental requirements compare with the requirements of multilateral and bilateral investment financing and export credit agencies (e.g., IFC, Canada's EDC [Export Development Canada], other bilaterals)?

Would a requirement that projects comply with US environmental standards enhance or diminish US corporate competitiveness?

Private-Sector Models

What can OPIC learn from private-sector approaches to managing environmental risk, in particular the practices of banks and insurance companies?

Resources

Are OPIC's internal resources sufficient to manage a portfolio of environmentally sensitive projects?

Is it a good use of OPIC resources to support projects that may be technically eligible for OPIC support on environmental grounds, but, due to their controversial nature, are highly resource-intensive for OPIC to monitor and manage with respect to stakeholder engagement and potential harm to OPIC's reputation?

Appendix F
The Institute's Working Group on OPIC

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