2007 Departmental Expenditure Report

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 Review and Resource Accounts 2006-07 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 10. This sets out the Department's aim and high-level objectives.

2 2006–07 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[1] 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.

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

Result: As at 31 March 2007, the Reserves Index was 2.72, 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: As at 31 March 2007, the Two-Year RCR was 1.80, above the required target.

(iii) For Fixed Rate Export Finance (FREF) support, ECGD must maintain a Mark-to-Market (MTM) value on its Old FREF[2] portfolio at a value no lower than minus £204 million. The MTM value must be calculated inclusive of the cumulative cash outturn[3] 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 cumulative Account 2 Reserves to Account 4[4]:

(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.

1 That is, after the notional transfer of reserves to cover FREF costs as described under items (iii) to (v) below.
2 The Old FREF – that business deriving from FREF commitments entered into by ECGD prior to 1st April 2001, including business deriving from such commitments which had not expired by that date.
3 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.
4 Account 4 comprises the Old FREF, New FREF and 2005 FREF portfolios.

Result: The net MTM valuation of the Old FREF portfolio at 31 March 2007 was £29.6 million. The target was therefore met. In accordance with the agreed formulae, £15 million was transferred from the cumulative Account 2 reserves to Account 4.

(iv) ECGD must 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[5] in respect of the New FREF portfolio, less the cumulative value of Administration Expenses incurred by ECGD in respect of the New FREF portfolio[6].

If the MTM value of the New FREF portfolio is negative, then 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[7] portfolio was £6.3 million at 31 March 2007. Total transfer from cumulative Account 2 reserves at 31 March 2007 in respect of the New FREF portfolio was £11.9 million, comprising £6.3 million for New FREF and £5.6 million for Interim LASU[8] in accordance with the agreed formulae.

(v) ECGD must maintain an MTM value on its 2005 FREF[9] portfolio at a value no lower than minus £30 million. Such MTM value must be calculated inclusive of the cumulative cash outturn in respect of the 2005 FREF portfolio, less the cumulative value of administration expenses incurred by ECGD in respect of the 2005 FREF portfolio.[10]

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 minus £646,000 at 31 March 2007. £646,000 was transferred from cumulative Account 2 reserves so as to restore the MTM value of the 2005 FREF portfolio to a non-negative value.

Key Target 2

To promote an international framework that allows UK exporters to compete fairly by multilaterally limiting or eliminating all subsidies, and by promoting the adoption of consistent practices for assessing projects and buyers.

Measures of Delivery

(i) To continue the process of updating the OECD Arrangement[11].

Result: Non-OECD members are being encouraged to support the terms of the OECD Arrangement under the OECD's Outreach Programme.

The Aircraft Sector Understanding is under re-negotiation; it is expected that this will result in the introduction in 2007 of a new regime of risk-related premium rates.

5 The footnote above applies here also to the New FREF portfolio.

6 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.

7 The New FREF portfolio – that business deriving from FREF commitments entered into by ECGD between 1st April 2001 and 31st March 2005 (inclusive), including business deriving from (i) renewals of FREF commitments originally given prior to 1st April 2001, and (ii) FREF commitments which had not expired by 31st March 2005.

8 Interim LASU refers to the portfolio of 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").

9 The 2005 FREF portfolio – that business deriving from FREF commitments entered into by ECGD between 1st April 2005 and 31st March 2008 (inclusive), including business deriving from FREF commitments originally given prior to 1st April 2008 which had not expired by that date

10 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.

11 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

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

Result: Despite a positive reception to technical work undertaken by ECGD, progress has been limited due to the different views on this issue within EU Member States. Further work towards CIRR reform continues.

(iii) To strengthen the existing Recommendation on Common Approaches to the Environment.

Result: The review by OECD members of the OECD Recommendation on Common Approaches on the Environment and Export Credits concluded in April 2007. Progress was made in all three of the UK's priority areas: achieving greater consistency in the identification and categorisation of project impacts; increasing the extent to which social impacts are included in the agreement; and defining more clearly the minimum international standards that must be met.

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

Result: A strengthened OECD Action Statement on Bribery and Officially Supported Export Credits was agreed in April 2006, introducing enhancements to existing anti-bribery and corruption measures. This was upgraded to a Recommendation of the OECD Council in December 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 continue within the OECD with the aim of developing guiding principles for common buyer risk assessment and pricing practices to facilitate risk premium convergence. Less progress has been made than the UK had hoped, but it continues to pursue this aim.

(vi) To introduce international guidelines to ensure responsible lending to low-income countries.

Result: ECGD has worked with OECD members, the International Monetary Fund and the World Bank to develop proposals to ensure that new lending does not lead to unsustainable debt burdens for former Heavily Indebted Poor Countries (HIPCs) and countries that the World Bank classifies as eligible for highly concessional loans and grants for the International Development Association. In April 2007, OECD Export Credit Agencies agreed that new lending to the latter group of countries should be subject to the same tests as are currently applied to HIPC markets under the OECD Statement of Principles on official Export Credit Support to heavily indebted poor countries.

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 in *ECGD News* publication.

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

a. ECGD was unable to meet the target relating to the allocation to insured parties of certain (Paris Club) recoveries due to technical difficulties with its IT system. Most of these allocations have been paid and work to clear the remaining payments is underway. During 2007-08 ECGD, once again, expects to meet the service delivery targets for allocation of Paris Club recoveries

b. The target relating to the 'Provision of Preliminary Response Letters within four working days' was achieved for 53% of cases in 2006-07. Although ECGD was taking corrective steps with respect to providing responses on straightforward cases, the target would not be met on complex cases where rigorous underwriting procedures were required. Customers have accepted that the target is inappropriate for such cases, and have been able to make use of ECGD's enhanced Website Calculator to determine approximate premium rates for the majority – about 80% - of enquiries. ECGD therefore stated its intention to review this (and all other) Charter targets during 2006-07 to seek to develop more suitable measures of service delivery.

As noted as its intent last year, ECGD duly undertook a review of its Customer Charter in the course of the year in order to reflect the current business environment and recent improvements made to its internal processing systems. An amended Charter came into effect on 2 April 2007 and can be found on ECGD's website.

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 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 2007, protection with a notional value of JP¥ 19,200m (£83 million equivalent) was purchased.

3 CORE TABLES

Please see ECGD's Resource Accounts – pages 42 to 94 of this document. This includes details of resources, spending and investment. Staff numbers and costs are included on pages 76 to 77, in addition to the section on personnel in the Annual Report on page 26.

4 DEPARTMENTAL INVESTMENT STRATEGIES

In the autumn of 2005, ECGD completed a major programme of work which involved the replacement of bespoke, separate systems with an integrated solution using commercial software packages.

As ECGD began to develop a deeper understanding of the new systems, it became apparent during the course of 2006 that, if full advantage was to be taken of their functionality and data-handling capabilities, further work involving significant resource would be needed. A Data Improvement Programme was started in the summer of 2006, with the key aims of developing appropriate processes and procedures together with robust systems and data. The Programme is expected to be largely complete by 31 March 2008. Work will continue thereafter in order to realise the longer-term benefits for ECGD from the new systems.

5 OTHER INFORMATION IN THE PUBLIC INTEREST

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