

# 2006 Departmental Expenditure Report

A Departmental Expenditure Report (DER) is the primary document through which a department sets out its accountability to Parliament and the public. This DER is presented alongside ECGD's Annual Report and Resource Accounts 2005-06 to provide a comprehensive review of ECGD's performance and expenditure during the financial year.

## 1 ECGD'S AIM AND OBJECTIVES

The aim of ECGD is "to benefit the UK economy by helping exporters of UK goods and services win business and UK firms to invest overseas, by providing guarantees, insurance and reinsurance against loss, taking into account the Government's international policies".

ECGD's full Mission Statement can be found on page 8. This sets out the Department's aim and high-level objectives.

## 2 2005-06 SERVICE DELIVERY AGREEMENT (SDA) TARGETS – RESULTS

### Key Target 1

To achieve the Financial Objectives set by Ministers.

#### Measures of Delivery

- (i) For its business relating to the provision of guarantees and insurance since April 1991 ("Account 2 business"), ECGD is required to maintain a Reserves Index of at least 1. The Reserves Index compares the cumulative adjusted<sup>1</sup> reserves and claims provisions to those estimated as required to ensure, with a 77.5% confidence, that the value of cumulative reserves, when added to the value of claims provisions, will be sufficient to cover eventual losses on contingent liabilities and claims paid.

$$\text{Reserves Index} = \frac{\text{Claims Provisions} + \text{Adjusted}^1 \text{ Cumulative Account 2 Reserves}}{\text{Claims Provisions} + \text{Required Account 2 Reserves}}$$

**Result:** As at 31 March 2006, the Reserves Index was 2.4, above the required target.

- (ii) For Account 2 business over the period 2005-2007, ECGD is required to maintain a Two-Year Reserve Coverage Ratio (Two-Year RCR) of at least 1.4. The Two-Year RCR is defined as the ratio of Account 2 premium earned (net of Account 2 administration costs) to expected losses on amounts at risk in respect of guarantees and insurance issued in the two financial years.

**Result:** Achievement against this target will be measured as at 31 March 2007. The value of the one-year equivalent, for 2005-06 only, was 1.43 including all of those outstanding IT development costs excluded from the calculation of the 2004-05 In-Year RCR.

- (iii) For Fixed Rate Export Finance (FREF) support, ECGD must maintain a Mark-to-Market (MTM) value on its Old FREF portfolio at a value no lower than minus £204 million. The MTM value must be calculated inclusive of the cumulative cash outturn<sup>2</sup> of the Old FREF portfolio since 1 April 2002 less the cumulative value of Administration Expenses incurred by ECGD in respect of the Old FREF portfolio since 1 April 2001.

If the MTM value of the Old FREF portfolio is negative, then ECGD must notionally transfer from its Account 2 Reserves to Account 4<sup>3</sup>:

- (a) the first £15 million of any negative MTM value equal to or less than £102 million; and  
(b) 14.7 per cent of each £1 of such negative MTM value between £102 million and £204 million.

**Result:** The net MTM valuation of the Old FREF portfolio at 31 March 2006 was -£32.8 million. The target was therefore met. In accordance with the agreed formulae, £15 million was transferred from the Account 2 reserves to Account 4.

<sup>1</sup> That is, after the notional transfer of reserves to cover FREF costs as described under items (iii) to (v) below.

<sup>2</sup> This measure shall include no more than 7.5 per cent of the value of any cash savings derived from refinancing undertaken by ECGD on the Old FREF portfolio since 1 April 2002 and no more than 7.5 per cent of the value of any future savings derived from such refinancing.

<sup>3</sup> Account 4 comprises the Old FREF, New FREF and 2005 FREF portfolios.

- (iv) To maintain a non-negative MTM value on its New FREF portfolio. Such non-negative MTM value must be calculated inclusive of the cumulative cash outturn<sup>4</sup> in respect of the New FREF portfolio, less the cumulative value of Administration Expenses incurred by ECGD in respect of the New FREF portfolio<sup>5</sup>.

If the MTM value of the New FREF portfolio is negative, ECGD must notionally transfer cumulative Account 2 reserves to Account 4 in order to restore the MTM value of the New FREF portfolio to a non-negative position.

**Result:** The net MTM value of the New FREF portfolio was -£5.3 million at 31 March 2006. Total transfer from Account 2 reserves at 31 March 2006 in respect of the New FREF portfolio was £11.3 million, comprising £5.3 million for New FREF and £6.0 million for Interim LASU in accordance with the agreed formulae.

- (v) To maintain an MTM value on its 2005 FREF portfolio at a value no lower than -£30 million. Such MTM value must be calculated inclusive of the cumulative cash outturn in respect of the 2005 FREF portfolio<sup>6</sup>.

If the MTM value of the 2005 FREF portfolio is negative, ECGD must notionally transfer cumulative Account 2 reserves to Account 4 in order to restore the MTM value of the 2005 FREF portfolio to a non-negative position.

**Result:** The net MTM value of the 2005 FREF portfolio was -£909,000 at 31 March 2006. £909,000 was transferred from cumulative Account 2 reserves so as to cover the associated administrative costs and to restore the MTM value of the 2005 FREF portfolio.

### Key Target 2

To promote an international framework that allows UK exporters to compete fairly by limiting or eliminating all subsidies and the adoption of consistent practices for assessing projects and countries on a multilateral basis.

#### Measures of Delivery

- (i) To continue the process of updating the OECD Arrangement<sup>7</sup>.

**Result:** Non-OECD members are being encouraged to support the terms of the OECD Arrangement under the OECD Outreach Programme. Following on from amendments to the OECD Arrangement introduced in 2005, the Large Aircraft Sector Understanding is currently under re-negotiation.

Negotiations are also under way on the amendment of export-credit-related provisions in the World Trade Organisation Agreement on Subsidies and Countervailing Measures. Negotiations are also under way on the amendment of export-credit-related provisions in the World Trade Organisation Agreement on Subsidies and Countervailing Measures, with UK interests being led by the Department of Trade and Industry.

- (ii) To reduce any subsidies inherent within Commercial Interest Reference Rates (CIRRs).

**Result:** Limited progress has been made in the year, as some EU Member States consider this to be a low strategic priority. Further work towards wider CIRR reform continues.

- (iii) To make the OECD Arrangement more flexible in responding to the needs of certain sectors, particularly project finance and renewable energy.

**Result:** In July 2005, a new sector understanding under the OECD Arrangement was agreed that introduced repayment periods of up to 15 years for Renewable Energy and Water projects. Hydro Power projects were included later in the year. Revised terms for project finance and structured finance cases were also introduced.

<sup>4</sup> The footnote above applies here also to the New FREF Portfolio.

<sup>5</sup> This obligation is subject to the following exception: when calculating the MTM value of the New FREF portfolio, ECGD is not required to include business deriving from commitments entered into by ECGD between 1 April 2001 and 31 March 2002 (inclusive) in respect of support for Airbus sales under the terms and conditions set out in the Large Aircraft Sector Understanding contained within the OECD Arrangement on Officially Supported Export Credits ("LASU"). This exception is subject to the condition that ECGD must transfer, from its Account 2 Reserves, the first US\$10 million worth of any costs (defined for the purposes of this condition to mean those costs to the Exchequer that arise from ECGD providing FREF for LASU business committed between 1 April 2001 and 31 March 2002 (inclusive) on terms not consistent with the FREF financial objective), and thereafter 50 per cent of any further costs that may arise, subject to an overall ceiling of US\$15 million.

<sup>6</sup> This measure shall include no more than 7.5 per cent of the value of any cash savings derived from refinancing undertaken by ECGD on the 2005 FREF portfolio and no more than 7.5 per cent of the value of any future savings derived from such financing.

<sup>7</sup> The OECD Arrangement on Officially Supported Export Credits seeks to foster a level playing field for official export credit support in order to encourage competition among exporters based on the quality and price of goods and services exported, rather than on the degree to which officially supported financial terms and conditions are more favourable.

## 2006 Departmental Expenditure Report

(iv) To strengthen the anti-bribery and corruption procedures of ECAs.

**Result:** Discussions continued on a new OECD Action Statement on Bribery and Officially Supported Export Credits with enhancements to existing anti-bribery and corruption measures. An agreement is expected to be reached in 2006.

(v) To build a consensus towards the incorporation into the OECD Arrangement of risk-reflective pricing for non-governmental buyer risk.

**Result:** Following a UK-inspired mandate, technical discussions are taking place within the OECD with the aim of developing guiding principles for common buyer risk assessment and pricing practices to facilitate risk premium convergence. These discussions are expected to continue into 2007.

### Key Target 3

To provide an efficient, professional and proactive service for exporters of UK goods and services which focuses on solutions and innovation.

#### Measures of Delivery

(i) Compliance with service delivery targets set out in ECGD's Customer Charter, performance against which is reported quarterly in *ECGD News*.

**Result:** Service delivery targets as set out in ECGD's Customer Charter, and reported quarterly in *ECGD News*, are being met, with two exceptions:

- a. The target relating to allocation of recoveries was met in 86% of cases. The remainder were delayed during the implementation of ECGD's new IT business systems.
- b. The target relating to the 'Provision of Cost Indications within four working days' was achieved for 62% of cases in 2005/6. It was noted last year that, although ECGD was taking corrective steps with respect to straightforward cases, the target would not be met on complex cases where rigorous underwriting procedures are required. During the first part of 2005/6, all cases were affected by the implementation of ECGD's new IT business systems. The systems were bedded down by the second half of the year, but an increase in complex cases remained a factor impacting performance. Customers have accepted that the target is inappropriate for such cases, and during 2006/7 ECGD will review this (and all other) charter targets to seek to develop more suitable measures of service delivery.

### Key Target 4

To reduce the concentration of risk prevalent in the ECGD portfolio of business by working with the private sector.

#### Measures of Delivery

Subject to market potential and satisfaction of value for money criteria:

(i) To have transferred risk of existing contingent liabilities to the private sector via Active Portfolio Management (APM).

**Result:** ECGD has continued to purchase further protection from private sector counterparties in respect of certain contingent liabilities. In the year to 31 March 2006, protection with a notional value of US\$320m was purchased.

## 3 CORE TABLES

Please see ECGD's Resource Accounts – pages 46 to 94 of this document. This includes details of resources, spending and investment. Staff numbers and costs are included on pages 79 to 79, in addition to the section on personnel in the Annual Report on page 40.

## 4 DEPARTMENTAL INVESTMENT STRATEGIES

ECGD has been engaged in a major programme of work to renew its major IT business systems for more than three years. Phase 1 was completed in the autumn of 2005.

Phase 1 included the replacement of a number of bespoke, separate systems with an integrated solution, using commercial software packages. The programme is improving the functionality and flexibility of ECGD's key systems, and the robustness and reliability of its data. Further enhancements to the programme will be undertaken in 2006-07, and as required thereafter.

### 5 OTHER INFORMATION IN THE PUBLIC INTEREST

The main body of this Annual Report describes ECGD policies on a wide range of topics. Information on recruitment, training and development, public appointments and policies related to the environment and sustainable development can be found in the relevant sections.